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Special Edition on Trade and Investment Law

GUEST ARTICLES

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CHIEF PATRON'S MESSAGE

"An investment in knowledge always pays the best interest"

-Benjamin Franklin

I am delighted to present the Special Edition of RGNUL Student Research Review on Trade & Investment Law.

The present edition aims to provide a platform to students, academicians and legal practitioners to express their original thought on the growing incidence of trade and investment in the global village we live in. I sincerely believe that it would help in providing momentum to quality legal research.

This edition of the journal contains articles covering different aspects relating to "Trade & Investment". Legal academicians and scholars all over the world are looking at the investment policies in India. In this globalised world, it is inevitable for various legal systems to effectively respond to the unique opportunities presented by Foreign Direct Investment. Issues such as Investor-State Arbitration, Regional Trade Agreements and the effect of WTO on developing countries are novel and require efficacious legal regulation. We hope that this humble initiative will play an instrumental role in fostering academic research in these unexplored areas of law.

I, on behalf of the students and faculty of RGNUL Punjab, express my deep gratitude to all the distinguished members of the Peer Review Board who have devoted their valuable time in reviewing the papers and providing their valuable insights. I would like to appreciate the efforts made by the Faculty Editor and the entire student-run Editorial Board. This issue of the RSRR, I hope, will be a trendsetter. I wish the journal all the best.

Professor (Dr.) Paramjit S. Jaswal
Chief Patron
RGNUL Student Research Review Special Edition
Vice-Chancellor, RGNUL, Punjab

PATRON'S MESSAGE

It is a matter of great satisfaction that the present edition of RGNUL Student Research Review Special Edition is continuing commendable success in the quest to promote legal elucidation. The objective of RSRR Special Edition is sharing knowledge on current legal issues and to enhance the understanding of these issues through extensive research.

It is great to see that an attempt is being made by this Special Edition to encourage deliberation and research in the area of 'Trade & Investment'. I hope that this Special Edition proves to play an instrumental role in finding legal solutions and identifying key issues in this area of law.

RGNUL Student Research Review Special Edition has always endeavoured to promote the cause of legal research by highlighting issues of contemporary importance. Further, I would appreciate the hard work of students in making this journal internationally renowned, which has received contributions from across the globe. With contributions in the field of relations between India and Japan, the dispute resolution process under the WTO and FDI, this Special Edition is an attempt to highlight the tremendous scope of work that is required in the field of Trade and Investments Laws.

I would like to express my gratitude to all the professionals and academicians who have joined this initiative as a part of Peer Review Board and shared their enormous experience to the success of this journal. Further I would like to appreciate the efforts made by Dr. Anand Pawar, the Faculty Editor for providing guidance to the Student Editors. I congratulate the Editorial Board of RSRR Special Edition and all the young scholars who took out time from their academics for this outstanding initiative and wish them success in all their future endeavors. Finally, I believe that the research papers will receive appreciation from the readers and experts; and will be beneficial to all concerned.

Professor (Dr.) G.I.S Sandhu
Patron
RGNUL Student Research Review Special Edition
Registrar, RGNUL, Punjab

FOREWORD

It gives me immense pleasure to write the foreword for the Special Edition of the RGNUL Student Research Review. I would like to take the opportunity to appreciate the efforts made by the students of RGNUL in the form of an Editorial Board for the successful completion of this edition. In the course of running the Review, the editors have not only learnt editing skills but also managerial skills.

I sincerely appreciate the effort of our student members of the Editorial board for their hard work and dedication because of which, it became possible to release this edition on time. They interacted with the leading academicians of this country and abroad, practicing advocates and other legal luminaries from across the globe. I would like to take this opportunity to thank our contributors for their excellent work.

This issue begins with a guest article co-authored by Mr. Harsh Kumar, Partner at Cyril Amarchand Mangaldas, New Delhi, one of the leading full-service law firms in India, having expertise in Mergers and Acquisitions, Private Equity, Corporate Governance and General Corporate, and Ms. Shambhawi Mishra, Associate at Cyril Amarchand Mangaldas, New Delhi, having expertise in Mergers and Acquisitions, Private Equity, Corporate Governance and General Corporate. Their article is based on India-Japan Investment Synergy wherein they have succinctly presented his views on the same. This issue features another guest article authored by Mr. Panayotis M. Protopsaltis, Research Fellow at Centre for American Legal Studies, Faculty of Business, Law and Social Sciences, Birmingham City University, U.K., and his article is based on Investors' Illegality in Investor-State Arbitration and the author has expertly elucidated the issue. Also, this issue features articles and a normative law article on topics like Burden of Proof in WTO, Investment Treaty Arbitration, Foreign Direct Investment and Investor-State Arbitration.

We would appreciate any further improvements in the journal as may be suggested by the contributors.

Dr. Anand Pawar
Faculty Editor
RGNUL Student Research Review Special Edition
Professor of Law, RGNUL, Punjab

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ABOUT THE GUEST AUTHORS

MR. HARSH KUMAR

Harsh Kumar is a Partner in the Delhi office of Cyril Amarchand Mangaldas. He is an alumnus of WBNUJS, Kolkata and has previously worked in the London office of Herbert Smith Freehills LLP. As part of the Firm's Corporate Practice group, Harsh focuses on Mergers & Acquisitions and Private Equity transactions. He also frequently advises clients on day-to-day corporate governance and general corporate matters. Harsh has advised several leading foreign and Indian blue chip companies on their inbound and outbound acquisitions, joint ventures, strategic alliances, and corporate restructuring across a range of industries, including healthcare, media, retail, e-commerce & logistics, IT & ITES, manufacturing and real estate. Harsh has also been involved in a number of significant cross-border and domestic transactions.

MS. SHAMBHAWI MISHRA

Shambhawi Mishra is an Associate in the Delhi office of Cyril Amarchand Mangaldas. As part of the Firm's Corporate Practice group, Shambhawi focuses on Mergers & Acquisitions and Private Equity transactions. She also frequently advises clients on day-to-day corporate governance and general corporate matters.

INDIA-JAPAN INVESTMENT SYNERGY

-Harsh Kumar* and Shambhawi Mishra**

1. INTRODUCTION

India and Japan are two leading global economies that share a common history against western imperialism, similar geo-political goals and an aspiration for an increased global recognition. Critics may espouse the recent Indo-Japan bonhomie nurtured by the heads of the two states – Mr. Shinzo Abe and Mr. Narendra Modi – as a forced collaboration to counter the increased Chinese domination, however, in the midst of dominant political and economic threats, India and Japan stand together as 'natural allies' bound together with similar cultural and political identities. This article discusses the recent successes in forging Indo-Japan cooperation and analyzes the recent impediments that may have bottlenecked an even greater cooperation between the two Asian giants.

Pre-India's independence, India's exports of iron ore to Japan were instrumental in Japan's fervent economic reconstruction post its debacle in the World War II. However, Japan's interest in the Indian economy began only post India's independence with the grant of first Yen loans to India.

The subsequent entry of Suzuki Motor into India in the early 1980s, followed by Honda's collaboration with the Hero Group paved the way for revolutionizing the Indian automobile sector and introduced advanced technology for mass production of cars that catered to the

*Partner, Cyril Amarchand Mangaldas, New Delhi.

**Associate, Cyril Amarchand Mangaldas, New Delhi, assisted by Vaishali Dhanawat, Trainee Legal, Cyril Amarchand Mangaldas.

changing public demand for novel cars.[1] These initial investments ushered in an era of economic camaraderie between the two countries, which later translated into significant investments across a range of sectors and industries. As of October 2016, there are 1,306 Japanese companies registered in various Indian states and 4,590 Japanese business establishments in India. This is a significant increase compared with 267 Japanese companies registered in India in the last decade.[2]

In recent times, India and Japan have strengthened their cooperation through a series of new initiatives such as economic investments, defense and security. For instance, Japan has recently inked a deal with India to sell nuclear technology and equipments, in order to strengthen its ties with India.[3] In 2016, the total FDI, from April to December was USD 35,844 million, out of which, Japan's contribution was about 8% and totaled USD 4,249 million. [4] Currently, Japan is the fifth largest investor in India in terms of FDI, with investments in automobiles, pharmaceuticals, electrical equipment, telecommunication, chemical and service sectors, aggregating up for 7% of India's overall FDI between April 2000 and March 2016.[5] The Japanese FDI in India, in the last few years has increased from USD 1.7 billion in 2013-2014 to USD 2.61 billion in 2015-2016.[6] As of October, 2016 there are 1,305 Japanese companies that are registered in India, which is a 13% increase from 2013. These

[1] Shrestha Shahadave, "Impact of Japanese FDI in the Development of Indian Automobile Sector: Case Study of Two Japanese Automakers", available at http://daigakuin.soka.ac.jp/assets/files/pdf/major/kiyou/kiyo_ h26_03.pdf.

[2] Embassy of Japan in India, "Japanese Business Establishments in India", available at http://www.in.emb-japan.go.jp/PDF/2016_j_cos_list_pr.pdf.

[3] Al Jazeera news and news agency, "Japan, India Sign Agreement on Civil Nuclear Power", available at http://www.aljazeera.com/news/2016/11/japan-india-sign-agreement-civil-nuclear-power-161111164153096.html.

[4] Department of Industrial Policy and Promotion, "Fact Sheet on Foreign Direct Investment", available at http://dipp.nic.in/English/Publications/FDI_Statistics/2016/FDI_FactSheet_OctoberNovemberDecember2016.pdf.

[5] Embassy of India, Japan, "India-Japan Economic Relations", available at https://www.indembassytokyo.gov.in/india_japan_economic_relations.html.

[6] *Infra* note 7.

companies have 3,961 establishments throughout India, which is 56% increase compared to 2013.[7]

The initial investments by Japanese companies in India have been the precursor to a slew of mega-deals between Japanese and Indian companies across sectors and industries. This includes Daiichi Sankyo's USD 5 billion majority acquisition of Ranbaxy, NTT Docomo's minority acquisition in Tata Teleservices for USD 2.7 billion and Nippon Life Insurance's minority acquisition in Reliance Life Insurance for USD 680 million. With India's ranking growing as the most attractive investment destination, both in Japan and across the world,[8] it is expected that India will remain a key destination for investment from Japan. The consumption driven market in India buoyed by foreign investments is likely to offer a rich potential to 'cash rich' Japanese firms who have faced souring of relations with China.

2. STRATEGIC PARTNERSHIP

Prime Minister Abe had predicted in his book "Towards a Beautiful Country: My Vision for Japan" that Indo-Japan relations have the potential to exceed Japanese ties with the US and China. The significant upsurge in the Indo-Japanese economic, political and strategic ties has led to India successively liberalizing its trade policy to facilitate inbound Japanese investments. Several institutional bodies, such as a dedicated 'Japan Cell' in Department of Industrial Policy & Promotion ("**DIPP**") and the Foreign Investment Implementation Authority ("**FIIA**"), have now been created to promote and facilitate Japanese investments and FDI projects in India.

The signing of the Comprehensive Economic Partnership Agreement ("**CEPA**") in 2011 buoyed trade relations between the two countries.CEPA aims to reduce or eliminate tariffs over the next

[7]Embassy of India, Japan, "India-Japan Economic Relations: Bilateral Brief", available at https://www.ind embassy tokyo.gov.in/bilateral_brief.html.

[8]*Supra* note 7.

10 years (until 2021) in respect of over 90% of the goods traded between India and Japan. CEPA also envisaged expansion of bilateral trade to USD 25 billion by 2014, and to provide a framework for enhanced cooperation between the two countries by facilitating trade in goods and services, increasing investment opportunities and protecting intellectual property rights.[9]

In addition to the CEPA, the Indian and the Japanese political leadership have pledged to realize the full potential of Indo-Japan Strategic and Global Partnership. The Government of India has also constituted a Core Group chaired by the Cabinet Secretary on the India-Japan Investment Promotion Partnership. One of the obligations of the Core Group is to co-ordinate and facilitate investments from Japan in various sectors to exploit the opportunity of investment and technology transfer.

An important milestone in this strategic partnership was the signing of MoU between Rajasthan State Industrial Development and Investment Corporation and Japan External Trade Organization ("**JETRO**"), for setting up an exclusive Japanese Economic Zone in the Neemrana Industrial Estate, which offers investors various benefits such as slashed tax rates among other things.[10] After the success of the Economic Zone in Neemrana, the government is planning to set up another Japanese Economic Zone in Ghilot in 500 acres of land.[11]

Japan is also an active suitor in India's "Make in India" initiative and provides the financial support for various such Government initiatives such as 'Skill India' and 'Digital India'.In December 2015, Prime Minister Shinzo Abe announced the establishment of the

[9]Press Information Bureau, "Ministry of Commerce and Industry", available at http://pib.nic.in/newsite/erelcontent.aspx?relid=73598.

[10]Dr. Anil Kumar Kanungo, "Japanese FDI in Indian Automobile Sector: Evolution and Practices", available at http://www.freit.org/WorkingPapers/Papers/ForeignInvestment/FREIT562.pdf.

[11]Business Standard, "Rajasthan to have second Japanese Industrial Zone", available at http://www.business-standard.com/article/news-ians/rajasthan-to-have-second-japanese-industrial-zone-115040800931_1.html.

Japan-India Make-in-India Special Finance Facility. Under this, Nippon Export and Investment Insurance ("**NEXI**") and Japan Bank for International Cooperation ("**JBIC**") will provide financial assistance of up to 1.5 trillion Yen for realising the Make in India initiative. [12] This amount will be realised for supporting direct investment of Japan into India, loan of operating capital required by Japanese Companies conducting business in India, including development of necessary infrastructure and loans for equipment and material procurement used for local production in India.[13]

Under the Make in India initiative, the Delhi-Mumbai Industrial Corridor was also launched pursuant to the MOU signed between India and Japan, which is a mega infrastructure project of USD 90 billion, covering an overall length of 1,483 kilometres between Delhi and Mumbai.[14] The project will see major expansion of infrastructure and industry – including smart cities and industrial clusters along with rail, road, port and air connectivity - in the states along the route of the Delhi-Mumbai Industrial Corridor. Many smart cities would be developed alongside.A total of 24 special investment nodes are envisaged to be created by the government that would support manufacturing, however, any type of industry could be set up. The main role of these hubs is to facilitate businesses, set up their factories quickly without any hiccups in land acquisition and resources, and provide cheap, fast and efficient transportation to ports as well as to the whole of India. Additionally, this project will house multiple National Investment and Manufacturing Zones - to be developed as a Model Industrial Corridor. It is estimated to have the potential to generate about 10 million jobs, once it's functional.[15]

Japan and India have also decided to take steps to develop "Japan Industrial Townships" in India especially in the Delhi-Mumbai

[12]Ministry of Economy Trade and Industry of Japan, "Announcement of Japan-India Make-in-India Special Finance Facility on a Scale of 1.5 trillion Yen", available at http://www.meti.go.jp/english/press/2015/1211_02.html.

[13]*Infra* note 14.

[14]Centre for Urban Research, "Delhi Mumbai Industrial Corridor", available at http://delhimumbaiindustrialcorridor.com.

[15]*Infra* note 16.

Industrial Corridor and the Chennai-Bengaluru Industrial Corridor regions in order to facilitate Japanese investment to India.[16]

Various Japanese companies are extracting full advantage of the Make in India initiative. An important example of this is the Japan's Hitachi group which has invested more than Rs. 100 crore for setting up a manufacturing base in Bengaluru for manufacturing ATM machines. This appears to be working in their best interest especially after the cash crisis being faced by the country due to demonetisation.[17]

Apart from the Make-in India initiative in which we have seen an active participation by the Japanese, Japanese Companies are also participating in other similar, parallel initiatives being taken by the Indian Government.

Recently, Yamaha, the famous two-wheeler manufacturer, got certified and rewarded for promoting the Skill-India policy, for providing training in bike mechanics and communication for customer service, at the vocational training centre in Chennai.[18]

Japanese participation involved substantial monetary contributions and technology transfers.The Government of India has pledged US $4.5 billion, with the Japanese Government promising an equal amount.

Japan is also assisting India in various ways for improving the maritime infrastructure, such as by setting up a 15 megawatt diesel

[16] Mohul Ghosh, "Japan's Make-in-India Agenda: Establishing 11 Industrial Townships and Doubling Investments", available at http://trak.in/tags/business/2015/05/07/japan-make-india-industrial-townships-investments/.

[17] Business Today, "Hitachi invests Rs. 100 crore to set up ATM making firm in India", available at http://www.businesstoday.in/current/corporate/hitachi-invests-rs-100-cr-to-set-up-atm-making-firm/story/230344.html.

[18] Business Standard, "Japanese companies contribute to the growth of Indian industry", available at http://www.business-standard.com/article/news-ani/japanese-companies-contribute-to-the-growth-of-indian-industry-116121400614_1.html.

plant in South Andaman Islands and setting off a chain of underwater surveillance sensors off the Andaman train.[19]

3. RECENT SETBACKS

India caught significant Japanese interest only after liberalization of the Indian economy in the early nineties. Japan's investment in India has increased over the years, however in comparison to the total FDI made by Japan, FDI in India is small. In the Financial Year 2015-2016, India-Japan trade reached USD 14.51 billion marking a decrease of 6.47% from Financial Year 2014-2015. In 2015-2016, India's exports to Japan were USD 4.66 billion while imports were USD 9.85 billion. This negative growth in trade with Japan is a matter of concern for India.[20]

The 'conservative approach' of the Japanese is well articulated in the context of the low trade volume between the two countries. The bilateral trade between the two countries is substantially lower than the trade between Japan and China. In 2009, less than 5% of total Japanese FDI came to India. The Japan Chamber of Commerce and Industry in its report to the DIPP titled "Suggestions for Government of India" dubs the Indian business environment as "tough", with tax inefficiencies, land acquisition challenges, multiple administrative bottlenecks, and difficult legal environment and labour issues consistently being named as the primary culprits.[21]

The World Bank's report on 'Ease of Doing Business in India' recognizes the subtlety of the Indian market, and the challenges that foreign investors often face while undertaking business in India. The

[19]Saturo Nagao, "A Japan-India Partnership in Maritime-Asia: Analysis", available at http://www.defencenews.in/article/A-Japan-India-Partnership-In-Maritime-Asia-%E2%80%93-Analysis-250416.

[20]*Supra* note 7.

[21]Embassy of Japan, India, "Suggestions for Government of India by Japan Chamber of Commerce and Industry in India 2016", available at http://www.in.emb-japan.go.jp/itpr_en/00_000064.html.

debacle that Posco[22] and Tata Motors have faced while investing on tribal land in India is well known and documented. Similarly, India's systemic inefficiencies in implementing the complicated land acquisition process play a significant role in the bottlenecks [23] associated in the implementation of the Delhi-Mumbai Industrial Corridor, which has been the beneficiary of Japanese investment. No wonder, India is ranked 130th out of 189 economies in the Ease of Doing Business Report issued by the World Bank taking into account the intricacy of the regulatory regime, the judicial delays in pronouncement of justice and enforcement of contractual obligations in India, the mundane compliances associated with taxes, and the difficulties in obtaining permits and basic infrastructure support.[24] Hopefully, some of the challenges associated with the Indian land acquisition procedures are likely to abate with the implementation of the Real Estate (Regulation and Development) Act, 2013.

Furthermore, the process of filing and servicing court proceedings is often complicated, tiresome and time consuming and based on the antiquated laws and regulations. One of the biggest challenges that foreign companies face while litigating in India is the problem of delay, with cases sometimes taking several years to be resolved.

Costs involved for engaging and retaining lawyers, incurred at the interim stage, enforcement costs, and miscellaneous costs among other things post significant obstacles to the litigating companies.

India's tax system which is riddled with multiplicity of direct and indirect taxes has constantly deterred foreign investors from Japan and other global destinations from investing into India. The dispute between Vodafone and the Indian government which garnered a lot of negative investor publicity coupled with the Indian government's

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[22] Jongsoo Park, "Korean FDI in India: Perspectives on POSCO-India Project", available at http://www.rlarrdc.org.in/images/POSCO-India%20Project.pdf.

[23] The Economist, "India: A New Dawn for Japanese Companies", available at https://www.eiuperspectives.economist.com/sites/default/files/EIU%20India%20Japan%20Mar31%2015_FINAL.pdf.

[24] The World Bank, "Ease of Doing Business in India", available at http://www.doingbusiness.org/data/exploreeconomies/india.

unpopular decision to retrospectively implement the General Anti Avoidance Regulation massively dampened global investment sentiments.[25]

Other instances of highly publicized battles with local subsidiaries of foreign businesses, including Nokia, and Nestle highlighted the uncertainty and ambiguity in Indian laws and the non-uniform application of the law. It is expected that the implementation of the Goods and Service Tax (GST) later this year should result in increased tax transparency and tax compliance and attract more foreign direct investments across sectors.[26]

Apart from enacting the Goods and Service Tax another positive step taken up by the Government to attract foreign investments is to set up a new 'tax simplification panel' to simplify the archaic income tax law, as part of an effort to make it easier to do business in India.[27] The panel will suggest ways to create predictability and certainty in tax laws without having a substantial impact on the tax base and revenue collection.

India's weak infrastructure manifested by its poor energy supply, unpaved roads, ineffective airports and ports also pose a major challenge to foreign investors. Infrastructure inefficiencies like inadequate power generation add a significant cost factor for manufacturing companies in the country.[28]

The recent pitfall in the Indo-Japan relationship has been on account of legal Tata-Docomo dispute which has marred Japanese interest in India. However, the two parties have finally reached a settlement,

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[25]Abhishek Vijay Kumar Vyas, "An Analytical Study of FDI in India (2000-2015)", available at http://www.ijsrp.org/research-paper-1015/ijsrp-p4631.pdf.

[26]The Economic Times, "Implementation of GST to attract more FDI", available at http://economictimes.indiatimes.com/articleshow/54310069.cms?utm_source=contentofinterest&hutm_medium=text&utm_campaign=cppst.

[27]Price Waterhouse Coopers, "Income Tax Simplification Committee First Report and Recommendations", available at https://www.pwc.in/assets/pdfs/news-alert-tax/2016/pwc_news_alert_20_january_2016_income_tax_simplification_committee_first_report_and_recommendations.pdf.

[28]*Supra* Note 27.

and Docomo is likely to have a smooth exit.[29] Another instance which has been a setback for Japanese investments is the Ranbaxy-Daiichi dispute, where the dispute arose, because Ranbaxy had misrepresented and concealed facts from Daiichi and had obtained investment in Ranbaxy on the basis of fabricated data. The Ranbaxy Daiichi dispute serves as an important lesson for other Japanese investors to be cautious while conducting their due diligence.

The problem of land acquisition is another boulder in the way of Japanese investors. Investors and manufacturers need timely acquisition of contiguous land to contain project cost escalation and meet project timelines. However, landowners are often wary of selling — given the potential future price appreciation and non-transparent price benchmarks. As a consequence, land for industrial development is not as easily available as it used to be earlier. The number of departments to be visited as well as the number of visits to each department makes the land acquisition process complex. High costs and transaction fees add to the overall costs of the land acquisition process. The problem of poor infrastructure, although being actively addressed by the Indian government also remains a niggling issue for ease of investment.[30]

Another one of the myriad problems being faced by the Japanese investors is the perplexing political and regulatory processes, which pose a major challenge for companies doing business in India. Investment in sectors which require continuous interface with various regulatory authorities expose the investor to delays in implementing the project, thus, affecting their profitability. Multiplicity of Indian enactments coupled with the lack of regulatory guidance also exerts considerable operational strain on investors investing in regulated sectors. A prominent example is of

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[29]Sayan Ghosal, "Tata, Docomo to bury the hatchet, but RBI hurdle remains to be cleared", available at http://www.business-standard.com/article/companies/tata-docomo-to-bury-the-hatchet-but-rbi-hurdle-remains-to-be-cleared-117022800274_1.html.

[30]Anshuman Magazine, "Challenges facing amended policies", available at http://epaperbeta.timesofindia.com/Article.aspx?eid=31808&articlexml=Challenges-facing-amended-policies-14022015301012.

Indian companies that list third party content on an electronic medium and are required to comply with a plethora of legislations - the Information Technology Act, 2000, the Indian Penal Code, 1860, the Indecent Representation of Women (Prohibition) Act, 1986 and several judicial pronouncements. Regulatory and enforcement authorities present at Central, State and Local levels in India have made it mandatory for the businesses to obtain various licenses and approvals before commencing operations.

Besides, Indian laws are generally not drafted in a simple language, making them difficult to be understood without ambiguity, giving room to the need of issuing clarifications regarding their interpretation. Citing this problem faced by foreign investors, the Ministry of Finance has taken a bold step by deciding to scrap the Foreign Investment Promotion Board ("**FIPB**").

This will result in smooth FDI inflow. Though the government has still not come up with a clear outline, it will surely uncomplicate the current problems being faced by the Japanese investors, when the time comes.

The difference in the approach in decision making between the decision makers in Indian companies and the Japanese counterparts has also resulted in setbacks and disputes, and consequently decelerated Japanese investments into India. Unlike their American, South Korean and the European counterparts, slowness in decision making process hampers the adaptability of Japanese companies to appropriately streamline for sudden changes in the Indian market.

In cases where there is an information asymmetry between the corporate office in Japan and its local Indian subsidiary, the implementation of key commercial decisions naturally gets affected.

Differences in decision making and cultural approach to issues have also resulted in increased labour unrest. Toyota had to close two of its plants near Bangalore, following unrest and strike by the workers

demanding an increase in the pay.[31] Similarly, in 2012, Suzuki Motors witnessed violent protests by labourers.[32]

However, Japanese investors / companies that have implemented India specific commercial strategy have had resounding success. Softbank has made aggressive investments in India and is largely the fulcrum of the Indian start-up ecosystem. Honda's constant focus on innovation in the automotive space has had a great success. Panasonic and Daikin have also competed with American and South Korean companies in grabbing a significant stake of the air conditioners market in India.[33]

4. MITIGATING THE CHALLENGES

Though there exist problems and the recent hiccups in investments into India from Japan, India continues to remain a bright spot for foreign investment. As a low cost manufacturing hub with English speaking workforce and a growing domestic market, India offers a significant economic advantage for foreign investment.[34] Bangalore, Chennai and the NCR Region have become hubs for Japanese investors engaged in diverse businesses, including IT/ITES, e-commerce, healthcare, transport and education.

Despite the struggle of a few Japanese investors in India, India showcases stories of unparalleled successful partnership between Indian and Japanese companies. Maruti Suzuki has managed to

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[31] The Hindu, "Toyota workers resort to hunger strike", available at http://www.thehindu.com/business/Industry/toyota-workers-resort-to-hunger strike/article5868206.ece.

[32] The Times of India, "Maruti's Manesar plant GM(HR) burned to death, 91 workers arrested; government says business confidence intact", available at http://timesofindia.indiatimes.com/india/Marutis-Manesar-plant-GMHR-burned-to-death-91-workers-arrested-government-says-business-confidence-intact/articleshow/15045097.cms.

[33] Sunny Sen, "Striking back", available at http://www.businesstoday.in/magazine/cover-story/japanese-brands-are-on-the-rise-in-india/story/201863.html.

[34] Kroll, "Expert Q&A: Outlook for Japanese investment in India", available at http://www.kroll.com/en-us/intelligence-center/blog/expert-qa-outlook-japanese-investment-india.

produce double the number of vehicles than its parent Suzuki Motor Corporation in 2016.[35] Similarly, auto-parts maker Motherson Sumi witnessed a 28.24% growth in its profits in the third quarter in 2016.[36] Softbank and Kukoyo Limited stand out as investors who are willing to bet on the Indian economic story and carve India as their number one priority market.[37] Nissan, which has set up a plant in Chennai and has exported more than 7,000,000 Indian made cars till date, considers India to be one of its largest hubs for investment.[38]

However, India would need to ensure that the foreign investors in general and Japanese investors in particular are not discouraged by the Indian regulatory challenges. Apart from creating transparency within the bureaucratic operation, it is essential to create transparent procedures with respect to filing of application with local authorities. Giving assistance to new investors in the form of identifying location, easy availability of information, setting up distribution channel etc. will help attract potential Japanese investors. The eBiz portal implemented under the aegis of the DIPP that seeks to create an investor-friendly business environment by making available relevant regulatory information – dealing with company incorporation, operational permits / licenses, and winding up - available to the concerned stakeholders on an online portal. As of date, 14 services, including company incorporation related services and basic tax registrations have been integrated with the eBiz portal to provide a single window clearance for operating a business in India. The Ministry of Labour and Employment has also launched the Shram Suvidha Portal in October, 2014 to enable compliance

[35]Ketan Thakkar and Ashutosh Shyam, "Maruti's production in 2016 to be double that of its Japanese parent", available at http://economictimes.indiatimes.com/industry/auto/marutis-production-in-2016-to-be-double-that-of-its-japanese-parent/articleshow/56227692.cms.

[36]Money Control, "Positive on growth, Motherson Sumi plans to set up 9 new plants", available at http://www.moneycontrol.com/news/results-boardroom/positivegrowth-motherson-sumi-plans-to-set9-new-plants_8482241.html.

[37]*Supra* note 25.

[38]Autocar Pro News Desk, "Nissan exports its 700,000th made-in-India car", available at http://www.autocarpro.in/news-national/nissan-exports-700-000th-india-car-23846.

with 16 out of 44 labour laws through a unified filing system.[39] These are transformational initiatives as it results in direct interaction between the regulator and the entrepreneur eliminating middlemen and reducing unnecessary delays and red-tapism.

India has taken major steps to integrate with the world economy and our foreign investment policies are proving to be more investor friendly. The regulators and policy makers have become active in responding to the needs of Japanese investors.

Issues regarding delays, labour issues, infrastructure and tax issues are constantly being addressed. Japan has pledged 35 billion USD in investment in India over the next five years, and proposes to double the foreign investment and the number of companies in India by 2019. In order to boost Japanese investment in India, India thus needs to disseminate information on investment opportunities, identify new areas of collaboration and co-operation, and ease procedural hassles.[40]

From an investor perspective, Japanese should consider undertaking an in-depth due diligence for taking an informed decision before consuming a transaction. After all, the Indian success story is replete with examples of investors who have undertaken the investment risks after detailed market analysis. Furthermore, investment in a good accounting system is the key to ensure transparency of information.

Ongoing training as well as unannounced audits and checks may be necessary to ensure compliance and transparency in books and records. Effective delegation to trusted local management may also ensure effective localization of the business model and evoke confidence in the local management.

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[39]DNA Research and Archives, "Labour reforms unveiled by Narendar Modi's government will boost investor sentiment: India Inc", available at http://www.dnaindia.com/money/report-labour-reforms-unveiled-by-narendra-modi-s-government-will-boost-investor-sentiment-india-inc-2026668.

[40]Geethanjali Nataraj, "India-Japan investment relations: Trends and Prospects", available at http://icrier.org/pdf/WorkingPaper245.pdf.

India should effectively remove these road blocks that currently mars its highway to foreign investment and collaboration. In turn, India will be allowing Japan a smoother access to a country fertile for development and its massive consumer base.

ABOUT THE GUEST AUTHOR

MR. PANAYOTIS M. PROTOPSALTIS

Panayotis M. Protopsaltis is a Research Fellow at the Centre for American Legal Studies, Birmingham City University, U.K. He read law at the National and Kapodistrian University of Athens, at the University of Paris II (Panthéon-Assas) and at the University of Paris I (Panthéon-Sorbonne) from where he holds a doctoral degree in public international law. He has conducted research, contributed to publications and taught public international law and international economic law at universities in France, Greece, India and the U.K. In addition to his academic work, he is a qualified lawyer in Greece.

INVESTORS' ILLEGALITY IN INVESTOR-STATE ARBITRATION

-Panayotis M. Protopsaltis*

1. INTRODUCTION

The asymmetry of rights and obligations between investors and States and the problem of introduction of investors' obligations monopolised the discussions on the content of international investment law since the 1960s. The failure of the attempts to impose international duties on multinational corporations through codes of conduct in the 1990s coupled with concerns over the ever-increasing power of arbitral tribunals perceived to favour investors' rights in the 2000s were some of the forces behind the backlash against investment arbitration.[1] Perhaps reacting to accusations of pro-investor bias, some arbitral tribunals tried to address investors' conduct within the existing legal framework, the pre-existing provisions in Bilateral Investment Treaties (BITs) and in International Investment Agreements (IIAs) adopted primarily for the protection of investors' rights. These efforts, according to some authors, led to the re-equilibration of the system in investor - State arbitration through the transition from the focus on States' responsibility to that on investors' responsibility.[2]

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*Research Fellow, Centre for American Legal Studies, Faculty of Business, Law and Social Sciences, Birmingham City University, U.K. The author may be contacted at: <pprotopsalt@gmail.com>.

[1] Waibel, M., Kaushal, A., Chung, K.-H. & Balchin, C., "The Backlash against Investment Arbitration: Perceptions and Reality", *Kluwer Law International* (2010).

[2] *See*, for example, the recently defended doctoral thesis of Inès El Hayek, La prise en compte du comportement de l'investisseurdans le cadre de l'arbitragefondésur les traitésd'investissement (Université de Paris I – Panthéon-Sorbonne 2017).

A prime example of these attempts relates to the interpretation of the so-called 'in accordance with the law' or 'legality requirement' provisions.[3] Originally introduced in the treaties of Friendship, Commerce and Navigation (FCN),[4] these provisions are today, albeit in various forms,[5] included in most modern BITs and in a number of multilateral instruments.[6] For many years, these provisions received limited attention, on the assumption that they referred to host States' procedures of admission of foreign investments.[7] With the exception of Sornarajah who first claimed that they establish an obligation of investors to comply with the laws and regulations of the host country,[8] scholars rarely invoked these provisions in the context of the discussion on investor's duties. Although in the ELSI case, in relation to the legality requirement provision of the US-Italy FCN Treaty, the ICJ referred to the obligation of foreign nationals or companies to conform to local applicable law,[9] UNCTAD seems to

[3]Dolzer, R. & Schreuer, C., "Principles of International Investment Law", *Oxford University Press*, 89 (2012); Joubin-Bret, A., "Admission and Establishment in the Context of Investment Promotion", *in* Hoffman, A.K., *Protection of Foreign Investment through Modern Treaty Arbitration* (ASA Special Series No. 34/2010), p. 10; Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18, Decision on Jurisdiction of 29 April 2004, ¶ 84.

[4]*See*, for example, US-Italy FCN Treaty (1948), Art. III, *in* Elettronica Sicula S.p.A. (ELSI), (United States of America v. Italy), Judgement of 20 July 1989, *ICJ Rec.* 1989, ¶ 68.

[5]Inceysa Vallisoletana, S.L. v. Republic of El Salvador, ICSID Case no.ARB/03/26, Award of 2 August 2006, ¶ 186.

[6]Protopsaltis, P.M., 'Compliance with the Laws of the Host Country in Bilateral Investment Treaties' in Αίνος μνήμης Καθηγητού Ηλία Κρίσπη: Συμβολές στην επιστήμη του δικαίου και των διεθνών σχέσεων (Sakkoulas 2015), pp. 583-585.

[7]Poulain, B., 'La conformité de l'investissement au droit local dans le contentieux investisseur – État', 2007/4 *Les Cahiers de l'arbitrage*, *Gaz. Pal.*du 14-15 décembre 2007, p. 44; Aguasdel Tunari, S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction of 21 October 2005, ¶ 146.

[8]Sornarajah, M., "Protection of Foreign Investment in the Asia-Pacific Economic Co-operation Region", *Journal of World Trade*, 29, 116 (1995).

[9]Elettronica Sicula S.p.A. (ELSI), United States of America v. Italy, [1989] ICJ Rep 15.

have noticed the possible effects of these provisions only in the late 1990s.[10]

The first arbitral award referring to a legality requirement provision included in the definition of investments covered in a BIT was rendered in 2001 in the Salini case. The Tribunal ruled that the relevant provision referred to the validity of the investment and not to its definition, [11] thus allowing for the disqualification from protection investments that are illegal under the law of the host country. Despite criticism against its theoretical acrobacy, [12] this award paved the way for the denial of BITs' protection to illegal investments.[13] Commenting on the Fraport award in 2007, Knahr observed that 'this award could 'open the gate' for states to make alleged violations of their domestic law by investors a regular objection to the jurisdiction of ICSID tribunals'.[14] Carlevaris rightly predicted a year later, that the meaning of the legality requirement provisions is likely to become increasingly relevant in future proceedings not only due to the growing frequency with which the clauses at hand recur in international instruments, but also due to two...decisions', in the Inceysa and the Fraport cases, 'in which two tribunals declined jurisdiction after having found that the investment agreements had been concluded in breach of the local law'.[15]

Both were right. Investment's illegality has become a regular objection of host countries and arbitral awards gradually defined the

[10] *Scope and Definition*, UNCTAD, 24, available at http://unctad.org/en/Docs/psiteiitd11v2.en.pdf; *cf. World Investment Report 2003*, UNCTAD, 167, available at http://unctad.org/en/docs/wir2003light_en. pdf.

[11] SaliniCostruttoriS.p.A. and ItalstradeS.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/04; *cf.* Schill, S.W., "Illegal Investments in Investment Treaty Arbitration", Law &Prac. Int'l Cts. & Tribunals, 11, 284 (2012); Knahr, Ch., "Investments 'in accordance with the host state law", *TDM*, 4, 3(2007).

[12] Douglas, Z., "The Plea of Illegality in Investment Treaty Arbitration" *ICSID Rev.-FILJ*, 29, 172 (2014).

[13] *Supra* note 3, at 20.

[14] *Supra* note 11, at 18.

[15] Carlevaris, A., "The Conformity of Investments with the Law of the Host State and the Jurisdiction of International Tribunals", *Journal of World Investment and Trade*, 9, 35 (2008).

conditions of application and the effects of the legality requirement provisions. Interestingly enough, some arbitral tribunals went further to consider the existence of a 'general rule that for a foreign investment to enjoy treaty protection it must be lawful under the law of the host State',[16] even in the absence of a relevant provision in the applicable BIT or IIA. Furthermore, some tribunals sought to deprive protection to investors failing to respect the rules of international law.

Despite their differences, the relevant awards nowadays generally agree that the legality requirement provisions establish an obligation of investors to comply with the laws and regulations of the host country. Furthermore, they seem to agree on the conditions of application of the legality requirement provisions relating to the conduct of the investor (wrongfulness) and of the State (circumstances precluding wrongfulness) that may trigger investors' responsibility for illegal investments.[17] In contrast, they have not been consistent with respect to the yardsticks of illegality or with respect to the effects of the illegality for the investor involved. In the first part of this article we will analyse the relevant awards relating to the requirement of compliance with national and with international law. The second part shall concentrate on the denial of protection of illegal investments and the arguments in favour of the restriction of the tribunals' power to deny jurisdiction.

2. THE YARDSTICKS OF ILLEGALITY

Arbitral tribunals relied on explicit or implicit legality requirement provisions in the applicable BITs and IIAs in order to examine the investor's initial or continuous compliance with the law of the host State or with the fundamental principles of the host State's law at the exclusion of investors' minor breaches. However, some tribunals went further to examine investors' conduct in the light of international law.

[16] Yaung Chi Oo Trading Pte.Ltd. v. Government of the Union of Myanmar, ASEAN I.D. Case No.ARB/01/1.

[17] *Supra* note 6, at 586-595.

2.1. Compliance with National law

Already in the ELSI case the ICJ had ruled that the reference to compliance with applicable laws and regulations in the US-Italy FCN Treaty'surely means no more than that Italian corporations and associations controlled by United States nationals must conform to the local applicable laws and regulations'.[18] In relation to an 'in accordance with the laws and regulations of the ... party' provision, the Tribunal in the Salini case contemplated illegality under national law in order to conclude that 'it has never been shown that the Italian companies infringed the laws and regulations of the Kingdom of Morocco'.[19] In the Tokios Tokelés case, in relation to the legality requirement provision of the applicable BIT, the Tribunal wondered 'whether the alleged violations establish that the assets invested by the Claimant were invested not "in accordance with the laws and regulations of" Ukraine'.[20] In the Mytilineos case, the Tribunal relied on Salini and Tokios Tokelés to rule in relation to a legality requirement provision 'that for the purposes of the BIT the investment has been made in accordance with the laws of Serbia and Montenegro and is thus protected under the BIT'.[21]

A number of subsequent awards followed the same approach. In other words, through the legality requirement provisions, host State's law becomes the yardstick of the legality of the investment and a condition for its protection. BITs' legality requirement provisions therefore introduce an exception to the general rule that a State cannot invoke its internal law to evade international responsibility.[22]

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[18] *Supra* note 9, at ¶ 72.

[19] Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[20] Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[21] Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia (UNCITRAL), Partial Award on Jurisdiction, 8 September 2006, ¶ 152.

[22] Vienna Convention on the Law of the Treaties (1969), art.27; Draft articles on Responsibility of States for Internationally Wrongful Acts (2001), art. 3.

However, arbitral tribunals did not analyse the process by which the relevant norms of domestic law apply in the international legal order. In the Fraport case, the Tribunal explained that the relevant legality requirement provision of the applicable BIT 'effect a renvoi to national law, a mechanism which is hardly unusual in treaties and, indeed, occurs in the Washington Convention. A failure to comply with the national law to which a treaty refers will have an international legal effect'.[23] According to De Visscher'[o]n est fondé à parler de référence (ou renvoi) quand la mise en application d'une norme relevant d'un ordre juridique donné exige le recours à une notion relevant d'un autre ordre juridique'.For example, when deciding on the right of a State to exercise diplomatic protection in favour of an individual, an international judge will previously verify whether this individual is a national of the State according to its national law.[24] By virtue of this renvoi, the tribunal does not apply national law in the strict sense, as Judge Morelli put it, 'no subordination of international responsibility, as such, to the provisions of municipal law is involved; the point is rather that the very existence of the international obligation depends on a state of affairs created in municipal law, though this is so not by virtue of municipal law but, on the contrary, by virtue of the international rule itself, which to that end refers to the law of the State.[25] Thus, according to Vierucci, 'the international legal order accepts to apply a legal rule created by the national legal order' and '[a]s a consequence, the international judge does not properly apply national law but the international law rule referring to the national one'[26] while, according to Gaja, municipal laws will 'be treated by an

[23]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.

[24]De Visscher, Ch., La notion de référence (renvoi) au droit interne dans la protection diplomatique des actionnaires de sociétés anonymes, *Revue Belge de Droit International*, 7, 2 (1971).

[25]*Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain) (Second Phase)*, [1970] ICJ Rep 3.

[26]Vierucci, L., "Special Agreements' between Conflicting Parties in the Case-law of the ICTY', in Bert Swart, B., Zahar, A. & Sluiter, G. (eds.), The Legacy of the International Criminal Tribunal for the Former Yugoslavia (Oxford University Press 2011), p. 420.

international court of tribunal as propositions of law' in the presence of 'some king of reference to them by a rule of international law'.[27] In addition to that, the scope of tribunals' powers introduces another restriction to the application of national law. For, as Judge Casesse points out, 'unless expressly or implicitly authorized to the contrary by an international legal rule, international judges cannot interpret national laws in lieu of national courts or administrative authorities. International judges may easily misapprehend or misconstrue national laws, because normally they lack the necessary legal tools for placing a correct interpretation on them'.[28]

The extent of the renvoi to the host State's law depends on the content of the relevant legality requirement provisions. Schill distinguishes between provisions that tie compliance with domestic law directly to the definition of investment protected and provisions linking compliance with domestic law to the provision on admission of new investments coupled with a limitation of the scope of application of the relevant investment treaty to existing investments made in accordance with host State law.[29] If this was the case, then the legality requirement provisions would cover only illegality at the initiation and not during the performance of the investment. Schill claims indeed that arbitral jurisprudence 'has rather consistently understood 'in accordance with host State law'-clauses to target only initial illegality',[30] in other words, to refer to host State's law at the time of the establishment of the investment.It seems however that arbitral tribunals have contemplated both initial and subsequent illegality. It has been argued that the use of the terms 'admitted', 'invested', 'made', 'implemented, 'permitted' or 'established' imply a

[27]Gaja, G., 'Dualism – A Review', in Janne, E. Nijman, J.E. & Nollkaemper, A. (eds.), New Perspectives on the Divide Between National and International Law (Oxford University Press 2007), p. 59.

[28]The Prosecutor v. Tihofil also known as Tihomir Blaškić, International Tribunal for the Prosecution of Persons Responsible for Serious Violations of International Humanitarian Law in the Territory of Former Yugoslavia since 1991, Decision on the Motion of the Defence Filed Pursuant to Rule 64 of the Rules of Procedure and Evidence, 3 April 1994, ¶ 6.

[29]*Supra* note 11, at 284-285.

[30]*Id.* at 397.

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[25]*Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain) (Second Phase)*, [1970] ICJ Rep 3.

[26]Vierucci, L., "Special Agreements' between Conflicting Parties in the Case-law of the ICTY', in Bert Swart, B., Zahar, A. & Sluiter, G. (eds.), The Legacy of the International Criminal Tribunal for the Former Yugoslavia (Oxford University Press 2011), p. 420.

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[28]The Prosecutor v. Tihofil also known as Tihomir Blaškić, International Tribunal for the Prosecution of Persons Responsible for Serious Violations of International Humanitarian Law in the Territory of Former Yugoslavia since 1991, Decision on the Motion of the Defence Filed Pursuant to Rule 64 of the Rules of Procedure and Evidence, 3 April 1994, ¶ 6.

[29]*Supra* note 11, at 284-285.

[30]*Id.* at 397.

requirement of initial compliance.[31] In the Fraport case, on the basis of a BIT provision defining investment as 'any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State', the Tribunal confirmed that '[t]he language of both Articles 1 and 2 of the BIT emphasizes the initiation of the investment'.[32] In contrast, the use of terms 'owned' and 'controlled' may be interpreted as a requirement of subsequent compliance.[33] References to compliance with laws 'applicable from time to time' or to compliance 'at all times' may point to an obligation of continuous compliance.

Webb Yackee rightly observes that the 'provisions typically do not mention which laws and regulations must be complied with for an investment to enjoy BIT protections'.[34] Dolzer & Schreuer claim that 'the words 'in accordance with the laws' relate not just to the laws on admission and establishment but also to other rules of the domestic legal order'.[35] However, in the Saba Fakes case, in relation to a BIT covering 'investments ... established in accordance with the laws and regulations', the Tribunal considered 'that the legality requirement contained therein concerns the question of the compliance with the host State's domestic laws governing the admission of investments in the host State'. The Tribunal explained that 'it would run counter to the object and purpose of investment protection treaties to deny substantive protection to those investments that would violate

[31] Obersteiner, Th., "In Accordance with Domestic Law' Clauses: How International Investment Tribunals Deal with Allegations of Unlawful Conduct of Investors", *Journal of International Arbitration*, 31,268-269 (2014); *cf.* Quiborax S.A., Non Metallic Minerals *S.A.* and Allan Fosk Kaplún v. Plurinational State of Bolivia, ICSID Case No.ARB/06/2.; Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No.ARB/10/3.

[32] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.; *cf.* Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No. ARB/09/1.

[33] *Supra* note 30, at 279; *contra*, Alasdair Ross Anderson *et al.* v. Republic of Costa Rica, ICSID Case No. ARB (AF)/07/3.

[34] Webb Yackee, J., "Investment Treaties & Investor Corruption: An Emerging Defence for Host States", *Virginia J. of Int'l Law*, 52, 740 (2012).

[35] *Supra* note 3, at 95.

domestic laws that are unrelated to the very nature of investment regulation. In the event that an investor breaches a requirement of domestic law, a host State can take appropriate action against such investor within the framework of its domestic legislation...unless specifically stated in the investment treaty under consideration, a host State should not be in a position to rely on its domestic legislation beyond the sphere of investment regime to escape its international undertakings vis-à-vis investments made in its territory'.[36] Consequently, 'a violation of the regulations in the telecommunication sector or of competition law requirements would not trigger the application of the legality requirement'.[37]

Similarly, in the Teinver case, the Tribunal considered 'whether Claimants acquired or made their investment in compliance with Argentine law' but found 'no evidence...that Claimants failed to comply with any Argentine laws or committed any illegalities in entering the SPA', in particular, 'that either Claimants or SEPI were not authorized to sign the agreement, that Claimants committed fraud or made a critical omission in how they represented themselves during the bidding process, or that Claimants engaged in any corruption or failure to comply with bidding or other procurement requirements'.[38] In the Ambiente Ufficio case, the Tribunal referred to 'the rules of public law or administrative law of the host State that forbid certain types of investments or require that these be made respecting certain principles aimed at protecting the interests of the host State', excluding 'from the purview of protected investments when they are not compatible with the ordre public of the host State'.[39] In the Mamidoil case, the Tribunal ruled that 'not every type of non-compliance with national legislation bars the protection of an investment' and 'that there must be an inner link between the illegal act and the investment itself. Illegal conduct of the investor will not

[36]Mr. Saba Fakes v. Republic of Turkey, ICSID Case No.ARB/07/20.

[37]*Id.* at ¶ 120.

[38]Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No.ARB/09/1.

[39]Ambiente Ufficio S.p.A. and others v. Argentine Republic, ICSID Case No. ARB/08/9.

affect the investment insofar as it does not relate to its substance or procedural requirements but rather occurs without any material connection to the investment'.[40]

Schill identifies breaches of national law contemplated in arbitral awards in relation to legality requirement provisions, in reality, provisions introducing a requirement of initial compliance, to include illegality per se, prohibition of ownership for foreign investors and legal investments obtained by illegal means.[41] Illegality per se was defined in the Tokios Tokles award as the case where 'the...investment and business activity...are illegal per se'[42] or where 'the assets had been touched in some way by illegality, or...their utilisation had been actively prohibited'.[43] Prohibition of ownership was contemplated in the Fraport case, referring to the prohibition of foreign investors 'under the Philippine Constitution, to hold more than 40% of the shares of locally incorporated companies holding concessions in the public utilities sector'.[44] Finally, legal investments obtained by illegal means contemplated in the Inceysa award include the case of fraudulent and illegal conduct of the investment.[45]

The distinction is by no means theoretical for, as Schill explains in relation to cases of illegality per se, 'no causality requirement needs to be met. In these cases illegality does not result from the investor's conduct to obtain an investment but is inherent in the operation of the investment'. In contrast, 'causality is necessary...in cases where the investor's conduct in acquiring a per se legal investment is illegal, such as fraudulent misrepresentations'.[46] Indeed, in the Hamester case, in relation to 'allegations of fraud in the initiation of the investment, and not with the multiple allegations of fraudulent conduct during the life of the investment', the Tribunal observed

[40]Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No.ARB/11/24.

[41]*Supra* note 11, at 291.

[42]Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[43]*Id.* at ¶ 97.

[44]*Supra* note 11, at 295.

[45]Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

[46]*Supra* note 11, at 308-309.

that 'the only question here is whether Hamester perpetrated a fraud, and thereby procured the signing of the JVA...If the JVA was obtained on the basis of fraud, it is an illegal investment that does not benefit from the protection'.[47] Similarly, in the Niko Resources, a case not involving a legality requirement provision, the Tribunal concluded the absence of 'link of causation between the established acts of corruption and the conclusion of the agreements', amongst others, because the contracts were concluded long before the acts of corruption and did not procure the contracts on which the claims were based.[48]

Both continuous compliance and compliance with any law and regulation were criticized, the first for introducing a risk of loss of investor's protection for any violation of domestic laws at any time during an investment's operation that would 'constitute an immense systematic setback for the effectiveness of the foreign investment protection regime',[49] the second for providing 'the Achilles Heel of investment arbitration if jurisdiction depends on the Claimant passing a full legal compliance audit'.[50] It is remembered that the requirement of full conformity of the World Bank Guidelines[51] was criticised at the time of their adoption for authorising States to take measures irrespective of the gravity of the illegality and failure to take into account the proportionality principle.[52] However, in principle, legality requirement provisions do not require full compliance. Hence, as Kriebaum concludes on the basis of previous

[47]Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24.

[48]Niko Resources (Bangladesh) Ltd. v. Peoples Republic of Bangladesh, Bangladesh Petroleum Exploration & Production Co. Ltd ('BAPEX') and Bangladesh Oil Gas and Mineral Corporation ('PETROBANGLA',ICSID Cases No. ARB/10/11 and ARB/10/18.

[49]*Supra* note 30, at 280.

[50]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

[51]The World Bank Guidelines (1992), Guideline I, Section 2.

[52] Protopsaltis, P., 'Les Principes directeurs de la Banque mondiale pour le traitement de l'investissement étranger', *in* Kahn, P. & Wälde, Th. (eds), *Aspects nouveaux du droit des investissements internationaux*, Académie de droit international de la Haye (Martinus Nijhoff Publishers 2007) p. 225.

arbitral awards, 'not every minor infraction will lead to a denial of investment protection. Only breaches of fundamental norms of a legal order will have such effect'.[53]

Indeed, in the Tokios Tokles case, the Tribunal distinguished between per se illegality and simple breaches of formalities, of bureaucratic finesses,[54]observing that 'to exclude an investment on the basis of such minor errors would be inconsistent with the object and purpose of the Treaty'.[55] Introducing a clear de minimis rule, in the Metalpar case, the Tribunal ruled that it would be disproportionate to punish the omission of timely registration of the company with denying the investor an essential protection.[56]

Since the LESI case, the legality requirement provisions were construed as a reference to the fundamental principles of the host State's law, thus excluding minor violations.In this latter case, the Tribunal observed that'la mention que fait Ie texte à la conformité aux lois et règlements en vigueur ne constitue pas une reconnaissance formelle de la notion d'investissement telle que la comprend Ie droit algérien de manière restrictive, mais, selon une formule classique et parfaitement justifiée, I' exclusion de la protection pour tous les investissements qui auraient été effectués en violation des principes fondamentaux en vigueur'.[57]

In the Desert Line Projects case, the tribunal referred to the exclusion of 'investments made in breach of the fundamental principles of the host State's law, e.g. by fraudulent

[53]Kriebaum, U., 'Investment Arbitration - Illegal Investments', *in* Klausegger, Ch., Klein, P., *et al.*, *Austrian Arbitration Yearbook 2010* (C.H. Beck, Stämpfli & Manz, 2010),p. 319.

[54]*Supra* note 11, at 292.

[55]Tokios Tokelés v. Ukraine, ICSID Case No.ARB/02/18.

[56]Metlpar S.A. and Buen Aire S.A. v. Argentine Republic, ICSID Case No. ARB/03/5.; Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia, UNCITRAL, Partial Award on Jurisdiction of 8 September 2006, ¶¶ 150-152; *cf.* Swembalt A.B., Sweden v. Republic of Latvia, UNCITRAL, Decision of 23 October 2000, ¶ 35.

[57]LESI, Sp Aet Astaldi, SpA c. Républiquealgériennedémocratique et populaire, ICSID Case No. ARB/05/03.

misrepresentations or the dissimulation of true ownership'.[58] Subsequent awards followed the same approach.[59]

2.2. Compliance with International Law

Explicitly and, more often than not, implicitly relying on article 31(3)(c) of the Vienna Convention on the Law of the Treaties (VCLT) and the principle of systemic integration, arbitral tribunals have applied the yardstick of international law in a number of cases, albeit never in the context of a legality requirement provision. In the World Duty Free case, for example, the Tribunal ruled that '[i]n light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal'.[60] Examining the applicable laws chosen by the Parties in their Agreement, the Tribunal then found that the 'public policy both under English law and Kenyan law (being materially identical) and on the specific facts of this case' to conclude that 'the Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of ex turpicausa non orituractio'[61] 'as a matter of ordre pubic international and public policy under the contract's applicable laws'.[62]

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[58]Desert Line Projects LLC v. The Republic of Yemen, ICSID Case No. ARB/05/17.; *cf.* Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri *A.S.* v. Republic of Kazakhstan, ICSID Case No. ARB/05/16.

[59]Inmaris Perestroika Sailing Maritime Services Gmbh and Others v. Ukraine, ICSID Case No. ARB/08/8.; Alpha Projekt holding GmbH v. Ukraine ICSID Case No.ARB/07/16.

[60]World Duty Free Company Limited v. Republic of Kenya, ICSID Case No. ARB/00/7.

[61]*Id.* at ¶ 179.

[62]*Id.* at ¶188; *cf. Supra* note 7, at 42.

It was in the Inceysa case that a tribunal introduced for the first time the yardstick of international law in the context of a legality requirement provision or, as Sasson explains, made its 'task easier by simply importing international law principles into the relevant municipal law'.[63] Relying on a BIT applying to 'investments ... made in accordance with the laws of the other Contracting Party', the Tribunal ruled that because the Constitution of El Salvador determined international law to be part of national law, 'the BIT, as valid law in El Salvador, is the primary and special legislation this Tribunal must analyse to determine whether Inceysa's investment was made in accordance with the legal system of that Nation'.[64]

The Tribunal then rightly observed that 'the Agreement does not contain substantive rules that permit a determination whether Inceysa's investment was made in accordance with the law of EI Salvador'. It therefore decided to test the legality of the investment under international law. On the basis of the provision on applicable law of the BIT referring to both 'the generally recognised rules and principles of international law' and 'the national law of the Contracting Parties', the Tribunal equated international law with the general principles of law of Article 38 of the Statute of the ICJ.[65] The Tribunal thus analysed the investment in the light of 'the general principles of law which the Arbitral Tribunal considers to be applicable in this case', the principle of good faith, the principle nemo auditor propriamturpitudinemallegans, the international public policy and the prohibition of unlawful enrichment.[66]

In this case, as Schill rightly observes, 'instead of dealing primarily with the question of whether the investor's fraudulent misrepresentations breached the law of El Salvador, the Tribunal labored on how the conduct in question was contrary to generally

[63]Sasson, M., "Substantive Law in Investment Treaty Arbitration: The Unsettled Relationship between International and Municipal Law", *Kluwer Law International*, 48 (2010).

[64]Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

[65]*Id.* at ¶ 222-24.

[66]*Id.* at ¶ 229-57.

recognized principles of international law',[67] according to Carlevaris, 'on the probable, but unproven, assumption of their conformity with domestic law'.[68]

Subsequently, a number of tribunals have considered the legality of investment as an implicit condition of applicability of every BIT and IIA. Interestingly enough, in this context, some tribunals have examined investor's breaches in the light of both national and international law. In the Plama case, the Tribunal observed that '[u]nlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring the conformity of the Investment with a particular law. This does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law...the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law. The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law.' The Tribunal found 'that the investment in this case violates not only Bulgarian law...but also "applicable rules and principles of international law", in conformity with Article 26(6) of the ECT which states that "[a] tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law"'.[69]

The Tribunal relied on the Inceysa and the World Duty Free awards to rule 'that the investment was obtained by deceitful conduct that is in violation of Bulgarian law' and that 'granting the ECT's protections to Claimant's investment would be contrary to the principle nemoauditurpropriamturpitud-inemallegans to add that such protection 'would also be contrary to the basic notion of international public policy - that a contract obtained by wrongful

[67] *Supra* note 11, at 300-301;*cf.* Moloo, R., Khachaturian, A., "The Compliance with the Law Requirement in International Investment Law", *Fordham Int'l L. J.*, 34, 1480(2011). *Supra* note 7, at 42.

[68] *Supra* note 15, at 43.

[69] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No.ARB/03/24.

means (fraudulent misrepresentation) should not be enforced by a tribunal'.[70] The presence of an implicit legality requirement in BITs was reiterated in subsequent awards, even though those endorsing this approach cautiously avoided references to international public policy.[71]

In the Phoenix case, discussing its jurisdiction rationemateriae, the Tribunal observed that 'international agreements like the ICSID Convention and the BIT have to be analyzed with due regard to the requirements of the general principles of law, such as the principle of non-retroactivity or the principle of good faith, also referred to by the Vienna Convention'. [72] In its analysis of the 'proper interpretation of the notion of investment in the general framework of the ICSID mechanism and the specific framework of the BIT, in light of the general principles of international law', the Tribunal discussed first the requirement of compliance with the law of the host country. Relying on the ICSID Convention and the legality requirement provision of the applicable BIT, it ruled that '[t]he purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State. The protection of foreign investments not made in accordance with the laws of the host State or investments not made in good faith, obtained, for example, through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and bona fide investments'.[73]

Subsequently, analysing the notion of investment in the light of the general principles of international law, the Tribunal concluded that 'States cannot be deemed to offer access to the ICSID dispute

[70] *Id.* at ¶ 143.

[71] SAUR International S.A. c. République argentine (Aff.CIRDI No. ARB/04/4), Décisionsur la compétenceetsur la responsabilité du 6 Juin 2012, ¶¶308; MamidoilJetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No. ARB/11/24.

[72] Phoenix Action, Ltd. v. Czech Republic, ICSID Case No.ARB/06/5.

[73] *Id.* at ¶ 100.

settlement mechanism to investments not made in good faith. The protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of most importance'.[74]

After the Phoenix award, a number of tribunals examined investors' compliance with both national and international law. By way of illustration, in the Hamester case, the Tribunal relied in the Phoenix award to rule that '[a]n investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation itself constitutes a misuse of the system of international investment protection under the ICSID Convention'.[75] It observed in addition that an investment 'will also not be protected if it is made in violation of the host State's law'[76] and relied on the Fraport award to examine investor's compliance with the express requirement of the applicable BIT.[77] In the Malicorp case, in the absence of a legality requirement provision in the applicable BIT, the Tribunal examined investors' conduct in the light of international law. The Tribunal wondered whether it 'would still have jurisdiction in the event the investor were seeking protection in a manner that was contrary to the principle of good faith', on the grounds 'that the safeguarding of good faith is one of the fundamental principles of international law and the law of investments'.[78]

Schill attributes the reference to the principles of international law in the Plama case 'to the combination of the absence of an explicit reference to domestic legality in an 'in accordance with host State law'- clause and the applicable law clause in Article 26(6) ECT'. The

[74] *Id.* at ¶ 106.

[75] Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24.

[76] *Ibid.*

[77] *Id.* at ¶ 126-129.

[78] Malicorp Limited v. The Arab Republic of Egypt, ICSID Case No.ARB/08/18.

Tribunal, Schill continues, '[p]otentially ... understood this ... clause as precluding a treaty-based tribunal from considering domestic law, therefore using the argumentative hook via principles of international law as a functional equivalent to the renvoi to domestic law effectuated by an 'in accordance with host State law'-clause'.[79] Focussing on good faith, Schill and Bray conclude that '[i]n view of both the Hamster and the Phoenix tribunals, the principle of good faith can therefore seen as serving the function of substituting for the non-existent 'in accordance with host state law' clause. At the same time, the tribunals suggest that the obligation to comply with good faith exists independently of the investor's duty to comply with domestic law'.[80] However, in a number of cases, despite the presence of a legality requirement provision in the applicable BITs, tribunals examined investors' conduct both in the light of national and in the light of international law. Interestingly enough, tribunals avoided to detach the test of compliance with international law from that of compliance with national law. Even in the Plama case, despite the absence of explicit reference to domestic legality, the tribunal felt the need to refer to both the Bulgarian law and the applicable rules and principles of international law. One therefore inevitably has to wonder whether tribunals did in fact introduce an additional yardstick and if so, what the relation of priority between the two may be.

In that respect, one should remember that in the ELSI case, the ICJ observed that the 'Italian corporations and associations controlled by United States nationals must conform to the local applicable laws and regulations...even if they believe a law or regulation to be in breach of the FCN Treaty and, indeed, even if it were in breach of the FCN Treaty.'[81] The priority of national law is confirmed by the OECD Guidelines for Multinational Enterprises, one of the major

[79] *Supra* note 11, at 313.

[80] Schill, S.W. & Bray, H. L., 'Good Faith Limitations on Protected Investments and Corporate Structuring', in Mitchell, A.D., Sornarajah, M. & Voon, T. (eds.), Good Faith and International Economic Law (Oxford University Press 2015), p. 95.

[81] *Supra* note 9, at ¶ 72.

surviving soft law instruments for the regulation of investors' conduct. According to the Guidelines, '[o]beying domestic laws is the first obligation of enterprises. The Guidelines are not a substitute for nor should they be considered to override domestic law and ₃ulation. While the Guidelines extend beyond the law in many cases, they should not and are not intended to place an enterprise in situations where it faces conflicting requirements.'[82]

Aside from the criticism in relation to the application of the general principles of law, the confusion over the distinction between the general principles of law and the general principles of international law and the role of good faith,[83] there are inherent limits to this exercise, stemming from the very nature of international law. For example, international law introduces rights and imposes obligations on States whose violation engages State responsibility.

The PCIJ in its Advisory opinion in the case of the jurisdiction of the Courts of Danzig admitted 'that the very object of an international agreement, according to the intention of the contracting Parties, may be the adoption by the Parties of some definite rules creating individual rights and obligations.'[84]

However, while international law has recognised some rights inuitu personae, amongst others, in favour of foreign investors, the same does not necessarily apply with respect to obligations, for despite attempts to establish liability of business enterprises for violations of international human rights law,[85] as Crawford rightly observes, 'human rights (and other obligations assumed for the benefit of individuals and corporations) arise against the state, which so far has

[82] *OECD Guidelines for Multinational Enterprises 2011 Edition*, OECD, available at https://www.oecd.org/corporate/ mne/48004323.pdf.

[83] *Supra* note 80, at 95-96.

[84] Jurisdiction of the Courts of Danzig, Advisory Opinion No. 15, *PCIJ Coll.*, Series B, No. 15, March 3rd, 1928, p. 17-18.

[85] Paust, J.J., "Human Rights Responsibilities of Private Corporations", *Vanderbilt J.Transnat'l Law*, 35, 803(2002); Dubin, L., "The Direct Application of Human Rights Standards to, and by, Transnational Corporations", *The Review - International Commission of Jurists*, 61, 39 (1999).

a virtual monopoly of responsibility'.[86] In contrast, individuals, including investors, cannot be held liable for their failure to respect these obligations.

3. THE EFFECTS OF ILLEGALITY

Although the legality requirement provisions themselves do not define the consequences of their violation, there is no doubt that their aim is to disqualify illegal investments from the protection of the BIT.[87] In other words, failure to comply with applicable laws and regulations of the host country leads to the loss of protection of the treaty. However, in the ELSI case, the ICJ did not draw this conclusion. It was only in the Salini case where an arbitral tribunal for the first time observed that '[i]n focussing on "the categories of invested assets (...) in accordance with the laws and regulations of the aforementioned party," this provision ... seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal'.[88] With the notable exception of the decision in the Aquas de Tunari case, often attributed to the difference of phrasing of the relevant provisions in the Netherlands-Bolivia BIT,[89] subsequent arbitral awards re-iterated the same conclusion, [90] disqualifying illegal investments from

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[86]Crawford, J., "Brownlie's Principles of Public International Law", *Oxford University Press, 121*(2012).; *cf.*Liberti, L., Quelle place pour la responsabilité des entreprises en droit international, *Forum de droit international*, 7, 235 (2005).

[87]McLachlan, C., Shore, L., & Weiniger, M., "International Investment Arbitration Substantive Principles", *Oxford University Press,* 181 (2007); *cf.* Sornarajah, M., "International Law on Foreign Investment", *Cambridge University Press,* 318 (2010).

[88]Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[89]Aguas del Tunari, S.A. v. Republic of Bolivia, ICSID Case No.ARB/02/3.; *Supra* note 3, at 22-24; *Supra* note 11, at 24-27.

[90]*Supra* note 11, at 3-4; Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18.; Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29; L.E.S.I. S.p.A. et ASTALDI S.p.A c. République algérienne démocratique et populaire, CIRDI Aff. No. ARB/05/3.; Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No. ARB/03/26.; Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18; Mr. Saba Fakes v.

protection. In that respect, the effect of the legality requirement provisions is similar to that of the denial of benefits clauses.[91]

As Carlevaris rightly points out, the main effect of the distinction between validity and definition, introduced in the Salini case,[92] is that the specific illegality of the investment will have to be established.[93] Sornarajah claims in error that '[t]he only authorities which could determine' the violation 'would be the local authorities of the host State ... the protection of the treaty lies then at the caprice of each State, for the local authorities may remove the foreign investment from the protection of the treaty simply by holding that it had violated the local rules and regulations governing its operation'.[94] The investor 'could be deprived of...protection by an ex post facto subjective determination that it is not of the type which is subject to protection because it had not satisfied the criteria of operating according to the laws of the host state'. [95] Nevertheless, determinations of national authorities, including national courts, are not binding upon arbitral tribunals,[96] all the more so, since violation of national laws constitutes a regular defence of the host countries, often used as pretext to avoid compensation. Obviously, the absence of violation justifying exclusion from protection will amount to violation of the BIT by the host country.

However, arbitral awards have not been consistent in relation to the denial of protection of illegal investments. In the Teinver case, with respect to the respondent's objections to jurisdiction on the grounds of the claimant's failure to comply with domestic laws and

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Republic of Turkey, ICSID Case No. ARB/07/20; Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v.The Argentine Republic, ICSID Case No.ARB/09/1.

[91] *Supra* note 3, at 18-21.

[92] Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/04.

[93] *Supra* note 15, at 44.

[94] *Supra* note 8, at 116.

[95] *Id.* at 117.

[96] Amco Asia Corporation, Pan American Development Limited, PT Amco Indonesia v. Republic of Indo-nesia, ICSID Case No. ARB/81/1.

regulations, the Tribunal noted 'that certain of the allegations raised under this objection may affect the merits of the claim and that it will be open to the Parties to make further submissions in respect of these allegations as appropriate during the merits stage of the Arbitration'.[97] Indeed, some tribunals declined jurisdiction whereas others denied substantive protection at the merits stage,[98] the criterion most often being that of initial or subsequent illegality. However, the classification of illegality as pertaining to jurisdiction, admissibility or merits has a number of important consequences, amongst others, in relation to review and res judicata.[99]

3.1. The Denial of Jurisdiction

Relying on the legality requirement provisions included in BITs, host States have claimed that illegal investments do not fall within the scope of investments covered by them or that they are not covered by the consent to arbitrate, thus contesting the tribunal's jurisdiction.[100] Krebaum explains that this leads to a paradox: host State law becomes both the yardstick to define tribunal's jurisdiction and the object of tribunal's review.[101] Carlevaris observes however that while the notion of investment for the purposes of establishing a tribunal's jurisdiction can only be construed by reference to international law, the law of the host State governs the legal relationship to which the dispute refers and, in the presence of a legality requirement provision, also its legality.[102] The compatibility of restrictions to consent with the Washington Convention was

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[97] Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanosdela Sur S.A. v. The Argentine Republic, ICSID Case No.ARB/09/1.

[98] Kriebaum (*Supra*, note 53), p. 310; *cf.* Newcombe, A., 'Investor Misconduct: Jurisdiction, Admissibility or Merits?', *in* De Mestral, A. & Lévesque, C. (eds.), *Improving International Investment Agreements* (Routledge 2013), p. 191.

[99] *Weibel, M., "Investment Arbitration: Jurisdiction and Admissibility", University of Cambridge Faculty of Law Research Paper No. 9/2014, pp. 66-70.*

[100] *Supra* note 67, at 1476; *Supra* note 15, at 39; *Supra* note 11, at 321-322; Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia, ICSID Case No.ARB/06/2.

[101] *Supra* note 53, at 308-309.

[102] *Supra* note 15, at 45.

confirmed in the Saba Fakes case. The Tribunal ruled that '[a]s far as the legality of investments is concerned, this question does not relate to the definition of 'investment' provided in Article 25(1) the ICSID Convention and in Article 1(b) of the BIT...while the ICSID Convention remains neutral on this issue, bilateral investment treaties are at liberty to condition their application and the whole protection they afford, including consent to arbitration, to a legality requirement of one form or another'.[103] In contrast, reliance on the so-called 'double-barrelled' test (meeting both the conditions of Article 25 of the Washington Convention and the BIT)[104] would have required a legality requirement to be implicit in the objective definition of investment under Article 25(1) of the Convention, a conclusion that some tribunals have explicitly contested.[105]

In the Fraport case, investment's illegality was treated as a matter of ratione materiae jurisdiction. The Tribunal ruled that Fraport did not havea-priory entitlement to ICSID arbitration because its 'unlawful investment, is not an "investment" which is covered by the BIT. As the BIT is the basis of jurisdiction of this Tribunal, Fraport's claim must be rejected for lack of jurisdiction ratione materiae'.[106] In the Inceysa case, the Tribunal considered that 'the consent granted by Spain and EI Salvador in the BIT is limited to investments made in accordance with the laws of the host State of the investment. Consequently, this Tribunal decides that the disputes that arise from an investment made illegally are outside the consent granted by the parties and, consequently, are not subject to the jurisdiction of the Centre, and that this Tribunal is not competent to resolve them, for failure to meet the requirements of Article 25 of the Convention and those of the BIT'.[107] A number of subsequent awards followed the

[103]Mr. Saba Fakes v. Republic of Turkey, ICSID Case No. ARB/07/20; *cf.* Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25.

[104]Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No.ARB/00/4.

[105]Metal-Tech Ltd. v. Republic of Uzbekistan, ICSID Case No.ARB/10/3.

[106]Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

[107]Inceysa Vallisoletana v. Republic of El Salvador, ICSID Case No.ARB/03/26.

same approach in order to decline [108] as well as to admit [109] jurisdiction.

However, some tribunals have introduced different criteria for that matter. By way of illustration, in the Phoenix case, the Tribunal distinguished between manifest and non-manifest violations. According to the Tribunal, '[t]he fact that an investment is in violation of the laws of the host State can be manifest and will therefore allow the tribunal to deny its jurisdiction. Or, the fact that the investment is in violation of the laws of the host State can only appear when dealing with the merits, whether it was not known before that stage or whether the tribunal considered it best to be analyzed as the merits stage'. [110] In the Arif case, the Tribunal distinguished between accepted and non-accepted illegality. It ruled that 'there are temporal limitations on a jurisdictional argument based on the illegality of an investment, where the legality of the investment has been accepted and acted upon in good faith by both parties over a period of time. This is not a case of a concealed illegality, or a class of assets prohibited to foreign investors such as, in some jurisdictions, a concession contract for a strategic resource. The investment was not made fraudulently or on the basis of corruption. In cases like the present one, the passage of time and the actions of the parties on the mutual assumption of legality cannot be ignored in the determination of jurisdiction.

The 'normative power of facticity' requires illegality in a case like the present one to be treated as an issue of liability and not jurisdiction'.[111] In other cases however, tribunals precluded denial of jurisdiction altogether in the presence of acceptance by the host country or, as Kriebaum explains, '[k]nowing acceptance by the host

[108]Alasdair Ross Anderson *et al.* v. Republic of Costa Rica, ICSID Case No.ARB (AF)/07/3; Metal-Tech Ltd. v. Republic of Uzbekistan, ICSIDCase No.ARB/10/3.

[109]Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No.ARB/11/24; Saluka Investments B.V. v. The Czech Republic, UNCITRAL, Partial Award of 17 March 2016.

[110]Phoenix Action, Ltd. v. Czech Republic, ICSID Case No.ARB/06/5.

[111]Mr. Franck Charles Arif v. Republic of Moldova, ICSID Case No.ARB/11/23.

State can cure the breach of the host State law or estop the host State from raising the illegality'.[112]

3.2. The Denial of Substantive Protection

The legality requirement provision has also been used as a defence of the host State for its interference with investment when the illegality occurred during the performance of the investment.[113] In such cases, arbitral tribunals have contemplated the denial of substantive protection.In the Fraport case, the Tribunal observed that 'the effective operation of the BIT regime would appear to require that jurisdictional compliance be limited to the initiation of the investment'. In contrast, 'allegations by the host state of violations of its law in the course of the investment, as a justification for state action with respect to the investment, might be a defence to claimed substantive violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its jurisdiction'.[114]

Drawing upon this award, in the Hamester case, the Tribunal observed 'that a distinction has to be drawn between (1) legality as at the initiation of the investment ("made") and (2) legality during the performance of the investment'. However, it found that 'Article 10 [i.e., a clause providing that the BIT applied to investment made in accordance with host State law prior to the treaty's entry into force] legislates for the scope of application of the BIT, but conditions this only by reference to legality at the initiation of the investment. Hence, only this issue bears upon this Tribunal's jurisdiction. Legality in the subsequent life or performance of the investment is not addressed in Article 10. It follows that this does not bear upon the scope of application of the BIT (and hence this Tribunal's

[112] *Supra* note 53, at 324; *cf. Supra* note 67, at 1497-1498; *Supra* note 11, at 16; Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No. ARB/03/25; Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18; Desert Line Projects LLC v. Yemen, ICSID Case No.ARB/05/17.

[113] *Supra* note 53, at 316, 319.

[114] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

jurisdiction) – albeit that it may well be relevant in the context of the substantive merits of a claim brought under the BIT. Thus, on the wording of this BIT, the legality of the creation of the investment is a jurisdictional issue; the legality of the investor's conduct during the life of the investment is a merits issue'.[115] Nevertheless, as already mentioned, other tribunals used different criteria. In the Phoenix case, the Tribunal reserved the merits stage to non-manifest violations whereas in the Arif case, the Tribunal reserved the merits stage to non-accepted violations.

Both denial of jurisdiction and denial of substantive protection have been heavily criticized. From the legal point of view, amongst others, Douglas claims that even though pursuant to the principle of systemic integration investment treaties may be interpreted in the light of general international law, recourse to the general principles and in particular good faith and the maxim that a claimant should not be able to profit from its own wrongs cannot be used by the tribunal to refashion an express provision of the treaty. Thus, if general principles may inform the interpretation of the substantive investment protection obligations and provide a basis for a plea of inadmissibility they may not be used to modify the express provisions of the arbitration agreement and carve out certain types of disputes from the tribunal's jurisdiction.[116]

Focusing on the mechanics of foreign direct investment Kriebaumargues that an investment is a process involving diverse transactions rather than an instantaneous act and illegality may have occurred at a time when certain steps in the process of establishment were already undertaken while others still follow at a later stage.

In situations where the illegality occurred already to obtain the initial investment, a denial of jurisdiction will be the appropriate reaction. In contrast, addressing illegalities that arise after the establishment of an investment at the merits stage is more

[115]Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, (ICSID Case No.ARB/07/24.

[116]*Supra* note 12, at 169-172.

appropriate and finds support in the language of many BITs.[117] Douglas criticised '[t]his temporal dividing line between pleas of illegality that go to jurisdiction and to the merits'. Taking the example of Fraport, he explains that the violation of the Anti-Dummy Law occurred 'at the time that Fraport's direct and indirect shareholding interests in PIATCO were acquired and hence fell on the jurisdictional side of the dividing line'. He rightly concludes that 'if those agreements had simply been executed after the shareholding interests were acquired, then this would be a problem for the merits' even though 'the essence of the illegality would be identical'.[118]

For some commentators, denial of jurisdiction is too drastic a sanction against any illegality of the investment. In his dissenting opinion in the Fraport case, Cremades observed that '[i]f the legality of the Claimant's conduct is a jurisdictional issue, and the legality of the Respondent's conduct a merits issue, then the Respondent Host State is placed in a powerful position. In the Biblical phrase, the Tribunal must first examine the speck in the eye of the investor and defer, and maybe never address, a beam in the eye of the Host State. Such an approach does not respect fundamental principles of procedure'.[119] Dealing with illegality at the merits stage allows investor to exercise his rights while his illegal conduct might, to quote Cremades again, 'excuse or limit any liability of the State Party in an arbitration pursuant to the BIT, depending on the circumstances'.[120]

As Webb Yackee observes, 'the tribunal will have the opportunity to balance the investor's misbehavior against the state's'.[121] All the more so since, as Carlevaris rightly suggests, investors' wrongful act might give rise to counterclaims of the State at the merits phase.[122]

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[117] *Supra* note 53, at 330-332.

[118] *Supra* note 12, at 175.

[119] Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines, ICSID Case No.ARB/03/25.

[120] *Id.* at ¶ 14.

[121] *Supra* note 34, at 741.

[122] *Supra* note 15, at 42.

According to Newcombe, dismissal on jurisdictional grounds may be avoided by treating investment's illegality as an issue of substantive admissibility.[123] This solution would lead essentially to the same result[124] but may indeed be better adapted to the distinction between definition and validity of the investment and may apply to both the case of initial and that of subsequent illegality. Douglas distinguishes between illegality in the acquisition of assets recognized under the host State's laws; illegality in the transaction resulting in the acquisition (investment procured by unlawful means in violation of international public policy or in violation of the host State's law, investment procured for an illicit purpose and investment procured in breach of registration requirements in the treaty); and, finally, illegality in the subsequent use of the assets by the foreign national. Relying on the doctrines of separability and competence-competence, he reserves denial of jurisdiction solely to investment procured in breach of registration requirements. In contrast, he proposes for misconduct in the acquisition of assets to be treated as question of admissibility or merits.

Investment procured in violation of international public policy should be a ground for inadmissibility since 'the concept of international public policy vests a tribunal with a particular responsibility to condemn any violation regardless of the law applicable to the particular issues in dispute and regardless of whether it has specifically raised by one of the parties'. Investment procured in violation of the law of the host State as well as illegalities in the subsequent use of the assets by the foreign national, on the contrary, should be treated at the stage of merits.[125]

These arguments are not that convincing. States have the right to exclude illegal investments from protection and validly limit their consent to arbitration to investments complying with their laws,[126]

[123] *Supra* note 98, at 198; *cf. Supra* note 7, at 42.

[124] *Supra* note 98, at 198.

[125] *Supra* note 12, at 177-185.For a criticism *see* Roe, Th., 'Illegality and Jurisdiction in Investment Arbitration', 2 *Turkish Commercial Law Review* (2016), p. 17.

[126] *Supra* note 11, at 18.

while tribunals do have the necessary tools in their possession to deal with unfounded host State's objections to jurisdiction and adequately protect investor's rights.

Legality requirement provisions should be interpreted in accordance with article 31.1 of the VCLT, that is, in accordance with the ordinary meaning to be given to them in their context and in the light of their object and purpose, an exercise that arbitral tribunals have yet to undertake.[127]

And the terms of the legality requirement provisions contained in BITs and in IIAs do not seem to support the difference of treatment depending on the gravity or the timing of illegality. In reality, the arguments in favour of denial of substantive protection aim at the introduction of some rule of proportionality in relation to the effects of investors' illegality, translating the uneasiness of theory with establishment of investor's obligations through BITs and IIAs, instruments traditionally reserved to investor's protection.

4. CONCLUSION

Arbitral tribunals' interpretation of the so-called 'in accordance with the law' or 'legality requirement' provisions are amongst the prominent examples of tribunals' attempts to introduce investors' obligations and address the criticism of pro-investor bias. The question of content of the legality requirement provisions seems today more or less settled.

Despite their differences, arbitral tribunals agree that on the interpretation of those provisions as well as on the conditions of their application relating to the conduct of the investor and of the State that may trigger investors' responsibility for illegal investments. In contrast, arbitral awards have not been consistent with respect to the yardstick and the effects of illegality for the investor involved.

[127] *Cf.* Dolzer, R., 'Domestic Conformity Clauses in Investment Agreements: Their Role and Their Limits', *in* Rovine, A. W. (ed.), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Brill/Nijhoff 2013), p. 27.

With respect to the yardstick of illegality, arbitral tribunals ruled that legality requirement provisions effect a renvoi to host State's law, thus making conformity with national law the yardstick of the legality of the investment and a condition of its protection. However, some tribunals examined investors' compliance not only with national but also with international law. Both requirements raise a number of questions in the light of the dualist theory.With respect to the effects of illegality, arbitral tribunals held that that legality requirement provisions refer to the validity of the investment and not to its definition, thus disqualifying from BIT's protection investments that are illegal under the law of the host country. However, arbitral awards have not been consistent in relation to the denial of protection of illegal investments. Most tribunals declined jurisdiction mainly in the case of initial illegality and denied substantive protection in the case of subsequent illegality.

Numerous issues remain to be settled: continuous compliance and subsequent illegality, content of fundamental principles of the law of the host country and proportionality principle, investor's good and bad faith, State's knowing acceptance, denial of jurisdiction versus denial of substantive protection, to mention just some. Arbitral tribunals have still to clarify a number of issues and surprises should not be ruled out. Nevertheless, investor's responsibility under international law is now acknowledged. Tribunals are moving towards a more balanced approach for investments' protection. Interestingly enough, despite the long struggle for the introduction of international obligations of investors, the change came somewhat effortlessly from where it was least expected, from BITs and investor - State arbitration, traditional instruments of investment's protection, rather than from the codes of conduct on multinational enterprises, traditional instruments of investor's control. BITs and arbitral awards may now perhaps safely replace the obsolete codes of conduct and their cachectic review mechanisms, since both essentially preach alike, investor's obligation to comply with the host country's laws and regulations.

[ARTICLES]

BURDEN OF PROOF IN WTO-A CONSISTENT TALE OF INCONSISTENCIES

-Jason John*

ABSTRACT

The WTO dispute resolution mechanism aimed at amicable resolution of disputes, rather than imposition of judgment of the Panel or Appellate Body has deliberately opted to do away with prescription of detailed rules of procedure in excess of what is provided for in the Dispute Settlement undertaking. The results of leaving procedural matters to the WTO dispute resolution body have resulted in consistency in the matter of burden of proof. The AB applies the criterion which it deems fit, without having due regard to previous rulings so as to cause dramatic differences in the outcomes of similar disputes. The lack of a coherent underlying principle in identifying the criterion to be used in allocation and operationalization of burden of proof results in unpredictability and inconsistency on the WTO dispute resolution mechanism.

1. INTRODUCTION

Ronald Dworkin, the famed American jurist introduces to us Judge Hercules, an ideal judge who always gives the right answers which best fits and justifies the law as a whole.[1] Dispute Settlement Body (hereinafter "DSB"), the opus magnum of the World Trade Organization is this which Dworkinian Hercules,[2] who interprets the highly nuanced web of interparty obligations under General

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*The author is a former Litigation Associate of Vaish Associates Mumbai and is presently pursuing LLM at National University of Juridical Sciences, Kolkata. The Author would like to thank Dr. Sandeep Bhat of NUJS Kolkata whose valuable comments and advice were instrumental in the completion of this paper.

[1] R. Dworkin, *Law's Empire* (1986).

[2] Sungjoon Cho, "Of the World Trade Court's Burden", *European Journal of International Law*, 20, 675-727 (2009).

Agreement on Tariffs and Trade (hereinafter "GATT") and the allied Multilateral Trade Agreements, in a manner which fits and justifies the entire WTO regime and is still correct. Procedural law of international tribunals have been called the "Antarctica of International Law"[3] the DSB is no exception to this, though much water has flown under the bridge of time since the DSB came into existence, large scale uncertainties plague the DSB system with Appellate Body (hereinafter "AB") engaging in a judicial ping pong on matters of procedure like burden of proof.[4] The causa causans of the uncertainty is the lack of express rule concerning the burden of proof in Panel and AB proceedings within the DSU.[5] Kazazi, in his authoritative work on international procedure, defines burden of proof as the obligation of parties to a dispute to prove the claims to the satisfaction of the tribunal which hears the dispute.[6] The English Common Law concept of burden of proof and the French Civil Law ideal of'La charge de la preuve' both ply in the same sphere of the Roman Law notion of 'onus probandi', and all the three are indiscriminately used in International Law, giving away its humble beginnings from municipal law,[7] despite the ideological similarity that the concepts share, and the difference of operational dimension creates problems of procedure in international law. Burden of proof in a Common Law System takes multiple forms while in operation but La charge de la prevueholds its conceptual form even in

[3]A.H Feller, *The Mexican claims commission, 1923*-1934, vii (1936).

[4]A glimpse through the WTO reports shows inconsistency in defining when is burden of proof discharged, while the earlier reports like *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R (25 April 1997) set the standard at establishing a prima facie case while the latter cases like, *European Communities - Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/AB/R, adopted 12 March 2001 lays down that weighing and assessing of the entire evidence is a prerequisite to determine whether a party has established its claim.

[5]Dispute Settlement System Training Module, World Trade Organization, 10.6, *available at* https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c10s6p1_e.htm (last accessed on Dec. 13 2016).

[6]Mojtaba Kazazi, "Burden of Proof and Related Issues: A Study on Evidence before International Tribunals", *Kluwer*, 30 (1996).

[7]*Ibid.*

operation. An international forum which deals with disputants coming from differing systems would come across as inconsistent if the above stated rules of evidence are used interchangeably.

Despite the WTO Dispute Resolution Mechanism being in existence for over two decades, issues of procedure like standard of review, judicial economy and burden of proof are yet to be made certain by the AB. The statements made by the AB regarding the allocation of burden of proof though look similar but they reveal substantial differences leading to dramatically different outcomes. The AB in earlier cases has adopted the classic plaintiff to prove allegation and defendant to prove exceptions.[8] However, in cases like US- Wool Shirts and Blouses[9] and EC - Hormones[10] the AB drew further distinction between provisions which are 'categorized' as exceptions and affirmative defences which the AB itself opted not to follow in later cases.[11] The result of this inconsistency is that no coherent principle underlying the allocation of burden of proof can be identified when different provisions of the covered agreements are to be interpreted in a single case.[12] The AB and Panels have failed to produce a consistent line of cases which conclusively lays down the law as to such procedural matters.[13]

The Panel and AB seem to be have zeroed in on a few criteria and have been relying on them in fits and starts without any consistency. The most common tool for allocation of burden of proof is the old school way of the plaintiff proving violation and defendant proving

[8]Appellate Body Report United States - Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, (hereinafter US - Gasoline).

[9]Appellate Body Report United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/AB/R (hereinafter US - Shirts and Blouses).

[10]Appellate Body Report EC -Measures Concerning Meat and Meat Products (Hormones), WT/DS26/AB/R, WT/DS48/AB/R(hereinafter EC - Hormones).

[11]Appellate Body Report India - Additional and Extra-Additional Duties on Imports from the United States, WT/DS360/AB/R.

[12]David Unterhalter, "Allocating the Burden of Proof in WTO Dispute Settlement Proceedings", *Cornell Int'l. Law Journal* 42, 209 (2009).

[13]Michelle T. Grando, "Allocating the Burden of Proof in WTO Disputes: A Critical Analysis", *J. of Intl Econ. Law*, 9, 615-656 (2006).

exception. The WTO bodies use the language criterion based on the plain language of the provision, the hierarchical criterion which looks into the hierarchy of the provisions[14] and the pleading criterion which allocates the burden on the party who pleads the provision to allocate burden of proof. The identification of one criterion and its consistent application of that can go a long way in establishing it as a formal GATT panel practice and bring in much needed certainty in the GATT regime. Unlike the Dispute Resolution bodies under GATT, the International Court of Justice in the Corfu Channel Case[15] ruled that the burden of proof rested on the applicant, managing to avoid controversy by being consistent with the maxim of 'Actoriinumbitprobatio' which places the burden squarely on the shoulder of the plaintiff to prove his case. The wisdom of ICJ in adopting the aforesaid old Roman maxim of allocation of burden of proof ensures that there is clarity qua procedure at the ICJ; the WTO Dispute Resolution Bodies on the other hand epitomize the 'too many chefs spoil the broth' adage by employing Common Law and Civil Law principles in addition to the old Roman maxim to operationalize burden of proof, causing a chaotic state of affairs at the Panel and Appellate body level.

The inconsistency in adhering to a specific criterion for the allocation of burden of proof is only the tip of the iceberg; greater uncertainties prevail over the rules as to discharge of burden of proof. The Panels and Appellate Body, at times, prefer establishment of prima facie case as the criterion and endorse the shifting of onus,[16] and at other times, onus shifting is discarded and a static burden of proof being determined at the end of the proceedings is preferred.[17] The irony is that the Panel and AB reports set varying standards for

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[14]Michelle T Grando, *Evidence, Proof, and Fact-Finding in WTO Dispute Settlement* 168 (2009).

[15]Corfu Channel (UK v Alb), 1949 ICJ 4 (Apr 9, 1949).

[16]Panel Report India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, Complaint by the European Communities and their member States, WT/DS79/R, (hereinafter India Patents).

[17]Panel Report, Korea - Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/R and Corr.1, as modified by Appellate Body Report WT/DS98/AB/R (hereinafter Korea Diary Products).

the establishment of prima facie case. While India - Patents specify a mere proof of violation US - Shirts and Blouses requisitions adducing of evidence and US - Section 301 Trade Act[18] fuses the Korea - Diary and US - Shirts and Blouses to a limited extent for determining the discharge of burden of proof. The Panel and AB seem to draw a distinction between the use of prima facie case as a threshold question and as a question of standard of proof.[19] The burden of proof seems to be an imbroglio in both its aspects of allocation and operationalization as the dispute resolution bodies adopt an inconsistent approach in dealing with these aspects of burden of proof.

2. BURDEN OF PROOF- ELUCIDATION OF THE CONCEPT

Burden of proof is a concept belonging to the law of evidence which when discharged, unsettles the default position. In the simplest of terms, it can be stated to be analogous to 'the burden of introducing evidence'.[20] Burden of proof decides who amongst the disputing parties must prove an issue, entailing a risk of adverse adjudication in case of failure to discharge the evidentiary burden. The function of burden of proof is twofold, with one arm directing the parties and the other operating on the court. First, it casts an obligation on one of the parties to initiate the presentation of evidence at the risk of losing the case on failure to do so, and second, it guides the Court on the way forward if the evidence presented is insufficient to arrive at a conclusion or if the evidence remains equivocal or equipoise. The success or failure to discharge the burden of proof results in one of three possible outcomes. A successful discharge of evidentiary burden by the Plaintiff or Defendant leads to a fact being proved or disproved, i.e., after considering the matters before it, the Court is convinced of the existence of a fact or believes in its existence or

[18]Panel Report, United States – Sections 301-310 of the Trade Act of 1974, WT/DS152/R, (hereinafter Section 301 Panel Report).

[19]Appellate Body Report, European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India, WT/DS141/AB/RW, ((hereinafter EC Bed Linen).

[20]Woodroff and Amir Ali, *Law Of Evidence*, 3188 (2012).

considers its existence so probable that a prudent man ought, under the circumstances of the particular case, to act upon the supposition that it exists or vice-versa in the case of 'Disproved'. A failure in discharge results in a fact not being proved or disproved resulting in a conclusion of not proved and an adverse conclusion who fails to prove the existence of such fact. From the above definitions, it is clear that the belief or disbelief of the Court is the paramount factor which makes or breaks a case. Court weaves its own answers and selects one party at the end as a winner, which is dependent more on the Court approving that a party has discharged his/her burden than on the actual burden of proof itself.

The WTO, being a global body, is an agglomerate of common law and civil law jurisdictions. The perception of the notion of burden of proof in this varying system is rather simple when compared to the sheer labour of determination of the DSB understanding of burden of proof which is notoriously fickle.[21] Burden of proof is ascribed with two meanings in Common Law, the first being the 'duty of a party to persuade the trier of fact, by the end of the case of the truth of the propositions'[22] and the second being what is called as 'burden of passing the judge',[23] which makes itself felt at an early stage and is one of producing sufficient evidence to justify the judge in leaving the issue to the jury or where there is no jury, to allow the hearing to continue.[24]

In Civil Law countries, the phrase of 'La charge de la preuve' takes a single meaning and is used to refer to the duty of the parties to prove their allegations as seen in the maxim 'actoriincumbitprobation'.[25]

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[21] *Supra* note 4.

[22] J.D Heydon, *Cases And Materials On Evidence*, 13 (1984)

[23] Joost Pauwelyn, "Evidence, Proof, and Persuasion in WTO Dispute Settlement: Who Bears the Burden?", *Journal of International Economic Law*, 1, 227-258 (1998).

[24] Cross & Wilkins, *Outline Of Law of Evidence*, 25 (1971).

[25] Mojtaba Kazazi, "Burden of Proof and Related Issues: A Study on Evidence Before International Tri-bunals", *Kluwer*,26 (1996); Joost Pauwelyn, "Evidence, Proof, and Persuasion in WTO Dispute Settlement: Who Bears the Burden?", *Journal of International Economic Law*, 1, 227-258(1998).

The overlapping of definitions can be seen in the former meaning of burden of proof in common law jurisdictions which is the burden to persuade the trier of facts.

The procedures adopted by International tribunals are more akin to civil law proceedings rather than common law proceedings. [26] Although the Respondent is expected to co-operate in the production of evidence, no harm is caused to the Respondent's case owing to wilful default in production of evidence; the failure of Claimant to produce evidence and non-persuasion, however, results in a decision against the claimant i.e., party bearing the burden of proof in Civil Law system.

The ICJ in the *Corfu Channel Case* ruled against the Claimant, i.e., UK when she failed to provide evidence of her assertion that Albania's acts caused damages to its ships remarking that it would 'pay no further attention to this matter'. Thus, burden of proof is that tie breaker element which helps the Court in ruling against the party bearing the burden, if the issue remains equipoise or at the failure of the proponent to drive home his assertion.

The first aspect of burden of proof is allocation of evidentiary burden which has already been dealt with, the next aspect of burden of proof is how and when a party is deemed to have discharged the burden that is cast upon him. When considering the discharge of burden of proof, the twin meanings of the phrase acquire significance. Burden of proof, in the first context, means the burden of establishing the case which never shifts from the party on whom the pleadings place such burden. In the second context, the meaning of burden of proof is the burden of introducing evidence which shifts constantly as evidence is introduced by the other side so as to preponderate over the other.[27] This burden that shifts on sufficient evidence being produced so as to warrant a finding is denoted as onus of proof which assists the Court in coming to a conclusion. The

[26]Michelle T Grando, *Evidence, Proof, and Fact-Finding In WTO Dispute Settlement*, 80 (2009).

[27]Woodroff and Amir Ali, *Law Of Evidence*, 3188 (2013).

person on whom the onus rests, if he fails to provide further evidence so as to cause the onus to shift, will invite an adverse order owing to the failure to discharge the onus of proof.[28]

3. ALLOCATION OF BURDEN OF PROOF AT THE WTO

Burden of proof was an issue considered by the quasi-judicial bodies under the GATT regimen right from the beginning. As early as in 1954, the Panel dealt with the issue of burden of proof qua the Complainant and proceeded to dismiss the complaint owing to non-discharge of burden of proof;[29] three decades later, in 1984, the Panel laid down rules regarding the discharge of burden of proof by the Defendant.[30] US Gasoline,[31] the first ever case to be heard and decided by Appellate Body, held that burden of proof rests on the party invoking an exception, laying down one of the canonical rules on burden of proof. US - Gasoline was a mere harbinger of what was to come, the DSB regime established under GATT 1994 had considered the question of Burden of proof in great detail- in fact, nine of the first eleven panel reports explicitly dealt with the issue of burden of proof.[32]

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[28]Cross & Wilkins, *Outline Of Law Of Evidence*, 27 (1971).

[29]Panel Report - Treatment by Germany of Imports of Sardines, BISD 1S/53" 5.

[30]Canada - Administration of the Foreign Investment Review Act Report of the Panel, L/5504 - 30S/140.

[31]Appellate Body Report United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R.

[32]US - Gasoline(*Supra* note 32); Appellate Body Report, Japan – Taxes on Alcoholic Beverages, WT/DS8/AB/R.; Appellate Body Report, United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear, WT/DS24/AB/R;Appellate Body Report, United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/AB/R; Appellate Body Report, Canada – Certain Measures Concerning Periodicals WT/DS31/AB/R;Appellate Body Report, EC Measures Concerning Meat and Meat Products (Hormones), WT/DS26/AB/R;Appellate Body Report, India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R; Appellate Body Report, Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R.

In US - Wool Shirts and Blouses[33] the AB considered the nature of Article 6 of the WTO Agreement on Textiles and Clothing (hereinafter referred to as "ATC") and devoted 5 pages only to discuss the issue of burden of proof.

The DSB endorsed the GATT panel practice[34] of placing the burden of proof on the party who asserts and held that "it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence."[35]

The second contribution of US- Shirts and Blouses to WTO jurisprudence is that it brought out the concept of an affirmative defence by holding that Article XX or Article XI:2(c)(i), are limited exceptions to GATT obligations in Articles I:1, II:1, III or XI:1 and thereby adorn the cloak of affirmative defences as against being positive rules establishing obligations in themselves.[36] The AB concluded that Article 6 of the ATC is not an affirmative defence but is an integral part of the transitional arrangement manifested in the ATC.

In view of Article 6 being a transitional safeguard, the Court allocated the burden to the complainant India.[37] The rules on burden of proof consolidated till the US - Wool Shirts and Blouses can be summarized as follows: the Plaintiff must prove the violation of any GATT obligation that it alleges,[38] the defendant must prove any

[33]Appellate Body Report, United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/AB/R.

[34]United States - Customs User Fee, adopted 2 February 1988, BISD 35S/245; ; Canada - Import, Distri-bution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, BISD 35S/37; United States - Measures Affecting Alcoholic and Malt Beverages, BISD 39S/206.

[35]*Id.* at 14.

[36]*Id.* at 15-16.

[37]*Id.* at 16.

[38]Appellate Body Report, Japan – Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

exception/affirmative defence it seeks to raise.[39]

EC - Hormones, the controversial[40] self-styled interpretative ruling[41] given by the AB, was considering the nature of and interplay between Articles 3.1 and 3.3 of the Agreement on the Application of Sanitary and Phytosanitary Measures (the "SPS Agreement"). Overruling the conclusion of the Panel that Article 3.3, which allows members, if justified scientifically, to introduce or maintain measures which result in higher level of protection as an exception to Article 3.1 which in turn enjoins members to base their sanitary and phytosanitary measures on relevant international standards, the AB held that Article 3.3, in the grand scheme of the SPS agreement is not an exception to Article 3.1.[42]

The AB cast the burden of proof on the Complainant as it was of the view that Article 3.3 recognizes the autonomous right of a member to establish higher degree of protection subject to the conditions provided within the agreement. The AB concurred with the ruling in US - Shirts and Blouses and ruled that the prescriptive language does not suggest any specific allocation of burden of proof and that mere description of a provision as exception does not make it an exception.[43]

The ruling, however, is an anomaly as the relationship of Article 3.3 with 3.1, i.e., Article 3.1, provides for sanitary and phytosanitary measures to be in sync with relevant international standards and states that this is subject the exceptions in 3.3 in the following words "except as otherwise provided for in this Agreement, and in

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[39] Canada – Certain Measures Concerning Periodicals WT/DS31/AB/R; United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear, WT/DS24/AB/R.

[40] Michele D. Carter, "Selling Science under the SPS Agreement: Accommodating Consumer Preference in the Growth Hormones Controversy", *Minn. Journal Global Trade*, 6 (1997).

[41] Sungjoon Cho, "Of the World Trade Court's Burden", *European Journal of International Law*, 20, 675-727 (2009).

[42] *Supra* note 10, at ¶ 104.

[43] *Ibid.*

particular in paragraph 3." The relation between 3.1 and 3.3 is unmistakably that of a rule - exception nature[44] and casting the burden to prove an exception on the Complainant by holding that clear cut language of a rule-exception relationship does not mean anything, is rather intriguing.

EC - Sardines concerned the interpretation of the Technical Barriers to Trade (TBT) Agreement relating to the adoption of and variation from international standards.[45] Emphasizing on the similarities that EC - Sardines shared with EC- Hormones, the panel reconfirmed the view taken in EC - Hormones that the nature of Article 2.4 is such that it allows a WTO member 'to depart from a relevant international standard' when it would be an 'ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued' by that Member through the technical regulation and burden was cast upon Peru, the complaining Member, to establishthe inconsistency with Article 2.4 of the TBT Agreement in relation to the measure applied by the European Communities.[46] This burden was held to include establishing that EC has not complied with the international standard and that the prescribed international standard is effective or appropriate for the purposes of objectives sought to be achieved by the defending party.[47] EC -Sardines like EC - Hormones also involves the manipulation of meaning of the word 'except' by the AB. The repeated trend of employment of interpretative zeal when the express wording is crystal clear puts a question mark on the basic rule of interpretation that the ordinary meaning is to be given to the words of a treaty while interpreting it.[48] The AB seems to have gone a bit too far by reading too much into the objects and purpose and has over contextualized the issue by conveniently

[44]Michelle T Grando, *Evidence, Proof, And Fact-Finding In WTO Dispute Settlement*, 80 (2009)

[45]Appellate Body Report, European Communities – Trade Description of Sardines, WT/DS231/AB/R.

[46]*Id.* at ¶274.

[47]*Id.* at ¶275.

[48]Article 31, United Nations, *Vienna Convention on the Law of Treaties*, 23 May 1969, United Nations, Treaty Series, vol. 1155, p. 331(Dec. 13 2016 07:06 AM)http://www.refworld.org/docid/3ae6b3a10.html.

forgetting the ordinary meaning of the word except found in Article 3.1 of SPS and 2.4 of TBT Agreements.

The next important case which dealt with the issue was Brazil - Aircraft[49] wherein the AB allocated the burden of proof on to Canada, the Complaint, owing to the nature of Article 27.2 (b) of the Agreement on Subsidies and Countervailing Measures (hereinafter mentioned as "the SCM Agreement"), which excluded developing country members from the prohibition on subsidies by allowing them special and different treatment. In line with the conclusion of the nature of right conferred in Article 6 of the ATC in US - Shirts and Blouses, Article 3.3 of the SPS Agreement in EC Hormones and Article 2.4 of the TBT Agreement in EC - Sardines, the AB approved that Article 27.2(a) of the SCM Agreement is a negotiated balance of rights and obligations for developing country Members subject to compliance with certain specific conditions.[50] Thus, as a provision that creates a positive right for developing country members, the burden of proof was allocated to the Complainant. More than the hierarchy of the provisions, it is the language that swayed the decision in Brazil's favour as the AB stressed on the meaning of the phrase 'shall not apply' and held that by virtue of the above phrasing the prohibitions do not apply.

This side stepping of the US - Shirts and Blouses criterion to a simpler and more literal approach of interpretation, showing a leaning towards using language as the criterion for allocating burden of proof, marks the evolution of language criterion in WTO.

US - FSC[51] is a case where the Appellate body applied the rule of defendant bearing the burden of proof in case of affirmative defences. The case pertained to a violation of Article 3.1(a) which was claimed to be justified under 5th sentence of footnote 59 to item (e) of the

[49] Appellate Body Report, Brazil – Export Financing Programme for Aircraft, WT/DS46/AB/R.

[50] *Id.* at ¶ 139.

[51] Appellate Body Report, United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW.

illustrative list of export subsidies read with footnote 5 of the SCM agreement.[52] The AB interpreting footnote 59 in the light of Article 3.1(a) of the SCM Agreement case held that footnote 59 does not alter the scope of item (e) of the Illustrative List or the meaning to be given to the term 'subsidies contingent...upon export performance' in Article 3.1(a) of the SCM Agreement.[53] The AB proceeded to conclude that the fifth sentence of footnote 59 constituted an affirmative defence that justified a prohibited export subsidy and in view of the ruling in US - Shirts and Blouses, the defending party had the burden to establish.[54] The AB conveniently forgot to use the language criterion and followed the approach of interpretation of texts on their hierarchical significance from the US - Shirts and Blouses line establishing a markedly consistent set of rulings in case of allocation of burden of proof in that line.

In EC - Tariff Preferences,[55] India requested the Panel to find that the 'Drug Arrangements' set out in certain EC Regulation were inconsistent with Article I:1 of the GATT 1994 and that the justifications on the basis of the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries ("**Enabling Clause**") was insufficient. The AB approved the finding of the panel that the Enabling Clause was an exception as it was worded similar to Articles XX,XXI and XXIV:5 of the GATT[56] and dismissed the argument that the Enabling Clause constitutes a 'special regime' for developing countries which 'encourages' the granting of tariff preferences by developed-country members to developing countries. Enabling Clause was held to be an exception in the nature of Article XX, XXI etc., of the GATT as its wordings showed marked similarities to authorize deviations from

[52]Panel report - United States - Tax Treatment for "Foreign Sales Corporations, Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/RW.

[53]*Supra* note 52, at ¶ 128, 131.

[54]*Supra* note 52, at ¶ 126, 133.

[55]Appellate Body Report, European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/AB/R.

[56]Panel Report, European Communities - Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/R.

the obligations. The Enabling clause was held to permit members to provide differential and more favourable treatment to developing countries despite the express bar against such transgressions in Article I and was therefore an express exception.[57] The plain old actiori incumbit probatio was adopted by the AB in EC - Tariff Preferences without the additional rills and flares of hierarchy of provisions of US - Shirts and Blouses line marks the return of the conventional rules of allocation of burden of proof in its pure sense in EC Tariff – Preferences.

The AB designed a fourth criterion in India - Quantitative Restrictions[58]-the pleading criterion, which was applied by the AB without its reason being explained and created further uncertainty qua procedure in the Apex WTO body.

The Panel allocated the burden of proof to the defendant under Article XXVIII: Section B 11, since India pleaded it as an affirmative defence.[59] This criterion was further used in India - Additional Import Duties[60] and neither the AB nor the Panel properly explained why the burden was allocated on the basis of pleading alone.

The consistent reliance of the AB on the law laid down in US - Shirts and Blouses seems to have come to an end after the earlier parts of the 21st century. The decisions in the cases of US - Upland Cotton where the AB meekly refused to consider the question of who bears the burden as the AB found 'no compelling reason for doing so on this particular issue'[61], India - Additional import Duties,[62] United

[57] *Id.* at ¶ 90.

[58] Appellate Body Report, India – Quantitative Restrictions on Imports of Agricultural, Textile and Indus-trial Products, WT/DS90/AB/R.

[59] Panel Report, India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Pro-ducts, WT/DS90/R.

[60] Appellate Body Report India – Additional and Extra-Additional Duties on Imports from the United States, WT/DS360/AB/R.

[61] Appellate Body Report - United States – Subsidies on Upland Cotton – Recourse to Article 21.5 of the DSU by Brazil, WT/DS267/RW and Corr.1.

[62] Appellate Body Report, India – Additional and Extra-Additional Duties on Imports from the United States, WT/DS360/AB/R.

States - Large Civil Aircraft (Second Complaint) where the AB delves into the question of obtaining evidence under Annex V of the SCM Agreement and power of the DSB to requisition evidence under Article 13 of the DSU,[63] Canada – Renewable Energy / Canada – Feed-in Tariff Program where the AB considered the burden of proof under several Articles of the GATT and opted for the general line toed by US - Gasoline rather than rely on US Shirts and Blouses criterion,[64] do not go on to discuss the allocation of burden of proof like their earlier counterparts and go in a different tangent when compared to the consistency of criterion seen in the cases discussed earlier. The problem of inconsistency in the criterion employed for allocation of proof is aggravated by such transgressions from the only line of consistent rulings starting from US - Shirts and Blouses qua the issue of allocation burden of proof.

4. DISCHARGE OF BURDEN OF PROOF

The question that gains significance in this circumstance post allocation is what is it that a litigant needs to establish so as to discharge the onus of proof cast upon him. Within the WTO, the ultimate call of who is to prove what and whether a party has discharged its burden of proof is always determined by the Court and the Court alone in the application of its discretion, decides whether a party has discharged its burden allowing the onus to shift to the other party.[65] The discretion of the dispute resolution bodies has been reiterated several times by the AB and the Panels.[66] The stand of the AB in relation to functioning of burden of proof is a murky quagmire. The AB and the Panels tend to rely on prima facie case as one of the trigger events causing the discharge of burden of proof. Even in the use of prima facie case, certain decision use prima

[63] Appellate Body Report, United States - Measures Affecting Trade in Large Civil Aircraft (Second Complaint), WT/DS353/AB/R.

[64] Appellate Body Report - Canada - Certain Measures Affecting the Renewable Energy Generation Sector and Canada - Measures Relating to the Feed-In Tariff Program WT/DS412/AB/R and WT/DS426/AB/R.

[65] Sungjoon Cho, "Of the World Trade Court's Burden", European Journal of International Law, 20, 675-727(2009).

[66] *Supra* note 10.

facie case as a threshold question while others treat it as a standard of proof. Even in cases where prima facie case is treated as a standard of proof, AB and panels opt to use it as an initial standard of proof while certain decisions consider it as a final standard of proof causing more confusion.

When prima facie case is used as a question of threshold, the Complainant must present a prima facie case and once the adjudicator is convinced of the prima facie case, he/she proceeds to determine the merits. A classic example of how prima facie case works as a question of threshold was given by the Panel in United States - Section 211 Appropriations Act wherein the Panel held that it is for the complaining party 'to submit arguments and evidence sufficient to raise a presumption' as to violation and on successfully raising 'such a presumption, the Panel's task becomes a matter of weighing the arguments and evidence available to it...'.[67] This observation of the Panel sets the tone for a line of rulings of the DSB, both Panels and AB to rule on the lines that it is essential that a presumption in the form of a prima facie case is needed to kick start the plot.

In US - Upland Cotton[68] and EC - Bed Linen,[69] the dispute resolution bodies employed burden of proof as a threshold which makes it similar to that of the duty of passing the judge in common law countries. In EC - Bed Linen,[70] the AB drew a distinction between a measure that is found not to be GATT inconsistent on merits and one which is not prima facie inconsistent with GATT. The AB opined that prima facie case is the penultimate question, which if answered positively, leads to the final question of decision

[67]Panel Report, United States - Section 211 Omnibus Appropriations Act of 1998, WT/DS176/R, as modified by Appellate Body Report WT/DS176/AB/R.

[68]Panel Report, United States - Subsidies on Upland Cotton, WT/DS267/R, Add.1 to Add.3 and Corr.1 as modified by Appellate Body Report WT/DS267/AB/R.

[69]Appellate Body Report, European Communities - Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India - Recourse to Article 21.5 of the DSU by India, WT/DS141/AB/RW.

[70]*Ibid.*

on merits. In US - Upland Cotton,[71] it was Brazil's case that Extra Territorial Income Act of 2000 passed by the US was violating Articles 8.1 and 10.1 of Agreement on Agriculture and Articles 3.1b and 3.3 of the SCM Agreement. The panel, however, refused to consider the claims as Brazil failed to make out a prima facie case of inconsistency with the WTO Agreements demonstrating that on the prima facie case question being answered in the negative, the final question of merits might never arise. Despite the apparent advantage of weeding out frivolous and vexatious complainants, the major defect of the threshold theory is that the standard of prima facie case requisitions but skin deep proof of an issue which is not really difficult to produce, a better standard of preponderance of evidence and not proof beyond reasonable doubt as opposed this common law-esque duty of passing the judge would serve the DSB better and avoid any major questions on the credibility of the conclusion arrived at.

Like in the case of allocation of burden of proof, US - Shirts and Blouses[72] lays down a major procedural criterion in the case of discharge of burden of proof being the use of prima facie case as an initial standard of proof. When used as initial standard of proof, it must be established by the complainant that there is a violation of a WTO agreement by adducing sufficient evidence and on successful establishment of prima facie case, the burden of proof shifts to Defendant who must adduce 'sufficient evidence'[73] to disprove the presumption. The AB held that once India discharged its burden to establish a prima facie case of violation, it is up to the US to 'convince' the Panel of its compliance with the WTO regime. Thus, the DSB sets the rules of the game in US - Shirts and Blouses to the extent that the party bearing the initial burden must establish a prima facie case which the opposite must rebut leading evidence.

Just like in the case of allocation of burden of proof, EC - Hormones follows US - Shirts and Blouses in the case of discharge of burden of

[71] *Id.* at ¶ 7.294.
[72] *Supra* note 9, at 14.
[73] *Id.* at 16-17.

proof too. The AB holds that it's a "general rule" that the complainant must establish a prima facie case of violation and once this is shown the onus of proof shifts to the defendant who must show the consistency of the measure with the WTO regime.[74] The AB in this case comes out a lot more clearly with the system of shifting onus by the court on the standard of prima facie case. Both US Shirt and Blouses and EC Hormones set a rather flimsy standard of proof on the party initially bearing the burden/Plaintiff as all that is required of them it establishment of a presumption which is a cake walk most of the times.

India - Patents[75] held that US had discharged the burden of proof by establishing prima facie case of violation of Article 70.8(a) of Trade Related Aspects of Intellectual Property Rights Agreement (TRIPS) and shifted the onus on India to rebut the claim. The ruling in US - Shirts and Blouses that India being the complainant had discharged its burden and it was up to US to convince the panel on satisfaction of requirement under Article 6 of ATC,[76] was confirmed by the AB in appeal and held that party bearing the burden must adduce evidence sufficient to raise a presumption as to the truth of its claim, which once successfully pulled off, shifts the burden of proof onto the other party to rebut the presumption.[77]

Later cases like Chile - Price Band[78] and Turkey - Rice[79] come out clearly as the AB and the Panel respectively held that the complaining party will satisfy its burden by establishing a prima facie

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[74] *Supra* note 10, at ¶ 104.

[75] Panel Report, India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, Compl-aint by the European Communities and their member States, WT/DS79/R.

[76] Panel Report, United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/R, upheld by Appellate Body Report WT/DS33/AB/R.

[77] *Id.* at 14-15.

[78] Appellate Body Report, Chile - Price Band System and Safeguard Measures Relating to Certain Agricul-tural Products – Recourse to Article 21.5 of the DSU by Argentina, WT/DS207/AB/RW.

[79] Panel Report, Turkey - Measures Affecting the Importation of Rice, WT/DS 334/R.

case with adequate supporting evidence. Thus, the US - Shirts and Blouses line of prima facie case as an initial standard of proof expressly states that the onus of proof shifts on establishment of the prima facie case and the buck passes to the opposite party to establish the falsity of the case by preponderance of evidence at the risk of adverse ruling on the basis of the prima facie case on failure to counter it.

For reasons best known to the Panel and AB, prima facie case has also been used as the final standard of proof to determine the discharge of burden of proof. Prima facie case as a question of final standard of proof is seen in cases like Canada- Aircraft[80] where the Panel after considering all the evidence over a 189 page discussion of law and fact held that prima facie was not established.

In EC – Export Subsidies on Sugar, the Panel in its overall conclusions held that the Complainants had established prima facie case that EC exports of sugar had overshot the limits, prima facie case of subsidies being provided by the EC established that the EC applied governmental measures and cross subsidization through EC Sugar regime when read alongside the fact that EC had been unable to prove that the excess quantities exported were non-subsidized and would result in the conclusion that EC had violated its obligation under the Agreement on Agriculture.[81] The case turned against the EC on the basis of the prima facie case and not on preponderance of evidence showing the power of establishment prima facie case to make or break a case.

In US - Section 301 Trade Act, further improvements were made in the form of additional requirement of presentation of arguments and a simpliciter that the defendant shall rebut "that prima facie case" which includes presentation of arguments and adducing 'sufficient'

[80] Panel Report, Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/R, upheld by Appellate Body Report WT/DS70/AB/R.

[81] Panel Report, European Communities - Export Subsidies on Sugar, Complaint by Brazil, WT/DS266/R, as modified by Appellate Body Report WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R.

evidence.[82] The Panel in US - Section 301 Trade Act takes the discussion further ahead and holds that when the parties submit evidence to a certain claim, the panel must balance the evidence and determine whether the party bearing the burden has 'convinced' the panel of the validity of its claims.[83]

The use of prima facie case as final standard of proof is fine in the absence of proper evidence as a presumption is a logical move in such dire straits, but the presumption method turns into a kamikaze if there exists any piece of evidence that is of worth.

Finally, Korea - Diary seems to have trodeen a new path untrodden yet by the other panels, seemingly discarding the ideas of prima facie case, onus shifting etc. and holds that it is for the panel to weigh and assess the evidence and arguments at the end of the process in order to determine the merits of the claim.[84]

This method of discharge of burden of proof known as the holistic approach deploys the discretion of court at the very end of the proceedings to see whether burden of proof is discharge.[85]

The holistic approach was also adopted by the panel in Canada - Wheat Exports and Grain Imports where the Panel weighed all the evidence on record to conclude that Section 87 of the Canada Grain Act was not GATT inconsistent owing to the failure of United States to establish the inconsistency.[86] Later in Dominican Republic - Import and sale of Cigarettes the Panel examined all evidence produced before it to conclude that fiscal measures of Dominican

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[82] Panel Report, United States - Sections 301-310 of the Trade Act of 1974, WT/DS152/R.

[83] *Id.* at ¶ 7.14.

[84] Panel Report, Korea - Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/R and Corr.1, as modified by Appellate Body Report WT/DS98/AB/R,

[85] Michelle T Grando, "Evidence, Proof, And Fact-Finding In WTO Dispute Settlement", *Oxford University Press*, 80 (2009).

[86] Panel Report, Canada - Measures Relating to Exports of Wheat and Treatment of Imported Grain, WT/DS276/R, upheld by Appellate Body Report WT/DS276/AB/R.

Republic was not proved to be GATT inconsistent.[87] Thus, the DSB uses yet another criterion for determination of discharge to muddy the pool further and to create even more uncertainties qua discharge of burden of proof.

5. CONCLUSION

An analysis of the AB decisions leads one to a maze of methods leading to numerous conclusions which arise out of circumstances that have a lot in common. The AB lays down the correct abstract legal principle for allocation of burden of proof but fails to apply it correctly owing to excessive reading into the words of the agreements or by ascribing meanings to the multilateral agreements. At times, the AB relies on language of the provision to allocate the burden, while at other times, the AB opts to see who pleaded what and in a third set of cases, the AB looks into the scheme of the agreement to allocate the burden on the basis of the hierarchy of the arrangement of the provision. Even in cases where the language holds the key to allocation of burden the AB brings in hierarchy to arrive at a contrary conclusion. The serially inconsistent and erratic tendencies in allocation of burden of proof has led to a whims and fancies regime of opting for the method which any judge finds good irrespective of how such situations had been dealt with by the AB earlier.

From the analysis of the decisions it is seen that the Panels and AB adopt a criterion based on language and another one based on hierarchy of agreements in majority of these cases. The language criterion fishes out phrases like "...shall not extend to the following..." in article XI: 2(c) as analysed in AB in US Shirts and Blouses, "...Article 3 shall not apply..." in Article 27.3 of the SCM Agreement, the express mention of the word exception in Article 2 of the ATC, Article 3.1 SPS Agreement and Article 2.4 of the TBT Agreement as analyzed in US - Shirts and Blouses, EC - Hormones

[87]Panel Report, Dominican Republic - Measures Affecting the Importation and Internal Sale of Cigarettes, WT/DS302/R, as modified by Appellate Body Report WT/DS302/AB/R.

and EC – Sardines, respectively. In all these cases, the dispute resolution bodies have been keen on analyzing the language of the provision in coming to a conclusion. However, the problem with language criterion is that the reliance on language criterion has been sporadic. Even in cases like US - Shirts and Blouses, despite having more than enough incentive to apply the language criterion, the AB opted not to rely on it and stated that terming a provision as an exception does not make it so and proceeded to apply the hierarchical criterion which is considered next.

The hierarchical criterion was evolved in the case of US - Shirts and Blouses wherein, the AB ruled that merely terming a provision as an exception will not make it an exception and went on to consider the grand scheme of GATT and held that ATC is a carefully negotiated balance of rights thereby rejecting the language criterion. The same pattern was followed in EC - Hormones, EC – Sardines, US – FSC where in the AB appreciated the hierarchy of agreements/provisions in the WTO environment and thereby gave rise to a near set criterion for allocation of burden of proof.

However the consistency of the hierarchical criterion has turned out to be a flash in the pan. In India – Quantitative Restrictions burden of proof was allocated on the basis of who raised the provision. In Brazil – Aircraft the allocation was made on the basis of the admission made by one party that it bore the burden of proof, and in Dominican Republic - Cigarettes none of the aforementioned criteria was considered and the holistic approach was employed.

The invisible sceptre of actiori incumbit probation, the conventional rule of Plaintiff to prove violation and Defendant to prove exception is ever present. Right from the pre-DSU era of German - Sardines to US - Gasoline and US Shirts and Blouses to EC - Tariff Preferences, a consistent reliance on this conventional rule is seen. The entire concept of the US Shirts and Blouses criterion of looking into the hierarchy flies on the wings of the conventional criterion. The rule that if the provision creating the exception is an affirmative right then the burden falls on the plaintiff is but a variant of le charge de la prevue of Civil law, onus probandi of Roman law and Plaintiff to

prove violation of right of Common Law. The consistency that the conventional criterion would have brought to the DSB is prompted by the whimsical interpretations of what provisions exist in a rule-exception hierarchy and utter disregard of cardinal rules of interpretation like ordinary meaning be given to the words of the treaty.

The question of discerning the discharge of burden of proof is murkier than the allocation of it. The AB and the Panels have used burden of proof as a tool to discern the discharge of the burden while other times they have opted to use the common law concept of arriving at a decision after consideration of all arguments and evidence. Even when prima facie case is employed, at times it is used as a threshold question. In cases like Korea - Alcoholic Beverages and US – Gambling, the dispute resolution bodies takes the stand that prima facie case is threshold question, a reasoning which aligns itself with the common law notion of the passing the judge so as to continue with the case. A reading of this nature would mean that prima facie question is to be answered at the penultimate stage with the final decision on merits being left to be decided on the basis of the decision on establishment of prima facie case.

Authoritative rulings in cases like US - Shirts and Blouses, EC Hormones and Chile - Price Bands support prima facie case as more of a standard of proof for shifting of burden. The sigh of relief one might have on seeing some kind of certainty is short lived as prima facie case, when employed as standard of proof, is further divided into prima facie case as initial standard of proof and prima facie case as final standard of proof. While US - Shirts and Blouses, EC Hormones and India – Patents consider prima facie case as an initial standard which causes the onus to shift causing the defendant to rebut, cases like Canada – Aircraft, EC - Export Subsidies on Sugar consider prima facie case as a final standard of proof.

Though not from the Appellate Body, Panel Reports on Korea - Diary, Dominican Republic - Cigarettes propose a third approach being the holistic approach wherein the evidence is weighed at the very end so as to assist the panel in determining whether the

evidence adduced was enough to persuade the Panel to come to a conclusion on the claim raised.

6. THE WAY FORWARD

The one stop solution is to incorporate the much needed procedural rules in DSU through an instrument like the statute of International Court of Justice, such affirmative action is more likely to cleave the wings of fancy of Panels and AB to conjure even more ways of allocation and discharge of burden of proof. Other alternative is to follow municipal law systems in relation to matters of procedure, a good example is the practice under UNCITRAL Model Law on International Commercial Arbitration (United Nations Commission on International Trade Law) which allows the Arbitral Tribunal to decide on its procedure. The Tribunals, however, opt to adopt municipal law or internationally accepted rules like International Bar Association Rules of Taking of Evidence in International Arbitration. Another option is that the dispute resolution bodies decide to adopt self-restraint and opt to follow one criterion, like the widely recognized hierarchical criterion for allocating burden of proof.

The issue of criterion for discharge of burden of proof is inherently discretionary and setting the discharge in stone will only deprive the Panels and AB of vital discretion. As the WTO dispute resolution mechanism is more related to Civil Law than Common Law, the use of prima facie case as question of threshold must be avoided. Dismissing a case on failure to establish prima facie case is a classic attribute of adversarial litigation and such a practice is never an adornment to amicable dispute resolution envisaged under the DSU. The adoption of prima facie case as initial standard of proof is a viable solution; the decision in US - Shirts and Blouses is the leading lamp in deciding the criterion for discharge as well. The AB has provided sufficient safeguards by insisting on evidence being produced and has not diluted the discretion of the dispute resolution bodies in any way. However the trouble here is the markedly adversarial nature of proceedings, which to a great extent can be avoided by adopting the holistic criterion. The preponderance of

evidence considered at the end while employing the holistic criterion takes the proceedings closer to the best evidence rule than the prima facie case which is a lesser threshold.

Jim Rohn, the hero of a famed American rag to riches success story, once noted that success is not magical or mysterious but it's a result of consistently applying basic fundamentals. The DSB is without a doubt one of the greatest achievements of the WTO and it enjoys unparalleled respect amongst most, if not all, trading nations. But the inconsistency in applying basic fundamentals like allocation of burden of proof and discharge of burden of proof can never be good for the Apex adjudicatory body of the WTO. The Panels and AB would be doing themselves huge favours by being consistent in determining the allocation of burden of proof by sticking to the hierarchical criterion established in US Shirts and Blouses owing to its proximity to the conventional rules of allocation of burden of proof in both Common Law and Civil Law systems and the flexibility it provides in interpreting multiple provisions. Similarly, the Panels and AB can toe the India - Patents way of requiring sufficient evidence for establishing prima facie case and use it as initial standard of proof due to that system being widely used in several municipal law systems. The Panels and AB would do well to remember that the world wants consistent delivery of established standards qua procedural aspects of the DSB and not whims and fancies machinery which makes the entire system unpredictable.

CAN ARBITRAL AWARD BE CONSIDERED AN INVESTMENT FOR THE PURPOSE OF INVESTMENT TREATY ARBITRATION?

-Ashita Alag and Aayush Marwah*

ABSTRACT

An arbitral award from an International Commercial Arbitration is rendered useless for the party in whose favour it is granted if the party is unable to get it enforced. The winning party in a commercial arbitration is seldom left with many choices to get its award enforced if the procedure of the national legal system of the country in which enforcement is sought is tedious, time consuming and non-arbitration friendly. Such actions by administration and the judiciary of the State cause gross injustice to the party seeking enforcement under international law.

A new ray of hope may arise for such a party if the non-enforcement of its award allows the party to claim a breach of the Bilateral Investment Treaty by the state in which enforcement is sought. A pre-condition for a claim to arise under any Bilateral Investment Treaty is the existence of an investment. Hence, for such an action to crystallise, at the very threshold the award arising from the commercial arbitration must be an investment under the Bilateral Investment Treaty. The authors discuss that the basic premise for such an approach is that by the unjust denial of enforcement of an arbitral award, the State has breached its obligation under international law and under the Bilateral Investment Treaty to accord fair and equitable treatment to the investors.

This paper attempts to examine the link between an award from a commercial arbitration and an investment under a Bilateral Investment Treaty. For that purpose, the authors have adopted a two-pronged approach. In the first part, the article endeavours to understand the scope

*Students, 4th Year, Amity Law School, Delhi (affiliated to Guru Gobind Singh Indraprastha University).

of investment. It lays down the link between the definition of investment under the Investment Treaties and the definition as per Article 25 of the ICSID Convention. Tribunals have used Article 25 to lay down certain basic factors that must exist for an investment. Hence, in the first part, the article examines the mingling between the definition adopted by the parties and these factors laid down by the tribunals in various awards. The article tries to establish the meaning of investment with respect to both these approaches and discusses the essentials of an investment as enunciated in Salini v. Morocco, popularly known as the Salini test.

In the second part, the article lays down the meaning of an arbitral award and then goes on to examine whether an arbitral award can fall within the meaning of investment as established in the first part of the article. The article lays down the differing approaches adopted by various tribunals in cases where they were confronted with the question of whether an arbitral award is an investment. In its first approach, the article tries to test whether an arbitral award can directly fall within the meaning of an investment. In case an arbitral award cannot directly be an investment, the authors in their second approach attempt to establish an indirect link with the subject matter of the award. The article discusses the observations of the tribunals in various cases wherein the main subject matter from which the award arose fell within the definition of investment. In case the subject matter falls within the definition of investment, the article examines if the award in such a case can indirectly fall within the definition of investment or not.

In essence the authors of the article are trying to discuss the legal rationale behind the relief available to the award creditor whose award has been unlawfully and arbitrarily denied enforcement by the host State. Such a right, if established will be a powerful weapon in the arsenal of the investor, when the State has unjustly refused to enforce the arbitral award and breached the Bilateral Investment Treaty.

1. INTRODUCTION

In the short history of Investment Treaty Arbitration (ITA), there have been a few questions that have been subject to different interpretations and without a definite answer. One such question, which has recently evolved in the jurisprudence of ITA and deserves

a definite answer, is 'Whether an arbitral award constitutes a part of an investment'? Or 'Whether an arbitral award is an investment'?

The question has gained importance in the present day with respect to what comes after the termination of arbitral proceedings. The seeds of the tedious process of arbitration are sown to reap the benefits of the fruit in terms of the award at the conclusion of the proceedings. There may be a scenario where the party in whose favour the award has been delivered is unable to enforce the award. In such a case all the efforts throughout the proceedings are rendered futile. It is in relation to this enforcement of the award that the issue of considering an arbitral award as an investment gains immense importance. In elementary terms, if an arbitral award is considered an investment, it allows an investor to initiate ITA under the Bilateral Investment Treaty (BIT) for the non-enforcement of the original arbitral award.

To determine whether an arbitral award is an investment or not, this article, in its first part looks at the contours of investment that have been defined over the brief history of ITA. It examines the links between the autonomy given to states to define investment in their agreements and the discretion given to tribunals while interpreting the term 'investment'. It goes on to assess whether a tribunal is limited by the definition of the parties or whether it can and under what circumstances can it move beyond the definition of the parties. The article further examines the various factors that have been held to be the basic requirements of an investment.

Once the meaning of investment has been explained, this article goes on to examine whether an arbitral award falls within this meaning of an investment. It studies the meaning of an arbitral award and then looks at whether the arbitral award itself or the subject matter from which it is arising satisfies the tests laid down for an investment in the first part. Once it has been assessed whether an arbitral award is an investment, either directly (where an arbitral award satisfies the test for investment) or indirectly (where the subject matter from which the award is arising satisfies the test for investment), the consequences of both the scenarios may be seen.

2. WHAT IS THE MEANING OF 'INVESTMENT'?

There are many diverse interpretations given to the word 'investment' and its essential attributes. The jurisprudence of the meaning of the term 'investment' has evolved over the time with various decisions of the tribunals. This part of the article will discuss the different interpretations and what has finally been established as a benchmark for categorizing an investment.

Black's Law Dictionary defines an 'investment' as, 'a term where capital is committed to make an income from it'.[1] While dealing with disputes Tribunals often need to look at the definition of 'investment' with reference to, firstly, the investment treaty; and secondly, Article 25 of the ICSID Convention.

While the ICSID definition per se may not be binding on other tribunals; however, the factors defining investment that have been laid down while interpreting Article 25 of the ICSID Convention are often used by tribunals world over while considering the definition of investment.[2]

2.1. Definition of Investment under BITs

States have the freedom to define investment under their BITs. Modern BITs usually keep a wide and open-ended definition of investment with an indicative list of specific kinds of investment. They usually include phrases such as "every kind of asset..." and go on to give a non-exhaustive list stating "in particular, though not exhaustively...."[3] They may include references such as "all assets, such as property, rights and interests of every nature" within the scope of investment.[4]

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[1]Henry Campbell Black, *Black's Law Dictionary*, 58 (1910).

[2]Cambell McLachlan, Laurance Shore & Matthew Weiniger, *International Investment Arbitration: Substantive Principles*, 164 (2008).

[3]Agreement for the Promotion and Protection of Investments, Bosnia & Herzegovina, Article 1.

[4]Agreement on Encouragement and Reciprocal Protection of Investments, France-South Africa, Article 1.

There is a common thread across most BITs while defining investment. After the wide phrase, the specifically listed categories would include, 'shares, property, contracts, rights conferred by law and intellectual property rights'.[5]

An example of a commonly used definition for investment in BITs is as follows:

"Investment means every kind of asset, owned or controlled directly or indirectly, and in particular, though not exclusively, includes:

(i) movable and immovable property and any other property rights such as mortgages, liens or pledges;

(ii) shares in and stock and debentures of a company and any other form of participation in a company;

(iii) claims to money or to any performance under contract having a financial value;

(iv) intellectual property rights, goodwill, technical processes and know-how;

(v) Business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources."[6]

There have been situations wherein the Tribunal has chosen to stick to the definition of investment chosen by the parties under BITs or Investment Treaties.

In Phillip Gruslin v. Malaysia,[7] the Tribunal denied jurisdiction as the transaction did not fit in the definition of investment in the Inter-Governmental Agreement between the parties. There are many instances where the tribunals have used a BIT definition as the

[5] *Supra* note 2, at 171.

[6] U.K. Draft Model BIT, Article 1, available at http://investmentpolicyhub.unctad.org/Download/TreatyFile/2847.

[7] Philippe Gruslin v. Malaysia, ICSID Case No.ARB/99/3.

benchmark to examine the scope of investment.[8] However, the autonomy given to the parties is not unlimited and a meaning apart from the one agreed to between the parties may also be attached to the term investment.[9]

2.2. Tribunals are not limited by the definition in BITs

In multiple cases, the Tribunal's jurisdiction has not been restricted to the definition of investment adopted by the parties. Moreover, there is a limitation on this freedom of the parties to define 'investment'. The freedom granted to the parties cannot be exercised in a manner that it results in anything agreed between the parties becoming an investment. Their definition has to be in tandem with the objective test enshrined under Article 25 of the ICSID Convention.[10]

Article 25(1) of the ICSID Convention requires that in addition to other criteria for the Centre to have jurisdiction there must be a legal dispute which is arising 'directly out of an investment'. Additionally, The Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States has said that:

"no attempt was made to define the term 'investment' so that the Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre under Article 25(4)."[11]

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[8]Generation Ukraine, Inc. v. Ukraine, ICSID Case No.ARB/00/9; SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ICSID Case No.ARB/01/13; Société Générate de Surveillance SA v. Republic of the Philippines, ICSID Case No.ARB 02/6; Tokios Tokelos v. Ukraine, ICSID Case No.ARB/02/18; Waguih Elie George Siag and another v. Arab Republic of Egypt, ARB/05/15.

[9]*Supra* note 2, at 170.

[10]Joy Mining Machinery Limited v. Arab Republic of Egypt, ICSID Case No. ARB/03/11.

[11]Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, IBRD, Section V,

There exists a view, which states that investment was not defined in specific terms in the ICSID Convention so as to not limit its meaning or scope.[12] It was left to the parties to lay out the provision under their BIT to include the disputes that can be referred to ICSID. However, as will be discussed within this part of the article, the interpretation of Article 25 of the Convention, by laying down certain qualifying factors for an investment puts certain limits on the parties' freedom to define investment. In fact, if the Article 25 threshold is not met, a matter could be excluded from ICSID jurisdiction.[13]

Elaborating upon the limitation on the parties' freedom to define investment, the Tribunal in Patrick Mitchell v. DRC[14] has observed that the freedom given to the parties does not allow them to arbitrarily open the ICSID jurisdiction to anything that they might agree upon to qualify as an investment. The Washington Convention is held to be superior to any BIT or agreement between the parties.

Therefore, the parties indeed have the autonomy to define investment in their treaties but this definition cannot be the sole criterion when the Tribunals are judging the scope of an investment. Certain factors can be used as limitations to this freedom while defining investment. The next question that arises is with regard to the substance of these limitations. The Tribunal, through various cases, has laid down multiple tests to be kept in mind while interpreting the word investment.

2.3. Objective Factors of 'Investment'

To prevent the parties from having unfettered freedom to define 'investment', the Tribunal has tried to put certain limits on this

¶27 available at https://icsid.worldbank.org/ICSID/ StaticFiles/basicdoc/partB.htm.

[12]David A Lopina, "The International Centre for Settlement of Investment Disputes: 'Investment Arbitr-ation for the 1990s", 4 *Ohio State Journal on Dispute Resolution*, 107, 114 (1988).

[13]*Supra*note 10, at 52.

[14]Patrick Mitchell v. DRC, ICSID Case No.ARB/99/7.

freedom by laying down objective factors that are required for an investment to exist.

Professor Christoph H.Schreuer has laid down a criterion for defining an investment and it includes the duration of investment, regularity of profit and returns, substantial commitment, contribution to host state's development and an element of risk.[15] In essence, if a transaction has these four factors, it will qualify as an investment. These factors have been observed to be the 'basic features of an investment' and were considered in the case of Fedax v. Republic of Venezuela, [16] the first ever case that challenged the jurisdiction of ICSID based on the transaction not being an investment. In this case, Fedax, a company used the Netherlands-Venezuela BIT to claim as a beneficiary of debt instruments endorsed to it. Venezuela contended that these debt instruments were not an investment, as Fedax had not made any foreign direct investment that involved a long-term transfer of financial resources. The Tribunal while rejecting this argument and holding that the promissory notes were an investment laid down certain 'basic features' that an investment possesses. The factors it laid down were- a) a certain regularity of profit and return, b) the assumption of risk, and c) a substantial commitment to and significance for the host State's development.

In CSOB v. Slovakia[17] also, a factor-based approach was adopted. The dispute arose after the separation of Slovak and Czech Republics. The Claimant in this case, a Bank, was privatized and its non-performing loan receivables were assigned to a Collection Company that was supposed to make payments for it to the Bank. A dispute occurred with respect to the above agreement and Slovakia argued that the dispute did not arise out of an investment, as CSOB had not made expenditure or outlays in the Slovak Republic. The Tribunal while rejecting this argument adopted the observations of the

[15]Christoph H. Schreuer, *The ICSID Convention: A Commentary*, 140 (2001).
[16]Fedax N.V. v.The Republic of Venezuela, ICSID Case No.ARB/96/3.
[17]Ceskoslovenska Obchodni Banka, v. Slovak Republic, ICSID Case No. ARB/97/4, 14 ICSID Rev. Foreign Inv. L.J. 251 (1999).

Tribunal in the Fedax case. It held that CSOB's continuing expanding activities in the Republics, which involved a significant contribution to the economic development, made it an investor.

Such an approach was also followed in Joy Mining Machinery Limited v. Arab Republic of Egypt.[18] The case related to performance guarantees given by the claimant to an Egyptian State controlled enterprise. The underlying contract was related to the supply of mining equipment. The Tribunal, while referring to the criteria laid down in Fedax, held that no investment existed in this case and the contract amounted to no more than a sales contract.

The factors laid down in Fedax v. Republic of Venezuela were reiterated in Salini v. Morocco[19] which held that 'a) Contributions in assets or money, b) A certain duration of performance of the contract, c) An element of risk, and d) A contribution to the economic development of the host State' are the relevant criteria for the existence of an investment. The Salini award said that investment under Article 25 of the Convention should be understood with reference to an objective criterion.

The objective criteria laid down has come to be known as the 'Salini criteria' or the 'Salini test' which is used to test whether a particular transaction would qualify as an investment or not. In this case, the dispute related to a contract of construction of Highways in Morocco by Italian contractors and whether it constituted an investment.

Under the BIT, investment was to be defined with reference to Moroccan National Law. Morocco argued that there was no investment and it was merely a commercial contract. However, the Tribunal while referring to the objective factors held that the transaction was an investment as per the objective criterion and under the BIT.

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[18] *Supra* note 10, at ¶55 & ¶56.

[19] Salini Costruttori S.p.A. and Italstrade S.p.A. v. Morocco, ICSID Case No. ARB/00/4, 42 ILM 609 (2003).

Tribunals have been inclined to consider certain factors while dealing with the existence of an investment. In laying down an objective test for a transaction be an investment, the Tribunal in Consortium Groupement L.E.S.I.- DIPENTA v. République algérienne-démocratique et populaire,[20] found the following factors relevant while judging if a contract for construction of a dam in Algeria was an investment or not: a) the contracting party has made contributions in the host country; b) those contributions had a certain duration; and c) they involved some risks for the contributor.[21]

Nevertheless, there can be no straightjacket formula to define what will qualify as an investment. Even the Salini factors cannot be applied strictly to every case. They have not been laid down in the Convention and hence, are not a mandatory requirement. However, the factors can be used as a guiding light while trying to understand the elements of an investment.

There cannot be a stringent list of factors, however, these factors can be used as helpful tools while judging the existence of an investment or seeing whether a transaction is an investment or not.

As has already been stated that the term investment was consciously left undefined in the Convention to afford a liberal interpretation; tribunals that sit in individual cases should impose any one such definition as applicable to all cases.[22]

However, the argument that the Convention does not define or lay down a minimum basic criterion for investment cannot be taken to mean that the parties can be allowed to agree to any meaning of investment.

In fact, the failure to add a definition of investment in the

[20]Consortium Groupement L.E.S.I.- DIPENTA v. République Algérienne Démocratique et Populaire, ICSID Case No. ARB/03/08, Award, 10/01/2005.

[21]*Ibid.* at ¶13.

[22]Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24/07/2008, ¶313.

convention was due to the inability to reach an agreement as to the definition.[23]

Therefore, a balance needs to be drawn between this freedom of the parties and laying down certain basic factors that can be applied by various Tribunals while determining the existence of an investment. There have to be some limits within which parties have the freedom to agree upon the definition of investment.

In the case of Rompetrol v. Romania it was observed, "As both Parties to this arbitration accept, Article 25 reflects objective 'outer limits' beyond which party consent would be ineffective."[24]

In fact the Chairman of the Regional Consultative Meetings of Legal Settlement of Investment Disputes as has very well elucidated this position:

"The purpose of Section 1 is not to define the circumstances in which recourse to the facilities of the Center would in fact occur, but rather to indicate the outer limits within which the Center would have jurisdiction provided the parties' consent had been attained. Beyond these outer limits, no use could be made of the facilities of the Center even with such consent."[25] It is these factors that have been laid down by the Tribunals that will form the outer limits of defining an investment.

The freedom of the parties is intact to define investment in their treaties; however, such a definition must be within the limits of these basic factors that have been laid down throughout the years. The factors are to be taken as akin to a boundary, and the parties are free to exercise their autonomy to define an investment within the boundary formed by the basic factors of an investment.

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[23]Christoph H. Schreuer, *The ICSID Convention: A Commentary*, 90 (2001).

[24] The Rompetrol Group N.V. v. Romania, ICSID Case No. ARB/06/3, 18/04/2008.

[25]ICSID, *History Of The ICSID Convention : Documents concerning the origin and the formulation of the convention on the Settlement of Investment Disputes between States and Nationals of other states*, Volume II-1, 566 (1968).

2.4. Contribution to the Economic Development of the Host State

The Tribunal in multiple cases including the Fedax case[26] and CSOB v. Slovakia[27] has used the contribution to economic development as a factor while dealing with an investment. In the Salini case,[28] contribution to economic development was set as a separate criterion for an investment. The question that is to be seen is whether the absence of such a contribution would disqualify a transaction from becoming an investment and further to what extent does a transaction need to contribute to the development of the host state for it to qualify as an investment.

Contribution to the economic development has been observed to be the 'only indication of an objective meaning' to be given to the term investment by Professor Christoph H. Schreuer.[29] Another aspect buttressing this view is that the Preamble to the ICSID Convention emphasizes the need for international cooperation for economic development, and on the role of private international investment in that regard.[30]

In Salvors v. Malaysia,[31] the Tribunal used the objective test instead of applying the BIT definition of investment. It observed that the transaction was not an investment, as it did not contribute to the economy of the host country. It stated that there is a requirement of a 'significant contribution to be made to the host State's economy.'[32]

However, the Salvors award was annulled by an ad-hoc committee for not even considering how investment was defined in the BIT and going beyond its powers. The Salvors Annulment Decision rejected

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[26] *Supra*note 16, at ¶ 43.
[27] *Supra*note 17, at ¶ 64.
[28] *Supra*note 19, at ¶ 52.
[29] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, 91 (2001).
[30] *Supra*note 17, at ¶ 64.
[31] Malaysian Historical Salvors SDN BHD v.The Government of Malaysia, ICSID Case No.ARB/05/10.
[32] *Id.* at ¶ 143.

the approach of using objective criteria to define investment as it went against the purpose of leaving 'investment' undefined in the ICSID Convention and allowing parties to agree on their own definitions through BITs or Multilateral Investment Treaties (MITs).[33]

In Pey Cassado v. Chile,[34] economic contribution to the host state's development was not considered as an essential factor for an investment. The Tribunal concluded that contribution to economic development was a consequence of investment and not a constitutive element of investment.[35]

Judge Shahabuddeen in his dissenting opinion disagreed with the committee in the Salvors annulment decision on the ground that an investment must contribute to the country's economic development.[36] He emphasized on the need for contribution to the economic development as an essential ingredient to constitute an investment.

He also said that the reference in the Preamble to economic contribution is not only as a consequence of investment but also as the very purpose of an ICSID investment.[37] This seems to be the correct view as the travaux préparatoire of the Convention has references to the economic development of the states.

Moreover, the fact that the Tribunal has used 'the contribution to economic development' as a factor in many cases while dealing with investments only adds to its importance as a factor to be considered while defining investment.

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[33]Malaysian Historical Salvors SDN BHD v. The Government of Malaysia, ICSID Case No.ARB/05/10.

[34]Víctor Pey Casado and President Allende Foundation v. Republic of Chile, ICSID Case No.ARB/98/2.

[35]*Id.* at ¶232.

[36]Malaysian Historical Salvors Sdn Bhd v. Government of Malaysia, ICSID Case No. ARB/05/10.

[37]*Id.* at ¶16.

The next question that needs to be seen is the amount of contribution to economic development of a country by a transaction for it to be an investment. Some unanimity can be found at this point. Wherever the tribunals have taken the contribution to economic development as a factor, they have observed that the contribution must be 'significant' or 'substantial'.[38] Both the Salvors award and the dissenting opinion in Salvors Annulment Decision[39] agreed on this point.

For there to exist an investment within the understanding of the Convention there should exist 'economic commitments of significant value, sufficient at least that one may agree that the operation is of a nature to promote the economy and development of the country concerned'.[40]

If this was not taken as the correct position then it would lead to a situation where any contribution, howsoever small, to the Gross Domestic Product (GDP) of the host state, would lead to it constituting an investment for ITA. Hence the transaction must meet a certain minimum threshold of contribution for it to qualify as an investment.

2.5. Balance between the BIT Definition of Investment and the Objective Factors

While the parties have the freedom to define investment, this power or freedom cannot be unfettered. Certain limitations need to be put on this freedom. The factors that have been laid down for defining an investment help in putting these limitations. It will be improper if parties are allowed to arbitrarily define the disputes and extend the tribunal's jurisdiction to those cases. Such a view would render meaningless the inclusion of the words 'investment' under Article 25 of the ICSID Convention while discussing the jurisdiction of the Tribunal.

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[38] *Supra* note 10, ¶53; *Supra* note 20, at ¶14; Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29.

[39] *Supra*note 31, at ¶123; *Supra*note 36, at ¶4 & 14.

[40] *Supra* note 20, at ¶14.

On the other hand, laying down universally applicable stringent standards or factors that must be ticked off before any transaction can fall within the meaning of an investment may also not be correct. This would not only take away the freedom of parties available to them while drafting and agreeing to BITs and agreements amongst themselves but also may in some cases arbitrarily exclude some transactions from the purview of an investment. This arbitrary exclusion owes to the dynamism of the investment world. Investments may vary in their form & nature and laying down a set criterion will lead to investments arbitrarily being excluded.

While dealing with the 'outer limits' for defining an investment, the important role played by the contribution of an investment to the economic development of the host state cannot be ignored. It may not be possible to define a strict GDP-specific figure for a transaction to be taken as contributing to a country's economic development, but it cannot be disregarded all together either. For an investment to exist, it must contribute to the economic development of host state. This is in consonance with the purpose for which an investment should be made and with the Preamble of the ICSID Convention.

Having a concrete formula for investment set in stone is not desirable. It will not only be against the objective of giving parties freedom to define what disputes can come to the tribunal but also create further complications. There can be cases where the BITs may give a wider definition of the term investment than given in the Salini test. Moreover, there are chances that the set criteria may go against what the parties have agreed to.

Even though the definition of investment has majorly evolved through ICSID jurisprudence, other Tribunals have used the factors-based objective test approach developed by ICSID as a reference point. In Romak v. Uzbekistan[41] the UNCITRAL Tribunal used the Salini test to decide whether a Swiss firm had made an investment in Uzbekistan or not.

[41]Romak SA v The Republic of Uzbekistan, PCA Case No. AA280, 26/11/2009.

This award determined the applicability of Article 25(1) of ICSID, its interpretation in the Salini test and established a link between ad-hoc and ICSID disputes to reveal that the 'inherent meaning' given to 'investment' is irrespective of the choice of dispute resolution mechanism.

The Tribunal should, therefore, not have a water-tight approach towards what defines an investment. A flexible approach based on the facts and circumstances of each case along with considering the Salini factors may be more practical and appropriate. A combined approach should neither ignore the weight given to certain factors forming an objective definition of investment nor ignore the freedom given to the parties.

In essence, the most viable and practical approach would be to keep certain objective factors for a transaction to be an investment but the application of these factors should be kept malleable for each individual case. This malleability is essential in order to uphold the freedom that has been given to the parties to agree upon the definition of investment. However, this freedom should be exercised within the outer limits, which are set by those flexible objective factors.

The motive behind discussing the definition of investment in this article will aid in understanding whether an arbitral award falls within the meaning of investment or not. Understanding the jurisprudence behind the factors taken into account while dealing with the scope of investment will be helpful in judging whether those factors exist in an arbitral award and hence make it equivalent to an investment or not.

3. WHAT IS AN ARBITRAL AWARD AND WHETHER IT IS AN INVESTMENT?

The question that has to be answered now is- 'Can an arbitral award constitute an investment for the purpose of ITA under a BIT?' A straight 'yes' or 'no' answer to the above question is becomes

important at the time of recognition and enforcement of the arbitral awards in the host state by the winning parties.

The authors in this part will discuss the different approaches adopted various tribunals across the board to determine whether an arbitral award constitutes an investment and the legal rationale behind such decisions. The article will discuss, first the definition of an 'arbitral award' and second, the article will move on to discuss the various decisions and interpretations taken by the tribunals to determine whether an arbitral award is an investment.

3.1. Definition of an Arbitral Award

It is important to discuss what an arbitral award is and what its essential elements are. Arbitration leads to the pronouncement of an award, which determines the rights and liabilities of the parties. An arbitral tribunal is bound to pronounce a final, valid, binding and an enforceable award.[42]

Article 34(2) of UNCITRAL Arbitration Rules states:"All awards shall be made in writing and shall be valid and binding on the parties. The parties shall carry all awards without delay". Even though there exists a plethora of rules on arbitration, no such rules give a distinct meaning of the term 'arbitral award'. The Working Group of the UNCITRAL Model Law defined it as: "Award means a final award which disposes of all issues submitted to the arbitral tribunal and any other decision of the arbitral tribunal which finally determines any question of substance or the question of its competence or any other question of procedure but, in the latter case, only if the arbitral tribunal terms its decision an award."[43]

Hence, an arbitral award is akin to a judicial decision, having the same function and rationale as a judgment, adjudicating all the issues that are in dispute.

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[42]Margaret L. Moses, *The principles and practice of International Commercial Arbitration*, 184 (2008).

[43]UNCITRAL's Project for a Model Law on International Commercial Arbitration, "Enforcement of the award", 2 *ICCA Congress Series* 201, 208 (1984).

The essential attributes of an award are:

(i) 'concludes the dispute as to the specific issue determined in the award so that it has res judicata effect between the parties; if it is a final award, it terminates the tribunal's jurisdiction;

(ii) disposes off parties' respective claims;

(iii) may be confirmed by recognition and enforcement

(iv) may be challenged in the courts of the place of arbitration'[44]

The New York Convention provides for the recognition and enforcement of the award rendered by an arbitral tribunal. The Convention provides a price to an arbitral award, which can be encashed by the party in whose favour the award is passed. However, the convention also provides for certain conditions and exemptions for the enforcement and recognition of the award. The model for recognition and enforcement as provided by the New York Convention has been adopted by most nations in their domestic arbitration law.

The New York Convention[45] as well as the ICSID Convention[46] provides that an award shall have the same value as a judgment of a court of law. Therefore, the signatories of these conventions have an international obligation to execute the arbitral awards and accord to them the same treatment as the judgments and decisions of the domestic courts.

3.2. Whether An Award Constitutes An Investment?

In this part, the article will elucidate whether an arbitral award can come within the ambit of enjoyment, usage and protection of an investment.

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[44]Julian D. M. Lew, Loukas A. Mistelis, Stefan Michael Kröll, *Comparative Analysis on Arbitration*, 631 (2003).

[45]New York Convention, Article 4- 5, 330 UNTS 38.

[46]International Convention on the Settlement of Investment Disputes, Article 53-54, 17 UST 1270.

In order to resort to protection under a BIT, the essentials to be established are:

(i) Whether an arbitral award, notwithstanding where it is made, constitutes an investment;

(ii) The unjust and arbitrary administrative or judicial interference has resulted in expropriation, denial of justice, or violation of excessive means clause, breaching the fair and equitable treatment under the BIT.[47]

The tribunals have provided different answers and interpretations to the above questions, which would be discussed in this part of the article.

The case of Saipem v. Bangladesh[48] was the first instance where the question, whether an arbitral award and an arbitration agreement constitute an investment and enjoy protection arose.

The commercial dispute arose between Saipem S.p.A., an Italian Oil &Gas Company, and Petrobangla, a Bangladeshi public entity. The two parties entered into a contract to build a natural gas pipeline in Bangladesh.

The contract was governed by the Bangladeshi law, and included an arbitration clause in case of a dispute. The arbitration clause provided that in case of any dispute arising out of the contract, the parties would resort to arbitration under Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC) in Bangladesh.

In accordance with the contract and the arbitration agreement, Saipem initiated arbitration proceedings against Petrobangla, seeking certain outstanding payments under the contract.

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[47] Loukas A. Mistelis, "Award as an Investment: The Value of an Arbitral Award or the Cost of Non-Enforcement", 28(1) *ICSID Review*, 64, 85 (2013).

[48] Saipem S.p.A. v. The People's Republic of Bangladesh, ICSID Case No.ARB/05/07.

Petrobangla moved the Bangladeshi Courts, who in turn revoked the authority of the arbitral tribunal to hold the arbitration proceedings. The tribunal, notwithstanding, such an order of the court continued the arbitration proceedings and passed an award in favour of Saipem. The High Court Division of the Supreme Court of Bangladesh refused to enforce the ICC award and observed that the award was "misconceived and incompetent inasmuch as there is no Award in the eye of the law, which can be set aside...A non-existent award can neither be set aside nor can it be enforced."[49]

Saipem filed a request for ITA with the ICSID against the Government of Bangladesh for the breach of the provisions of the BIT between Italy and Bangladesh. Saipem claimed that due to the undue intervention of the Bangladeshi Courts in the ICC arbitration, they were precluded from the enforcement of the arbitral award against Petrobangla.

According to Saipem, these acts of the Bangladeshi Courts constituted judicial expropriation and deprived Saipem of any compensation from the breach of the contract.

The tribunal first noted whether Saipem had made an investment in Bangladesh in accordance with Article 25 of ICSID Convention. The tribunal examined that to determine whether the investor (Saipem) made an investment, the 'entire operation' has to be taken into consideration, i.e., 'the Contract, the construction itself, the Retention Money, the warranty and the related ICC Arbitration'.[50] Applying the Sailini test,[51] discussed above, the tribunal concluded that Saipem had made an investment within the ambit of Article 25 of the ICSID Convention.

However, the tribunal concluded that rights from an arbitral award arise indirectly from the investment. A dispute arising out of the ICC Award is not a dispute arising directly from the original

[49] *Id* at 50.
[50] *Supra* note 48, at ¶ 110.
[51] *Supra* note 48, at ¶ 111.

investment. The tribunal was unwilling to agree that the ICC award itself constituted an investment under Article 25 of the ICSID Convention.[52]

The Claimant contested that the ICC award was within the ambit of 'credit for sums of money connected with the investment' set out in Article 1(1)(c) of the BIT.[53] The tribunal concluded that:

"The rights embodied in the ICC Award were not created by the Award, but arise out of the Contract. The ICC Award crystallized the parties' rights and obligations under the original contract. It can thus be left open whether the Award itself qualifies as an investment, since the contract rights which are crystallized by the Award constitute an investment within Article 1(1)(c) of the BIT."[54]

It can be concluded that the Tribunal was reluctant to hold that an arbitral award directly constitutes an investment. However since the initial contract (subject matter) fell within the ambit of investment, the arbitral award arising out of such a contract would constitute an investment indirectly. In essence, the dispute arose out of a subject matter that constituted an investment but the award did not directly arise out of that investment. The award instead, indirectly arose out of that investment.

The case of ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan[55] briefly provided an observation that an arbitral award indirectly constitutes an investment. The dispute was between ATA Construction, a Turkish enterprise and the Kingdom of Jordan under the Jordan-Turkey BIT.

ATA Construction and Arab Potash Company (APC) (Jordanian Company) had a building and construction agreement, with an ad hoc arbitration clause in case of a dispute. The dispute between the

[52] *Supra* note 48, at ¶ 114.
[53] *Supra* note 48, at ¶ 125.
[54] *Supra* note 48, at ¶ 127.
[55] ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan, ICSID Case No. ARB/08/2.

parties arose due to the collapse of a dike in the Dead Sea, constructed by ATA and due to certain outstanding payments to ATA. APC brought arbitration proceedings against ATA Construction to seek compensation for the collapse of the dike. The Tribunal passed an award in favour of ATA.

APC moved the domestic court, Jordanian Court of Appeal, to set aside the award passed by the arbitral tribunal. The Court set aside the award and also annulled the arbitration agreement between the parties. Subsequently, the Court of Cassation, on appeal, also annulled the arbitral award. Therefore, the domestic courts extinguished ATA's right to arbitrate.

Subsequently, ATA Construction filed a request for arbitration in ICSID. However, the tribunal rejected jurisdiction, rationae temporis over the claims of the Claimant since the dispute arose from the original agreement, signed in 2000. However, the Jordan-Turkey BIT was signed in 2006. Thus, the tribunal formed under the BIT lacked jurisdiction to resolve the disputes, which arose prior to it signing of BIT.[56] The decision of the Court of Cassation is 'legally equivalent'[57] and 'indistinguishable'[58] from the dispute under the original contract. The tribunal however noted that annulment of the right to arbitrate would amount to a breach of the BIT, as it has a financial value in connection with the investment.[59]

In the light of the above facts, the tribunal also briefly commented on whether an arbitral award constitutes an investment. The tribunal, following the *Saipem award* concluded that a Final award regarding a claim of money or financial performance comes under the scope of the 'entire operation' and would constitute an investment.[60]

The tribunal supports the decision by the Saipem and ATA tribunals as to the liability of the states towards award creditors for unlawful

[56] *Ibid.*
[57] *Id.* at¶ 94.
[58] *Id.* at¶ 103.
[59] *Id.* at¶118.
[60] *Id.* at¶ 113.

interference with the arbitral award. Therefore, the award creditors have a right to submit their claim to ITA.[61]

Additionally, in the case of Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador,[62] the Tribunal made a brief observation on the scope of the investment and its relation to arbitral awards. The tribunal observed that:

"Once an investment is established, it continues to exist and be protected until its ultimate 'disposal' has been completed - that is, until it has been wound up."[63]

The tribunal gave a wide interpretation to the term investment in the BIT. According to the above conclusion, the scope of investment would include all the activities, management, usage, arbitral awards as well as judicial proceedings in the host state.

Thus, it has been seen in the first part of the article that the definitions of investment under ICSID as well as the BITs are subject to wide interpretations. In light of the above factors, it would be safe to conclude that investment is a bunch of rights and liabilities, and the arbitral award arising out of a contract (that is an investment) would also indirectly come under the scope of 'entire operation' of an investment.

A conflicting approach to the above cases was taken in the case of GEA Group Aktiengesellschaft v. Ukraine,[64] where the Tribunal adopted a narrower approach and it refused to accept that an arbitral award constitutes an investment. The initial dispute was with regard to a supply contract of fuel between the GEA (German company) and Oriana, a Ukrainian state-owned petrochemicals plant. The Claimant (GEA) discovered that certain quantity of fuel supplied to Oriana had been misappropriated and suspected Ukrainian

[61] *Supra* note 47, at 78.

[62] Chevron Corporation and Texaco Petroleum Corporation v.The Republic of Ecuador, UNCITRAL, PCA Case No. 2009-23.

[63] *Id.* at ¶. 58.

[64] GEA Group Aktiengesellschaft v. Ukraine, ICSID Case No.ARB/08/16.

Government's role in it. The parties negotiated to solve the dispute by entering into a Settlement Agreement and a Repayment Agreement, where Oriana agreed to offer payment to GEA. The agreements provided that any disputes, concerning the Settlement and Repayment agreement should be resolved via commercial arbitration under the ICC Arbitration Rules.

GEA pursuant to the above agreements obtained an arbitral award from the ICC worth US $30 million. GEA moved the Ukrainian courts for the recognition and enforcement of the arbitral award. However, the Ukrainian Courts refused to enforce the award on the grounds that repayment agreement was improper and unlawful under the Ukrainian law.

GEA filed for an ITA and alleged that Ukraine had committed several breaches of the BIT and not accorded fair and equitable treatment to the investor under Germany – Ukraine BIT.

The tribunal first dealt with whether GEA had made an investment in Ukraine. The Claimant contended that the Conversion Contract, the Settlement Agreement, the Repayment Agreement, as well as the ICC award that arose out of them, constituted an investment.[65]

The tribunal considered each of the points separately and observed that the neither the Settlement or Repayment agreement, nor the final ICC award constituted an investment within the BIT.[66]

The rationale given by the Tribunal was that under Article 25 of the ICSID Convention, "the ICC Award – in and of itself – cannot constitute an investment.

An arbitral award is a legal instrument, which provides for the disposition of rights and obligations arising out of the Settlement Agreement and Repayment Agreement." [67] Moreover, since the Tribunal held that neither the Settlement Agreement nor the

[65] *Id.* at ¶ 157.
[66] *Id.* at¶ 157-161.
[67] *Id.* at ¶ 161.

Repayment Agreement constituted investments, there was no question of considering the award that arose out of them as an investment.

The tribunal further enunciated that even if it were assumed that the Settlement and Repayment Agreements constitute an investment under the BIT or the award is characterised as directly arising out of the Contract, which the tribunal did not consider as an investment,[68] an award would still not constitute an investment. The tribunal concluded:

"The fact that the Award rules upon rights and obligations arising out of an investment does not equate the Award with the investment itself. In the Tribunal's view, the two remain analytically distinct, and the Award itself involves no contribution to, or relevant economic activity within, Ukraine such as to fall – itself – within the scope of Article 1(1) of the BIT or Article 25 of the ICSID Convention"[69]

The tribunal further observed that it did not find any merits in the case of the Claimant, and the Claimant failed to prove that the Ukrainian courts applied the law discriminately against them.

The tribunal referred to the decision in Saipem, and concluded that, "the Tribunal has been presented with no evidence that the actions taken by the Ukrainian courts were 'egregious' in any way; that they amounted to anything other than the application of Ukrainian law; or that they were somehow deliberately taken to thwart GEA's ability to recover the ICC Award."[70]

The observation of the Tribunal in this case can be said to have limited the scope of 'investment' under the BIT and under Article 25 of the ICSID Convention for various reasons. Firstly, the Tribunal held that an award independently does not constitute an investment since it only determines the rights and obligations of the parties;

[68] *Id.* at ¶ 146-153.
[69] *Id.* at¶ 162.
[70] *Id.* at¶ 236.

Secondly, the tribunal concluded that the Settlement and the Repayment Agreement did not constitute an investment and hence the award that arose out of such agreement did not even indirectly constitute an investment; and thirdly, the Tribunal said that even if the contract from which an award arose constituted an investment, the award would still not be an investment.

The case of Romnak v. Republic of Uzbekistan[71] was another interesting case discussing the issue at hand. The tribunal in the present case was formulated under the UNCITRAL Rules on Arbitration.

Romnak was a Swiss Company who contracted with Uzkhleboproduct (Uzbekistan Company) for trading in wheat and wheat products. The contract had an arbitration clause, under the rules of GAFTA. Disputes arose between the two parties with regard to outstanding payments and Romanak initiated commercial arbitration proceedings. The award was passed in favour of Romnak, who was unsuccessful in the enforcement and recognition of the award in the domestic courts of Uzbekistan. Subsequently, after the denial of enforcement of the commercial arbitration award, Romnak initiated ITA against the Republic of Uzbekistan.

The tribunal denied jurisdiction to adjudicate on the dispute, on the grounds that the subject matter of the award, i.e the initial contract is not an investment. The tribunal examined the meaning of the investment under the BIT and concluded that a distinction has to be maintained between an investment and purely commercial contracts.[72] Further, it noted that 'mechanical application' of the definition of the investment would 'produce a result which is manifestly absurd or unreasonable'.[73]

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[71]Romak S.A. (Switzerland) v. The Republic of Uzbekistan, UNCITRAL, PCA Case No. Award, 26/11/2009.

[72]*Supra* note 71, at ¶ 185.

[73]*Supra* note 71, at ¶ 184; Joy Mining Machinery Limited v. Arab Republic of Egypt, ICSID Case No. ARB/03/11.

The tribunal declared that, the GAFTA award was directly and 'inextricably linked' to the initial contract between the parties, and therefore, to determine whether Romnak made an investment under the BIT, the entire economic transaction with respect to the contract is to be taken into account.[74] Hence, it was concluded that since, the initial contract between the parties did not constitute an investment under the BIT, the award was merely an instrument to determine the rights and liabilities of the parties arising out of the contract.[75]

The approach undertaken by the tribunal in this case to deny protection under the BIT is in consonance with the decision in Saipemand ATA. Since the initial transactions between the parties were merely commercial in nature, the arbitral awards would not be protected under the definition of investment.

The White Industries Australia Limited v. The Republic of India[76] was another case where the tribunal discussed whether an arbitral award constitutes an investment. The tribunal examined all the above decisions and followed the decisions in Saipem and Chevron.

In this case, there was a contract negotiated between Coal India and White Industries for the development of an Open Cast Coal Mine. The contract contained an arbitration clause that required all disputes to be submitted to the ICC International Court of Arbitration. Disputes subsequently arose between White Industries and Coal India and White Industries filed a request for Arbitration. The arbitral tribunal passed an award in favour of White Industries.

White Industries applied for enforcement in the Delhi High Court, whereas Coal India moved an application in Calcutta High Court for setting aside the award. The Calcutta High Court rejected the setting aside application filed by White Industries. Subsequently, White Industries appealed against this decision before the Division Bench of

[74] *Supra* note 71, at ¶ 211.
[75] *Ibid.*
[76] *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30/11/2011.

the High Court at Calcutta. The Court dismissed the appeal. Against this dismissal, White appealed to the Supreme Court of India and meanwhile Delhi High Court stayed the enforcement proceedings. The matter since then lingered in the Supreme Court.

In 2010, White initiated the investment arbitration proceedings by way of filing the Notice of Arbitration, for not providing fair and equitable standards by the Courts to them to get the arbitral award enforced.

The tribunal briefly commented on whether an arbitral award constitutes an investment and concluded in line with the observations of Saipem v. Bangladesh and Chevron v Ecuador:

"...that rights under the Award constitute part of White's original investment (i.e., being a crystallization of its rights under the Contract) and, as such, are subject to such protection as is afforded to investments by the BIT."[77]

The tribunal further dissented from the observations made in GEA v. Ukraine, and observed that:

"The Tribunal considers that the conclusion expressed by the GEA Tribunal represents an incorrect departure from the developing jurisprudence on the treatment of arbitral awards to the effect that awards made by tribunals arising out of disputes concerning 'investments' made by 'investors' under BITs represent a continuation or transformation of original investment."[78]

Thus, it was reiterated that an arbitral award, arising out of a commercial arbitration would constitute an investment, though indirectly. The observations are in line with the protection offered to an investor under the BIT. An investor can bring ITA against the State, which refuses to enforce the rights of the investor under an arbitral award from a commercial arbitration. The pre-condition to such a claim is that the main subject matter from which the dispute

[77] *Id. at* ¶ 7.6.10.
[78] *Id. at* ¶ 7.6.8.

originally arose constitutes an investment. The State has an obligation under international law to provide fair and equitable treatment to the investors. The unlawful non-enforcement of an award would be against the notions of fair and equitable standards, and the State can be held liable for breaching such an obligation.

Frontier Petroleum Services Ltd. v. The Czech Republic[79] was another case where the observations of the tribunal on the issue are noteworthy.

The claimant in the present case had obtained interim and final awards against a Czech government entity, MA, with regard to a breach of an agreement between the two parties. The proper place of execution of the awards was the Czech Republic. The Czech Courts refused the enforcement and recognition of the awards on the grounds of public policy under Article V (b)(2) of the New York Convention.

Frontier (Claimant) initiated ITA against the Czech Republic under the UNCITRAL Rules. They claimed that the Czech Courts have wrongfully refused to recognize and enforce the awards. Hence, they have not fulfilled their obligation under the BIT to provide fair and equitable treatment to the investors.

The tribunal, in this case, considered whether the Czech Republic breached its legal obligations under Canada-Czech Republic BIT as a consequence of the refusal by the Czech courts' to recognise and enforce a commercial arbitration award on grounds of public policy.

The tribunal accepted at the threshold that the Claimant had made a significant investment in the Respondent State.

The tribunal further observed that it would have jurisdiction rationaemateria over the dispute if the actions or the measures taken by the Respondent have affected the control, management, use, enjoyment and disposal of the investment.

[79]Frontier Petroleum Services Ltd. v. The Czech Republic, UNCITRAL, Final Award, 12/11/2010.

Accordingly, it was observed by the tribunal that, "by refusing to recognise and enforce the Final Award in its entirety, the Tribunal accepts that Respondent could be said to have affected the management, use, enjoyment, or disposal by Claimant of what remained of its original investment."[80]

Thus, the refusal of enforcement by the courts would affect the original investment made by the claimant. Such an interpretation directly references that an arbitral award can be categorized as an investment and refusal to recognise and enforce an award would affect the investment made by the claimant in the host state. Accordingly, an arbitral award passed in commercial arbitration would also comprise an investment, and refusal to enforce it would constitute a breach of the fair and equitable treatment under the BIT.

4. CONCLUSION

It has been rightly pointed out that ITA is a hybrid of private international law and public international law.[81] The article has discussed the value that an arbitral award given in International Commercial Arbitration would hold in an ITA.

Defining the term investment has not been as simple as States defining the term in investment treaties. Investment has not been defined categorically in the rules of various tribunals or the ICSID Convention. States have been given the autonomy to choose and agree upon their own definitions of investments. However, this is the where the complication arises. The definition decided by the parties has not been the sole criteria for the judging the existence of an investment for the purpose of ITA.

Support has been found for having an objective criterion to define an investment and to have a list of certain elements that exist in an investment. ICSID has expanded the meaning of Article 25 of the

[80] *Id.* at ¶ 231.

[81] Zachary Douglas, "The Hybrid Foundations of Investment Treaty Arbitration", 74(1) *British Yearbook of International Law*,151, 195 (2004).

ICSID Convention to conclude that it includes an objective criterion comprising of factors to understand the meaning of an investment.

Such a criterion was laid down in various cases starting from the Fedax case. The Salini case finally laid down these factors that came to be known as the 'Salini test' to judge the existence of an investment. These factors include a) contributions in assets or money b) a certain duration of performance of the contract, c) an element of risk, and d) a contribution to the economic development of the host State. In effect, these are the factors that would determine whether a transaction would qualify as an investment or not.

Hence, a balancing act needs to be performed while defining investment between the parties' freedom to define the investment and the factors considered essential to constitute an investment. The balance can be seen to be achieved in an 'outer limits' approach. In essence, the parties' freedom to define anything as an investment cannot be absolute. There need to be certain limitations on this freedom. The factors constitute these limitations in the form of outer limits. In simpler terms, the parties' freedom is maintained in the fact that parties can define investments in their treaties but they have to keep themselves within the boundary defined by the factors. These factors work as the limitations.

It is based on this accepted approach of understanding an investment that we examine whether an arbitral would constitute an investment or not. The determination of whether an arbitral award can be considered an investment or not will assist in the enforcement of the award. This assistance is evidenced by the fact that an arbitral award that is an investment will allow a party to initiate ITA under the BIT for non-enforcement.

An arbitral award is futile for the winning party unless there is a proper mechanism to enforce the award. The New York Convention provides for a well-established judicial mechanism for the recognition and enforcement of the arbitral award in the domestic courts of the country.

With the increase in arbitration as a preferred means of dispute resolution, the parties voluntarily follow most of the arbitral awards without any recourse to any judicial mechanism. The problem arises when the judicial mechanism in the country of enforcement is non-arbitration friendly and does not follow the guidelines enshrined in the New York Convention. Such actions by the domestic courts and administrative bodies are prejudicial to the winning party in the arbitration proceedings.

The New York Convention provides guidelines to the states for the recognition and enforcement of the award. However, it does not create a binding obligation on the state to follow the mandate of the Convention.

The result is that in certain situations the enforcement is tedious, long and subject to local law and lengthy proceedings. Therefore, in such cases, there are immeasurable risks to the award creditor, which renders his arbitral award futile.

Hence, this article discusses the alternative that can be used by the investors and award creditors to enforce their award in the host state. The essential attributes, which should be fulfilled before taking such an action, are:

(i) The States to which the parties belong to have signed a BIT.

(ii) The party has made an investment in the host state and is an investor, within the meaning of Article 25 of ICSID and the BIT. The investment should satisfy the *Salini* test.

(iii) The judicial inaction and interference have breached the fair and equitable treatment of the investor, such as to cause the denial of justice, expropriation or be against the effective means clause in the BIT.

The article has examined the various decisions of the tribunals, which have discussed whether an arbitral award can come under the ambit of 'investment'. The Tribunals in Saipem, ATA Construction,

Chevron, White and Frontier have to some extent included arbitral awards within the meaning of investment under certain circumstances.

The tribunal in Saipem and ATA Construction observed that the definition of an investment would include the 'entire operation' and any property or rights of the investor would come under the scope of investment. Therefore, an arbitral award, as well as a judicial decision in the favour of the investor would indirectly constitute an investment. The tribunal in White Industries v. India, followed the observations in Chevron, Saipem, and Frontier and concluded that arbitrary and unlawful interference by the host state in the enforcement proceedings of a valid award which is an investment would violate the protection granted to it under the relevant BIT.

In Frontier v. Czech Republic, the tribunal concluded on similar lines as the above decisions. The tribunal observed that an arbitral award in favour of the investor comes within the ambit of the management, usage, and protection of an investment.

In Romnak v. Uzbekistan, the tribunal denied protection to an arbitral award under the definition of investment in a BIT. However, such denial was based on valid and justified grounds. Where the subject matter or the contract, from which the award arises, does not satisfy the factors of investment, the arbitral award cannot constitute an investment.

However, the tribunal in GEA v. Ukraine, was averse to the conclusion that 'an arbitral award constitutes an investment'. The tribunal refused to adopt the approach in Saipem and ATA Construction.

The tribunal observed that an award is merely, 'a legal instrument for the disposition of rights and obligations of the parties'[82] and does not constitute an investment. It further reasoned that an ICC arbitral award arising out of repayment and settlement agreement between

[82] *Supra* note 64, at ¶ 161.

the parties would not constitute an investment when such repayment and settlement agreements are not investments under the BIT.

The Tribunal, in GEA, was in consonance with the observations of the Tribunal in Saipem till the point that it observed that the award was not an investment because the Settlement Agreement and the Repayment Agreement (subject matters) are not investments. In essence, if the subject matter is not an investment then the award arising out of the subject matter will not be an investment indirectly.

However, the tribunal adopted a narrow and strict approach for the definition of investment. Its view that even if the agreement were held to be an investment, the award arising out of it would still not be an investment, even indirectly, cannot be said to be the correct approach. Such an observation went against the observations in Saipem v. Bangladesh and the cases following it. Moreover, such an approach can be used by the states to refuse enforcement of awards for their vested interest and prejudice the investors.

It can, therefore, be concluded that Investment Treaty protection can be accorded to a party who has suffered injustice through the actions of domestic courts. However, a mere dissatisfaction from the decision of the domestic courts on non-discriminatory and justified grounds, would not entitle protection to the investor who wishes to enforce the award. Protection under the BIT or ICSID would only be accorded when there has been evidence of discriminatory practice by the courts.

Therefore the authors are of the view that an award cannot simply be construed as an instrument crystallizing the rights and obligations of the parties. There is a clear majority support by the tribunals in the favour of the conclusion that an arbitral award that arises out of the contract (which is an investment) is indirectly a part of the investment. The authors also support this proposition propounded by a majority of the tribunals. Such a conclusion provides additional protection to the investors who have faced injustice due to the refusal of enforcement of the award in the domestic courts. The investors, however, have to prove that non-enforcement of an award

from commercial arbitration is due to the discriminatory and unlawful practice of the state and directly affects the rights of the investors under the BIT. The investors further have to prove that such actions of the state directly lead to denial of justice, expropriation and violation of the effective means clause in the BIT.

Hence, it is concluded by the authors that investment protection under the BIT for non-enforcement of arbitral awards arising out of commercial arbitration is an important weapon in the armory of the investors against the powerful states when they unlawfully interfere with the rights of the investors.

DOES ARBITRATION PROMOTE FDI?

-Aditi Sharma and Mira Subramanian*

ABSTRACT

The research paper focuses on the presumption that Investment Treaty Agreements facilitate foreign direct investment. It is generally under this pretext that nations, especially developing nations, enter into investment treaties. But the real question is how far these treaties are effective in delivering on this goal. The paper analyses the prevalent theories, both in favor and against the very notion of BITs leading to FDI. We have observed the position of various regions and the activities therein to see if there exists any link between proliferating arbitration treaties and increasing FDI. Special focus has been given to India and the various shortcomings of the present system. After considering all the observations, we finally come to the conclusion that investment treaties are but only one of the factors influencing FDI. Their role is not so prominent and decisive. They are complementary, and not a substitute, for investment development reforms. However, a nation's credible commitment is very well decided when it follows the rules of the treaties. Ignorance of the treaties would reduce the respectability of a nation in the international community. The need for arbitration, apart from it promoting FDI, also arises when we talk about the problem of pendency of cases in countries like India, through arbitration and use of other alternative dispute techniques these problems can be reduced significantly. This, in a way, will amount to 'killing two birds with one stone'.

1. INTRODUCTION

One of the remarkable developments in international law has been BITS or bilateral investment treaties. During the past few decades, the practice of countries entering into BITs has increased

*Students, 5th year, BA LLB (Hons.), Gujarat National Law University, Gandhinagar.

tremendously.[1] Today, there are over 2100 and more BITs[2] and more than 170 countries have signed at least one or more BITs.[3] Foreign investors are offered a series of economic rights, including the right to arbitrate, in anticipation that this will increase FDI inflow to the country, which in turn will provide the country with the opportunities for infrastructure projects, financing, new jobs and economic stability.

While the number of investment treaties has increased worldwide, there has been a growing trend in FDI too, whereby global FDI inflows have increased by 9% in 2013 amounting to $1.45 trillion in comparison to the slump in 2012 when global FDI inflows declined by 18% amounting to $1.35 trillion.[4] Though 2014 saw a decline of 16% amounting to $1.2 trillion, but according to global investment trends monitor (UNCTAD), the FDI flows are projected to recommence growth in 2017 and by 2018 would surpass $1.8 trillion. In lieu of increased rights and investment potential of investors, many claims have been put forth, and are soaring, to enforce their rights especially when government conduct has an adverse effect on their investments.

There are still persistent doubts that whether the expansion of BITs or IIAs in general incentivize or increase inflow of FDI.[5] Such treaties are but only one of the variables to affect the decisions of the investors, there are many other variables that have a bearing on investor's decision such as benefits to the investors and potential

[1]Mirian Kene Omalu, *Nafta and the Energy Charter Treaty: Compliance with, Implementation and Effectiveness of International Investment Agreements* 10 (1999).

[2]Susan D. Franck, "The Legitimacy Crisis in Investment Arbitration: Privatizing Public International Law through Inconsistent Decisions", *Fordham Law Review* 73 1521, 1522-23 (2005).

[3]Antonio R. Parra, "Settlement of Investment Disputes: The Experience of ICSID in Transition Countries and Elsewhere", European Bank of Reconstruction and Development Publication, 39 (2001).

[4]United Nations, World Investment Report- 2014, "Overview: Investing in SDGs: An action plan", vii, available at http://unctad.org/en/PublicationChapters/wir2014ch4_en.pdf (last accessed on 12 October 2016).

[5]Organisation for Economic Co-operation and Development, *International Investment Perspectives*, 35-37 (2005).

financial risk. The investors are presumed to make rational decisions i.e. decisions which give them maximum profits with only a minimal risk factor. The other variables affecting their decisions also include the size of the market they are investing in, the level of real income that they would receive from their investment, the skill levels present in the host economy, the availability of infrastructure and such other resources which facilitate the growth of their investment. Some other factors can be the stability of an investment environment,[6] the availability of appropriate human capital,[7] access to effective enforcement procedure, [8] embedded personal and professional relationships, [9] among other factors. Though the availability of investment treaty arbitration had some influence on the decisions of the investors, no specific scope or impact of that role has been articulated. However, to the extent that such dispute resolution mechanisms in investment treaties may influence the decision of investing in a particular venture or the manner in which the investor structures his transaction,[10] to such extent, the impact and scope of the role of these treaties are worthy of consideration and particularly where countries are using alternative dispute mechanisms to attract foreign investments.[11]

In India, there has been a tremendous increase in FDI since liberalization in the 1990s. To facilitate investments, India started entering into BITs in mid 1990s. The objective was to offer favorable conditions and treaty based protection to the foreign investors and

[6]The World Bank, World Development Report 2005, "A Better Investment Climate for Everyone", 19-24, 79-80 (2004), available at: http://siteresources.worldbank.org/INTWDR2005/Resources/complete_report.pdf (last accessed on 12 October 2016).

[7]Koji Miyamoto, "Human Capital Formation and Foreign Direct Investment in Developing Countries, Working Paper 211, (July 2003)", available at http://earthmind.net/fdi/oecd/oecd-human-capital-fdi.pdf (last accessed on 12 October 2016).

[8]*Supra* note 3, at 18-21, 24.

[9]Nina Bandell, "Embedded Economies: Social Relations as Determinants of Foreign Direct Investment in Central and Eastern Europe", *Soc. Forces*, 81, 411 (2002).

[10]*Supra* note 2, at 1535.

[11]"Effective ADR Mechanism Can Fetch More FDI than China", *Express India*(5 November 2005).

investments that would eventually attract the investors from abroad to invest in the growing economy of India with enhanced securities against adverse changes, thus promoting investment inflow.[12] But how far has India succeeded in attaining these objectives are a debatable question. Also, have the BITs truly facilitated FDI is a moot question and does the credible commitment of the host country has any impact on decision of investors, which shall be attempted by the paper to answer.

2. INVESTMENT TREATIES AND FOREIGN DIRECT INVESTMENT

What is an Investment Treaty? It is an agreement made between two or more sovereigns that safeguards the investments made in signatory countries.[13]

Such agreements can be bilateral or multilateral through which international community has tried to foster 'rule of law' in developing countries in order to promote investment and development in those countries.[14] These treaties are considered a means to satisfy the need to promote and protect foreign investment and with a view to enhance the legal framework, under which foreign investment operates.[15] Investment treaties also have other functions like signaling receptivity to foreign investments[16] and

[12]Prateek Bagaria & Vyapak Desai, "Protecting Investments by US Companies in India in the absence of India-Us Bilateral Investment Treaty, Nishith Desai & Associates", available at http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Protecting_Investments_by_US_companies_in_India_in_the_absence_of_India-US_Bilateral_Investment_Treaty.pdf (last accessed on 12 October 2016).

[13]Susan D. Franck, "The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future", *U.C Davis Journal of International Law and Policy*, 12, 52 (2005).

[14]Lawrence Freidman, "Doing Business in Developing Countries: The Importance of Rule of Law", *New York City Bar*, available at http://www.nycbar.org/international-affairs-council-on/event-transcript-doing-business-in-developing-countries-the-importance-of-the-rule-of-law (last accessed on 12 October 2016).

[15]*Supra* note 1, at 2.

[16]Kenneth Vandevelde, "The Economics of Bilateral Investment Treaties", *Harvard International Law Journal*, 41, 470 (2000).

enhancing nation's reliability as a reputable international player.[17] There exists a paradigm shift in investors' substantive and procedural rights with the increase in investment treaties, irrespective of a government's motivation.[18] Through these treaties, a supranational set of protection is created that would apply independent of national laws and be enforceable through arbitration which is not completely dependent on the national courts.[19]

Unlike customary international law, there are specific substantive standards for investment rights articulated by investment treaties. With specific set of substantive rights, investment treaties offer appropriate compensation for expropriation, promises of freedom from unreasonable or discriminatory measures, guarantees of national treatment of the investment, assurances of fair and equitable treatment, promises that investments will receive full protection and security, undertakings that a sovereign will honor its obligations, and assurances that FDI will receive treatment no less favorable than that accorded under international law.[20]

Not only the specific substantive rights but also the investment treaties have come with innovative and revolutionary procedural rights that provide investors with a mechanism to enforce substantive rights directly. Therefore, these treaties allow the investors to have an agreed forum to redress alleged wrongs.[21]

Before the advent of these treaties, parties relied on treaties of friendship, commerce and navigation.[22] The main focus was on trade and not investment. Also there was no dispute resolution mechanism. Prior to these treaties, if investors were aggrieved by the actions of the host government, they had very limited remedies,

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[17]Beth A. Simmons & Lisa L. Martin, "International Organizations and Institutions", *Handbook of Inter-national Relations*, 192 (2001).

[18]*Supra* note 6, at 5.

[19]*Supra* note 16.

[20]Giorgio Sacerdoti, "Bilateral Treaties and Multilateral Instruments on Investment Protection", *Hague Academy of International Law*, 265-75, 299 (1997).

[21]*Supra* note 6, at 7.

[22]*Supra* note 16.

specifically:[23]

(i) To negotiate with the sovereign;

(ii) To sue the sovereign in their own courts, where most of the times the sovereign would raise the plea of sovereign immunity;

(iii) To ask the home government to negotiate diplomatically on their behalf; or

(iv) To lobby with the home government to espouse a claim on their behalf before the International Court of Justice.

It can be said that the investors did have opportunities to resolve their disputes but the same were not satisfactory. These remedies were lengthy, cost and time consuming and there was no effective protection for the vindication of their rights.[24] Even if the claims were successful, the home government may elect not to transfer the damages to the investor.[25]

Investment treaties, on the other hand, allow the investors to arbitrate with the sovereign as a matter of right thereby permitting the investors to initiate adjudication, in a manner similar to that of a private attorney, against inappropriate government actions or conduct.[26] Not only investors but also their governments can benefit from such an arrangement by outsourcing the function to the interested parties in the dispute and prevent itself the trouble of distinguishing between the meritorious and unmeritorious claims against host governments. Investment treaties provide a reliable and neutral forum for investors, one that is free from political and

[23] *Supra* note 2, at 1536-38.

[24] Jeswald W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries", *International Law*, 24, 655, 659 (1990).

[25] *Supra note* 2, at 1537.

[26] Hannah L. Buxbaum, "The Private Attorney General in a Global Age: Public Interests in Private Inter-national Antitrust Litigation", *Yale Journal of International Law*, 26, 219 (2001).

diplomatic processes, to enforce rule of law. Now the countries are trying to achieve these goals by means of reflection of rule of law through these treaties and encourage investment and development.

An important aspect of investment treaties is that it permits the investors to have a degree of control over the method of dispute resolution which they ultimately elect. While some treaties permit parties either to litigate their BIT claims before national courts or arbitral tribunals, not all treaties do this. Instead, many treaties limit the acceptable dispute resolution mechanisms to arbitral tribunals. Nevertheless, parties may still have an option to arbitrate before various international institutions, such as the International Chamber of Commerce, the Stockholm Chamber of Commerce, or before an ad hoc arbitral body organized under the UNCITRAL Arbitration Rules.[27] While ad hoc arbitration under the UNCITRAL Rules has been utilized, the most common form of dispute resolution under investment treaties is to permit arbitration before the World Bank's International Centre for the Settlement of Investment Disputes (ICSID).[28]

The prospect of large stake litigation is one of the major reasons to analyze the benefits of BITs. Governments find themselves increasingly subject to the claims under investment treaties.[29] Inevitably, government will either lose or win the claim. Governments create risks by promising the investors their substantive rights and a forum for vindicating violation of those rights. The creation of those risks is equivalent to waiver of sovereign immunity, litigation risk that would mean the possibility that the sovereign may be subject to suit for the conduct that allegedly violates an investment treaty and the possibility that the sovereign will have to defend against the claim, and the ultimate liability.[30] For defense, government may indulge into expenses worth

[27] *Supra* note 15, at 53-54.

[28] *Supra* note 2, at 1542.

[29] Barton Legum, "Investment Treaty Arbitration's Contribution to International Commercial Arbitration", *Dispute Resolution Journal*, 60, 71, 72 (2005).

[30] Tobin and Rose- Ackerman, "Foreign Direct Investment and the Business

millions but the same is necessary or at least economically efficient because a single government measure may lead to claims worth millions or billions.[31] For instance, the investors making claims under NAFTA have alleged over $1 trillion in damages, it is a different story that they were awarded only $35 million.[32] However, there have been cases in recent past where awards have been really high.

In Pope & Talbot v. Mexico,[33] Canada was held liable for $461,565. In Metalclad Corporation v. Mexico,[34] Mexico was held liable for $16,685,000.Occidental Exploration and Production Co. v. Ecuador,[35] Ecuador was held liable for $75, 074,929. CME Czech Republic B.V. v. Czech Republic,[36] CME was awarded $269,814,000 in damages for breach of an investment treaty. In yet another dispute under the Energy Charter Treaty, Yukos Oil Company is seeking $100 billion dollars from Russian Federation for having defaulted in payment of $20 billion dollars in taxes.[37] International Arbitration Court on July 28, 2014, ordered Russia to pay $50 billion to Yukos

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Environment in Developing Countries: The Impact of Bilateral Investment Treaties", *William Davidson Institute*, William Davidson Institute Working Paper No. 587, Working Paper No. 22, (2003).

[31] *Supra* note 2, at 1512.

[32] Richard Newfarmer, *Beyond Merchandise Trade: Services, Investment, Intellectual Property and Labor Mobility*, in *Global Economic Prospects*, World Bank Publication, 97, 107-08 (2005), available at http://siteresources.worldbank.org/INTGEP2005/Resources/gep2005.pdf (last accessed on 12 October 2016).

[33] UNCITRAL, *Award in Respect of Damages* (May 31, 2002), available at http://ita.law.uvic.ca/documents/Pope-Damages.pdf (last accessed on 13 October 2016).

[34] Metalclad Corporation v. Mexico, ICSID Case No.ARB (AF)/97/1, 40 I.L.M. 36 (2001), available at http://ita.law.uvic.ca/documents/MetacladAward-English.pdf (last accessed on 13 October 2016).

[35] Occidental Exploration and Production Co. v. Ecuador, LCIA Case No. UN3467, available at http://ita.law.uvic.ca/documents/oxy-ecuadorfinalaward_001.pdf (last accessed on 13 October 2016).

[36] UNCITRAL, Final Award (Mar. 14, 2003), available at http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf (last accessed on 13 October 2016).

[37] *Supra* note 16.

for expropriating the assets of Yukos.[38]

In developing countries, domestic legal regimes are insufficient to adequately protect the property rights of foreign investors. This serves as a major impediment to foreign investment. BITs help fill this legal void and supply an international rule of law providing investor-friendly substantive rules and supporting institutional structure enforcing these rules, thereby acting as a credible commitment device making investments more favorable to foreign investors.[39] It is hypothesized that countries with weak property rights tend to show their commitment of upholding property rights of the foreign investors in order to attract investment.[40]

Under the treaties, many substantive promises are made to promote investor's interest, including rights associated with the combination of 'most favored nation' providing that nationals of the nation will be treated no less well than the nationals of other parties; national status; 'fair and equitable treatment'; right against expropriation in form of prompt, adequate and effective compensation; and right to transfer investment assets or proceeds out of the host country in convertible currency.[41] But what reasons do investors have to believe in these promises? Will they take the decision to invest based solely on these promises? Scholars argue that the credible commitment of treaties will also depend on the incorporation of enforceable promises to arbitrate treaty disputes.[42] Another argument on that

[38] Megan Davies, "Court Orders Russia to Pay $50 billion for seizing Yukos Assets", *Reuters U.K.*, (Jul., 28, 2014), available at http://uk.reuters.com/article/2014/07/28/uk-russia-yukos-idUKKBN0FX08M20140728 (last accessed on 13 October 2016).

[39] Jason Webb Yackee, "Bilateral Investment Treaties, Credible Commitment and Rule of (International) Law: Do BITs Promote Foreign Direct Investment?" *Law and Society Review*, 42, 805, 807-808 (Dec., 2008), available at http://www.jstor.org/stable/29734155 (last accessed on 13 October 2016).

[40] *Infra* note 51, at 3.

[41] Rudolf Dolzer & Magrete Stevens, *Bilateral Investment Treaties*, The Hague, Martinus Nijhoff Publishers (1995).

[42] Thomas W. Walde, "The Umbrella Clause' in Investment Arbitration: A Comment on Original Intentions and Recent Cases", *Journal of World Investment & Trade*, 6, 183-237 (2005).

behalf is that effective institutional solutions to the credible commitment problem involve not only creating the formal rules but also creating and implementing a judicial system that will impartially enforce these rules.[43]

For development of economy, it is inevitable to have an independent and effective judiciary.[44] At times, although not all, the treaties can be self-enforcing in the sense that the countries that breach the treaties will suffer unacceptable losses to their reputations as international law abiding nations.[45]

Given that under such treaties, the players associate themselves with high risks, it becomes pertinent to analyze the consequences of these treaties and arbitration thereunder, to see whether these treaties actually serve the purpose of promoting foreign investments.

There have been many ideas suggesting that such treaties do not play any significant role in promoting FDI. On the other hand, some other theories suggest that investors' decisions do take into account the rights provided by these treaties and would favor an investment in a country that will uphold the treaty.

There are protagonists to the theory that effect of treaties on FDI is negligible and they believe that the 'other' factors or forces of the market play a much significant role in attracting FDI. On the contrary there are protagonists to the theory that treaties have a special and decisive role in attracting FDI.

The UNCTAD, the World Bank, IAB among others have conducted researches and studies over the impact of investment treaties on FDI. Many of the reports suggest that treaties have minimal role to play in promoting FDI, however, it is also suggested that treaties can be one

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[43]Douglas C. North, "Institutions and Credible Commitment", *Journal of Institutional Theoretical Economics*, 149, 11, 21 (1993).

[44]Alvaro Santos, "The World Bank's Uses of 'Rule of Law' Promise in Economic Development", *The New Law and Economic Development, Cambridge University Press*, 282 (2006).

[45]*Supra* note 41, at 809.

of the many factors to affect the investment decisions of the investors.[46]

Some studies by UNCTAD have focused on issues in the 1990s that suggested a weak indication that signing an investment treaty has a positive influence on FDI.[47] In conclusion the study said that BITs play a minor role in influencing FDI flows.[48] It suggested that there are other factors that play a more prominent role in influencing FDI flows. Therefore, investment treaties may not cause investment but maybe correlated with investment levels.

A World Bank economist, Mary Hallward-Dreimer, is also skeptic about the effect the investment treaties have on FDI. She suggests that the measure of impact of investment treaties on FDI is statistically insignificant and the major role is played by the host country's market in determining the FDI flows.[49] Her study suggests that signing a treaty does not necessarily enhance property protections, that BITs do not act as substitute for broader domestic reforms and those countries that record any growth from such treaties already have reasonably strong domestic institutions and are likely to gain from ratifying a treaty.[50] According to her, to the extent that investment treaties act more as a complement to, rather than a substitute for, domestic institutional reform, the real value from investment treaties may only come when they are a signal of future institutional reforms and trade liberalization.[51] Therefore, it can be said that trade liberalization or institutional reforms that precede or follow the signing of an investment treaty has bearing on

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[46] *Supra* note 6, at 13.

[47] United Nations Commission on Trade and Development, *Bilateral Investment Treaties in the mid-1990s*, UNCTAD/ITE/IIT/7, Sales No. E.98.II.D.8, 122 (1998).

[48] *Id. at* 141-142.

[49] Mary Hallward-Driemeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit-and They Could Bite", 18(2003), available at http://econ.worldbank.org/files/29143_wps3121.pdf (last accessed on 12 October 2016).

[50] *Id. at* 22-23.

[51] *Ibid.*

the decisions of investors.[52]

Yackee in his research states that there is no evidence that formally strong investment treaties meaningfully influence the investment decisions.[53] He suggests that the common perception that formally strongest investment treaties promote FDI is not true and has no association with increased investment. He relies on Macaulay's 'Non-Contractual Relations in Business' and argues that, "formal trappings of domestic laws often have effects on private behavior that are at best indirect, subtle and ambiguous."[54]

On the contrary, some other studies suggest that investment treaties do have a bearing on the decisions of the investors. A study carried out by Salacuse and Sullivan suggests that when developing countries sign treaties with OECD countries, FDI is likely to increase especially if the OECD country is U.S.[55]

Study by Neumayer and Spess suggests that developing countries that sign more BITs with developed countries receive more FDI flows.[56] According to them, BITs may sometimes substitute domestic institutional quality and the positive effect of BITs on FDI decreases as the governments become more stable.[57]

IAB Report of 2010 suggests that effective institutions that provide

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[52] *Supra* note 6, at 14.

[53] Jason Webb Yackee, "Bilateral Investment Treaties, Credible Commitment and Rule of (International) Law: Do BIT's Promote Foreign Direct Investment?" *Law and Society Review* 4, 42, 805, 807 (2008), available at http://www.jstor.org/stable/29734155 (last accessed on 13 October 2016).

[54] *Id. at* 808.

[55] Jeswald W. Salacuse & Nicholas P. Sullivan, "Do BITS Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain", *Harvard International Law Journal*, 46, 67, 109, 111 (2005).

[56] Eric Neumayer & Laura Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment in Developing Countries?"(2005), available at http://eprints.lse.ac.uk/archive/00000627/01/World_Dev_(BITs).pdf#search=%22washington%20spess%20foreign%20investment%20BIT%22 (last accessed on 13 October 2016).

[57] *Id. at* 22-24.

easily accessible and reliable information have impact on creating an enabling investment climate. [58] The report suggests, "For governments interested in attracting foreign direct investment (FDI), improving the rule of law, including the country's dispute resolution mechanisms, is a top priority. A stable, predictable arbitration regime, as part of the broader framework for the rule of law, is one of the factors that drive foreign investment." [59] According to the study, apart from assisting in attracting FDI, arbitration reduces strain on local courts, especially in a country like India, where courts have huge amount of pending cases, arbitration can be very useful. Moreover, arbitration has flexible procedural rules than litigation. Past studies have found that more than two-thirds of multinational corporations prefer international arbitration, either alone or combined with other alternative dispute resolution mechanisms, to resolve cross-border disputes.[60]

In India, although FDI has increased but still the full potential of India to attract FDI has not been realized. One of the reasons cited is lack of efficient dispute resolution system, apart from excessive bureaucracy. Indian courts are known for their backlogs of cases, which was partly the reason for enactment of Indian Arbitration and Conciliation Act of 1996.[61] The Act is heavily based on UNCITRAL Model Law.

Following is an attempt to analyze whether investment treaties actually promote FDI and as the case may be what is the role of these treaties in India in relation to FDI.

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[58] Indicators of Foreign Direct Investment Regulations in 87 Economies, "Investing Across Borders", 11, World Bank, (2010), available at http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf (last accessed on 13 October 2016).

[59] *Id.* at 61.

[60] *Id.* at 62.

[61] "International Commercial Arbitration: An Indian Perspective", Asia Law, (2004), available at http://www.asialaw.com/Article/1972177/Search/Results/International-Commercial-Arbitration-An-Indian-Perspective .html? Keywords= wipo (last accessed on 13 October 2016).

3. ARBITRATION- AN IMPORTANT CRITERION FOR EFFICIENT INVESTMENT

While there are suggestions as to the fact that dispute-settlement procedure in treaties will influence the investment behaviours to a certain extent, there are other studies which suggest that it would be challenging to isolate the effect of individual treaty rights, more particularly the role of dispute resolution mechanisms.[62]

Though there is a lack of empirical evidence to prove that such effects on FDI are due to arbitration, also that such evidence might not be explicitly available but would be found implicitly as we would see further.

The factors driving investment decisions by multinational corporations are changing. When seeking business opportunities, companies are now more concerned about financial and political risks, with a focus on stable and predictable business environments.

In response, governments everywhere recognize that their chances of attracting more foreign investment depend on making their investment climate more competitive.[63]

According to the report, 'Investing Across Borders' by WTO there are mainly four Characteristics for nations which score well in their scale for investment potential, one of which is Arbitrating Commercial Disputes, this further has four sub points:[64]

Strong arbitration laws in line with arbitration practice. Modern Arbitration Laws have been implemented by many countries. Ideally these are consolidated in one law or a chapter in civil code and are coherent, up-to-date, and easily accessible. A strong legal framework

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[62]Deborah L. Swenson, "Why Do Developing Countries Sign BITs?",*U.C. Davis J. International Law & Policy* 12, 131, 152-55 (2005).

[63]Indicators of Foreign Direct Investment Regulations in 87 Economies, "Investing Across Borders", V, World Bank, (2010), available at http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf (last accessed on 13 October 2016).

[64]*Id* at 12.

should be linked with efficacious arbitration practices and greater understanding of the benefits of arbitration.

Autonomy to tailor arbitration proceedings: Good arbitration systems provide a malleable option for commercial dispute resolution. Parties should be able to choose how to run their arbitration processes, including whether they will be ad hoc or administered by an arbitral institution, the qualifications of the arbitrators, and the language of the proceedings.

Supportive local courts: A good arbitration system is associated with firm support from local courts for arbitration proceedings as well as steady, efficacious execution of arbitration awards.

Adherence to international conventions: Adherence to and implementation of international and regional conventions on arbitration such as the New York Convention and the ICSID Convention, mark a government's wilful responsibility to the rule of law and to safeguard the investor rights.

According to this above criterion we can observe the strength of Investment efficiency of different parts of the world:

East Asia and Pacific - Here the laws generally offer broad party autonomy in arbitration, though there are some restrictions. But the Enforcement of arbitral awards is slow in most of the region, taking more than a year or so in some of them.

Eastern Europe and Central Asia - There are more or less 80% countries which have enacted specific laws on commercial arbitration, less than in other regions. This region has the largest share of countries with laws on commercial mediation and conciliation.

Latin America and The Caribbean - Apart from Argentina, all other countries included in the WTO's survey have specific laws on commercial arbitration. In some countries the legal framework for arbitration is spread across various decrees and codes, resulting in

legal controversies and complexities. Almost half the countries surveyed in the region have also enacted laws on commercial arbitration.

Middle East and North Africa – all the countries surveyed in this region are having laws on commercial arbitration. There are few restrictions on subject matter arbitrability. The region's enforcement of arbitration awards in local courts is among the slowest in the world.

South Asia – All the countries surveyed have laws on commercial arbitration, all of these are parties to the New York Convention and all, except India, to the ICSID convention. The Laws on Arbitration in this region particularly provide broad party autonomy in arbitration proceedings, with the exception of restrictions on using foreign counsel in domestic arbitration proceedings in Bangladesh, India and Sri Lanka. There is no confidentiality of the proceedings.

The following is the division of the analysis of the effect arbitration has on foreign investments on the basis of potential and reality. Firstly, Section A looks at the relationship of FDI and investment treaty's dispute resolution mechanism. It mainly deals with the potential relationship between the dispute resolution mechanisms contained in investment treaties and investment levels. Section B will evaluate how arbitration in these treaties indirectly creates incentives for FDI by fostering the development of rule of law.[65]

There are case studies which provide useful models for directly evaluating what impact investment treaty arbitration may have upon such decisions involving foreign direct investment. While there are many treaties which provide for arbitration as a final remedy for breach of treaty rights, there are others which provide for Unique Dispute Resolution thus providing with an opportunity to consider the relationship between dispute resolution mechanisms and

[65]Susan D. Franck, "Foreign Direct Investment, Investment Treaty Arbitration and Rule of Law", *Global Business and Development Law Journal*, 19, 354, 355 (2007), available at http://www.mcgeorge.edu/Documents/Conferences/JUDIND_FRANK_MASTER.pdf (last accessed on 13 October 2016).

investment decisions. This hypothesis for finding potential relation between FDI and investment treaties considers those countries that have signed investment treaties with limited or no right to such arbitration.

(i) The Place Holding Model

In this model, the investors are less concerned with the particulars of a dispute resolution provision and care more about establishing a place within a market. China is an example of such a model.[66] While many BITs do not offer foreign investors any forum to resolve their disputes[67], China often permits Chinese courts to resolve investment disputes. Particularly, China required that all other substantive claims be resolved before national courts even though there is a narrow exception permitting arbitration for the valuation of an expropriation claim.[68]

This reliance on the court system and limited access to arbitration has not stopped investors from making substantial investments in China.[69] This suggests to a situation where the investors will invest irrespective of procedural rights in these treaties.[70]

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[66]K.C. Fung, "Trade and Investment among China, the United States and the Asia-Pacific Economies: An Invited Testimony to the U.S. Congressional Commission", 4 (2005), available at http://econ.ucsc.edu/faculty/working papers/tradeandinvestment.pdf (last accessed on 13 October 2016).

[67]Agreement on the Mutual Protection of Investments between the Government of the Kingdom of Sweden and the People's Republic of China, July, 1 1979, Arts. 6-7, available at http://www.unctad.org/ sections/dite/iia/docs/bits/china_ sweden.pdf (last accessed on 13 October 2016).

[68] *Agreement between the Government of the People's Republic of China and Government of the Kingdom of Denmark Concerning the Encouragement and Reciprocal Protection of Investments*, Art. 8 (1986), 84 U.N.T.S.83 (No. 24573), available at http://www.unctad.org/sections/ dite/iia/docs/bits/china_denmark .pdf (last accessed on 13 October 2016).

[69]Ted G. Telford & Heather A. Ures, "The Role of Incentives on Foreign Direct Investment", *Loy.L.A. Int'l & Comp. L. Rev.* 23, 605, 612 (2001).

[70]United Nations, "China FDI Fact Sheet", (2005), available at http://www.unctad.org/sections/dite_dir/docs/wir05_fs_cn_en.pdf (providing empirical evidence

(ii) The Political and Economic Reality Model

This model talks about a situation where the existing political and economic conditions of a country are strong enough, which thus renders the creation of such a dispute resolution mechanism unnecessary. This model might also point out the nature of the political, economic and legal structures within the states who have signed such treaties.[71] Australia is an example of this model. In the year 2004, Australia and United States finalized a Free Trade Agreement (AUSFTA).[72] This agreement gives substantive investor rights but does not provide any forum to redress a breach of treaty.[73] This does not affect the trade relation as studies show that trade and investment have flowed, and will probably continue to flow, fluidly between these two countries.[74]

A 'Political and Economic Reality' model might suggest that two nations with shared economic and political goals, and substantial cross-border investment flows, recognize that they are both likely to be on the receiving end of investor-state disputes.

(iii) The Market Liberalization Model

Liberalization is a process of opening up of markets, allowing public participation in areas previously monopolized by the government, and promoting competition. Market Liberalization can be seen due to presence of several factors. It might include new trade rules to build a larger market, relaxing restrictions on industry to permit and enhance market access, increasing transparency in regulations etc. This modernization and liberalization of investment regime

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regarding the increase in FDI inflows to China between 1985 and 2004), (last accessed on 13 October 2016).

[71] United States- Australia Free Trade Agreement (AUSFTA), (2004).

[72] *Ibid.*

[73] *Ibid* at Art. 11.

[74] "United States Trade Representative, Australia: Trade Summary", available at http://www.ustr.gov/assets/DocumentLibrary/Reports_Publications/2005/2005_NTE_Report/asset_upload_file243_7453.pdf (last accessed on 13 October 2016).

promoted FDI irrespective of the existence of substantive or procedural rights in Bilateral Investment Treaties. Example of such a model can be Brazil and Ireland. Both these countries have modernized and liberalized their economies during the past 20 years. These two countries reflect a situation that UNCTAD observed, namely that Bilateral Investment Treaties may be unrelated to the amount of FDI. There may be suggestions that the economic success, irrespective of the existence of a BIT, may be considered as a model of market liberalization.[75]

Might be that the provisions of Private dispute resolution created by the parties, for use in enforcing specific negotiated commercial contracts, are more direct, effective, and reliable manner of controlling investment-related risk.[76]

(iv) Investment Treaty Arbitration: Does the implementation of rule of law have effect on FDI?

The availability of treaty arbitration can indirectly contribute in promoting investment by providing independence to adjudicate and/or a model for national courts to follow the rule of law. There are arguments which say that the availability of investment treaty arbitration adversely affects the rule of law in developing countries.[77] There are also suggestions that the existence of IDR for FDI infuses the development of rule of law in national courts by creating a regime that gives a privilege to foreign investors and removes investment disputes from local courts.[78]

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[75] UNCTAD, "Investor-State Disputes and Policy Implications", (2005), TD/B/COM.2/62 available at http://www.unctad.org/en/docs/c2d62_en.pdf (last accessed on 13 October 2016).

[76] Francis Delacey, *Enforcing Contracts in Developing Countries*, in Law in Transition.

[77] Jeswald W. Salacuse & Nicholas P. Sullivan, "Do BITS Really Work: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain", *Harv. Int'l Law Journal* 46, 67, 113 (2005).

[78] Mark Halle & Luke Eric Peterson, "Investment Provisions in Free Trade Agreements and Investment Treaties: Opportunities and Threats for Developing

The existence of a functioning arbitral institution in a country is an indication of a solid arbitration practice. But more than 10% of the countries surveyed do not have such an institution, including Afghanistan, Angola, Bangladesh, Cambodia, Kosovo, Montenegro, Papua New Guinea, Rwanda, Sierra Leone, and the Solomon Islands. In some countries such institutions are not active, as in Ethiopia and Liberia.[79]

There are many assertions as to the evolution of Rule of Law and whether this can be done simultaneously with the establishment of such treaties which ask for arbitration instead of Court system. But these assertions overlook several vital matters, which suggest that investment treaty arbitration may actually benefit the rule of law, or at a minimum, do not adversely affect a country's adherence to the rule of law.[80]

(v) Investment Treaty Arbitration as a Complement to Domestic Courts

The World Bank on this subject suggests that investment treaty arbitration is no substitute for local institutions; rather, it can facilitate and improve domestic institutional reform. Another analysis by Hallward-Dreiemer suggests that Bilateral Investment Treaties are more, rather than less, effective in promoting higher institutional quality, particularly where strong institutions already exist.[81]

For such Bilateral Investment Treaties which give a choice to investors for choosing between arbitration and court litigation, one might even wonder whether investment arbitration might "make

Countries", 23-24, (2005) available at http://www.undprcc.lk/web_trade/publications/BITcompleted.pdf (last accessed on 13 October 2016).

[79] *Supra* note 63, at 11.

[80] *Supra* note 65, at 366.

[81] Mary Hallward-Driemeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit-and They Could Bite", 21 (2003), available at http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-3121 (last accessed on 13 October 2016).

domestic courts to compete for the business of resolving commercial disputes and thus improve their quality."[82]

(vi) Domestic Courts as a complement to Investment Treaty Arbitration

Investment treaties arbitration and national courts have a mutually beneficial relationship. The above statement has been further elaborated by Susan Frank,[83] in her paper wherein she states:

"Arbitration does not occur in a vacuum, and the existence of investment treaty arbitration does not vitiate the need to encourage the development of a judicial system where rights are adjudicated in a fair, impartial and predictable manner. Nurturing the development of the rule of law in national courts not only develops local judicial institutions but also promotes confidence in the overall process of resolving investment disputes".

The point of view taken by Susan Frank though mentions the outcome of the symbiotic relationship does not explain the process that is undergone to achieve such a relationship, in the first place. As per a hypothesis, [84] this mutually beneficial relationship can be achieved when there is an integration which occurs because of the economically/politically powerful locals, the local legal practitioners such as firms which deal with foreign investors and disputes of such nature.

These locals usually have a specific and private interest to make sure that local judicial bodies support arbitration and they also many times possess political power to initiate legal reforms to guarantee this support. This would be one of the ways to achieve the status of a symbiotic relationship.

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[82] Tom Ginsburg, "International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance", *International Rev. of Law & Economics* 25, 119 (2005).

[83] *Supra* 65 at 368.

[84] Catherine A. Rogers, "International Arbitration, Judicial Education, and Legal Elites", *Penn State Law*, 72 (2015)

There are three main ways by which the National courts may involve themselves in such treaty disputes. First, as many of these treaties permit investors to bring their claims in national courts, under appropriate circumstances, investors may elect to litigate treaty violations.[85] Second, the process of investment arbitration gets critical support from the national courts. While a court's role tends to be limited in ICSID arbitration proceedings,[86] national courts have a role to play in enforcing ICSID arbitration awards.[87] Confidence in local courts promotes confidence in the overall process of resolving treaty claims. Third, even with the availability of courts for international law claims, national courts are still critical for the resolution of investor's national law disputes.[88]

(vii) Arbitration as a Method to Maximize Party Control

Arbitrating treaty claims may have very little concerning the escape from the jurisdiction of local courts, but it may be concerned more about maximising of party control.[89] Using arbitration as a mode of resolving disputes may have more to do with party choice, control over the process and enforceability of an award.

After all this there is a pertinent question of Why an Effective Commercial Arbitration regime matters for foreign investors? As per the Study conducted by WTO there are two main reasons for why does this matter to the investors:

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[85]UC-Davis Symposium, *Romancing the Foreign Investor BIT by BIT*, comments of Jim Loftis, (2005)

[86]*Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, Art. 26,4 I.L.M. 524 (1966).

[87]*Id.* at Art 54.

[88]Occidental Exploration and Production Co. v. Ecuador, LCIA Case No.UN3467, available at http: //www.italaw.com/documents/Oxy-EcuadorFinalAward_001.pdf (last accessed on 14 October 2016).

[89]Don Thompson, "Lawsuits Want to Limit Free Trade Pact Several Groups Claim a NAFTA Provision Weakens State and Federal Laws", *Monterey County Herald*, 23 February 2005, available at http://www.senate.ca.gov/ftp/SEN/COMMITTEE/SUB/BP_INTER_TRADE/_home/Article_2_23_05.doc (last accessed on 14 October 2016).

Firstly, Complex Commercial Contracts require reliable, flexible dispute resolution mechanisms. Arbitration and other forms of ADRs like mediation give a considerable party autonomy. These characteristics of confidentiality, party autonomy, flexibility in procedures and easy enforcement caters to the concerns of dispute resolution for the businesses.

Secondly, the companies in general prefer arbitration over court proceedings. Formal Dispute Resolution through litigation can be a lengthy process. Even if courts treat foreign companies fairly, domestic firms are more familiar with court procedures and can use their own lawyers and language. Foreign Firms have a perspective that well established, predictable arbitration regime is a mitigating risk by providing legal security to investors.

From the point of view of a company, the system of arbitration does not just attract FDI but also helps in reducing the burden for local courts, which are often congested and have huge case backlogs-by providing an alternative method of dispute resolution that can have fewer more flexible procedural rules than litigation. These companies prefer to use international arbitration rather than domestic litigation to resolve disputes, whether with a private party or the state.

Corporations want Arbitration proceedings with minimal intervention from courts, and arbitration awards that are easily enforced. There are many modern statutes which limit the intervention process, but there is little an arbitration tribunal can do if a jurisdiction allows court to intervene.

Arbitration has a close relation to domestic courts at certain stages of the arbitration process- such when there is enforcement of arbitral awards. Accordingly, it is important that national courts support arbitration as a means of resolving commercial disputes.

When countries are attempting to improve the strength of their arbitration regimes, they cannot just examine arbitration in isolation. There is a relationship between private arbitral proceedings, domestic courts, and the general legal climate of a country. The

South Asian region is the slowest to enforce domestic arbitration awards. Within the region it takes longest to enforce a domestic or international arbitration award in Pakistan.[90]

Looking at the trends in the growing preference of companies to arbitrate in order to resolve their commercial disputes, countries have made substantial progress in improving their arbitration frameworks. Another important characteristic that WTO quotes in its report is adherence to International Conventions. Implementation and adherence to international and regional conventions on arbitration such as New York Convention and the ICSID Convention signal a government's commitment to the rule of law and its investment treaty obligations, which reassures investors.[91]

Choosing to arbitrate investment disputes does not mean that local courts are incapable of adhering to the rule of law and administering impartial justice. The adjudicative unbiasedness and neutral stance of treaty arbitration gives a useful model for national decision-makers and thus promotes adherence to the rule of law. Similarly, in a domestic court system, following the rule of law provides useful support to promote confidence in the investment treaty process. Conclusively, this mutually benefiting relationship has the capacity to help in increasing investor confidence in the settlement of investment-related disputes and provide a useful incentive for foreign investment.[92]

4. FROM AN INDIAN PERSPECTIVE

The concept of Bilateral Treaties came to India in the mid '90s and was initiated by the Government of India. The objective of such treaty was to offer favourable conditions and treaty based protection to the foreign investors and investments which would eventually influence investors from abroad to invest in the growing economy of

[90]"World Investment Climate", (2010) available at http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf (last accessed on 20 January 2017).

[91]*Supra* note 63, at 72.

[92]*Supra* note 65, at 372.

India with enhanced securities against adverse changes, thus promoting investment inflow.

In comparison to several developing economies India is definitely considered a much safer jurisdiction to invest. Investors do not have to worry about issues like nationalization, rampant expropriation, politically motivated and forceful confiscation of property etc. But still there are many other issues which are crucial while deciding where investors in India would like or rather need to seek protection and security. There are many reasons to opt for protection. Though rule of law is a very predominant concept in India, some of the central issues, surrounding the legal structure in India are the clarity of laws, rules and regulations.

There are some very common problems that the Investors investing in India might face:

(i) Regulatory Uncertainty

India's regulatory system is opaque and sometimes very volatile which makes it difficult for the investors to feel secure in investing. The changing regulations and its interpretations often leave the investors and their investments in a limbo.

Thus, it is essential for every investor here to take protective measures to enable them to mitigate damage and loss that might be caused by an active rule making body.

(ii) Delay in Justice

In India it's a very common notion that justice is a lengthy procedure. The Indian Legal System is fraught with delays which many a time makes the investors wary of choosing India as an investment venue despite the lucrative prospects it entails for foreign investment, with statistics suggesting that the average pendency time of a case in the Indian Judiciary is fifteen years.[93] The investors are

[93]Ronald J Bettauer, "India and International Arbitration: The Dabhol Experience". *The Geo. Wash. Int'L.Rev* 41, 381 (2010).

apprehensive about the fate of their investments should it so happen that they face a suit in India. The delay in Indian judicial system is due to numerous reasons such as acute shortage of judges, lengthy and cumbersome procedure for a suit, unnecessary adjournments sought by the parties. Thus, the undue and unreasonable delays in justice necessitate that an investor before investing in India takes all due measures to protect his investment which will prove a worthy defence against the getting entangled in the long drawn process of the Indian judiciary at some later point in time.

(iii) Delay in permission and clearances from non -judicial authorities.

There are suggestions from International and National Authorities that there has been a decrease in foreign investments in India due to the hurdles in the land acquisition, environment clearances and delay in the bureaucracy. Various approvals from authorities like Foreign Investment Promotion Board, Reserve Bank of India, Pollution Control Boards, and Directorate General of Foreign Trade etc make the process a lengthy one and also make it tedious. Moreover, the post investment approval procedures have also created difficulties with project implementation.

Thus bureaucratic delays, discretionary interpretation, are impediments to investments in India making it very essential for investors from other countries to seek protection of their investments under the international investment treaty regime.

(iv) Intervention by Courts

In India, any case remotely related to the country is brought before the courts and the court, even if the relation is negligible, give preference to such domestic parties. In the famous case of White Australia Industries Ltd. V. Coal India Ltd.,[94] the Indian Courts set aside the 2002 ICC arbitral award and instead seized upon the underlying coal contract's stipulation that Indian law will govern the

[94]Australia Industries Ltd. v. Coal India Ltd., 2004 (2) *Cal Law Journal* (Cal) 197.

contract. In consequence the Australian government took India to an Investment Arbitration.

(v) Corruption

India ranks 76th in the list of corrupt nations in the world, with the least corrupt nation ranked first.[95] Corruption in India permeates nearly all branches of government and bureaucracy and has made it thoroughly impossible for any work requiring government sanctions to proceed without greasing the hands of the government officials and ministers alike. Corruption in bureaucracy not only results in loss of profit for investors but also loss of an opportunity for them.

Hence, it is essential for foreign investors to protect their investment from being exposed to the banes of the corruption in India.

(vi) Government Contracts

Most of the large projects attracting foreign investment particularly in Infrastructure Sector (road, rail, power, port) are implemented on PPP models and therefore government's role becomes very important.

Taking note of such uncertainties and ever changing stands, multiple reasons including political uncertainties make such projects vulnerable to long delays and make them require protection.

Conclusively, we can say that though the government has tried to establish a fair and speedy arbitration regime in India, but due to the various limitations as mentioned above, such a system does not guarantee an easy resolution of commercial disputes.

Therefore, unless the government recognises these limitations and works toward improving them, arbitration would play only a miniscule role in attracting FDI in India.

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[95] "Corruption Perceptions" index, (2010) available at http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results, (last accessed on 14 October 2016).

5. CONCLUSION

Investment treaty arbitration in particular has a very different role to play in the future of foreign investment. Governments are likely to continue to focus upon the capacity of dispute resolution mechanisms to affect investor's confidence, work towards minimization of investment risk, and creation of incentives for investing abroad.[96] Meanwhile, as the dispute resolution process at ICSID and other institutions gains momentum, investors are likely to become more sensitized to the benefits that treaty arbitration can offer both at the time of structuring the initial investment and dealing with problems after they arise.[97] One should therefore continue to evaluate the possibilities and pitfalls inherent in this new form of dispute resolution to ensure that it plays a productive role in economic, legal, political and social development.

As there is a mixed view about the effect of arbitration on FDI so we cannot generalize it by saying that Arbitration always promotes FDI. As we have seen in various case studies and surveys that the conclusion is different in every case. But the fact which can be accepted here is that arbitration in affirmation affects FDI even though the scale might vary, but promoting arbitration directly or indirectly promotes FDI.

[96]Khozem Merchant, Snow Calls for an Arbitration System to Ease India Fears, *Financial Times*, (8 November 2005), available at http://news.ft.com/cms/s/d810ddf8-5078-11da-bbd7-0000779e2340.html (last accessed on 14 October 2016).

[97]*Supra* note 62.

INVESTOR-STATE ARBITRATION (PROGRESSING TOWARDS BETTER SYSTEM OF DISPUTE SETTLEMENT)

-Kshitij Asthana*

ABSTRACT

India, a country with extreme population and diversity, is in a great turmoil due to the recent arbitral awards going against her. There has been an absolute threat of humongous adverse awards going against India if no attention is paid towards the pendency of copious claims in the International Arbitration Tribunals. This can be understood as an early hint to make certain amendments in the existing model for BITs which actually are paving a path to these arbitrations. A question that is also taken into consideration lately by many scholars is "do we even need a BIT?"With respect to the threat of more awards going against it, the Government of India, in the year 2015, prepared and proposed a new draft model for BITs. Meanwhile, the Law Commission of India while finalizing the report on Amendments to the Arbitration and Reconciliation Act, 1996, realized the risk to International Investment treaties and after the draft model was made public for comments and suggestions, the Law Commission came up with an analysis of the draft model and suggested certain edits in the draft.

In this research article, the researcher will try to explain the concept of Investor-State Arbitration starting from the scratch, stand of different countries with respect to the ISA (both developed and developing), whether it is of any help to the developing countries, India's stand on the ISA after the first adverse award and the benefits it offers to the Investors. The researcher will also take into consideration the Draft Model BIT proposed by Government of India and Analysis of the Model Draft of the BIT done by the Law commission through its report specifically the Most Favored Nation Clause and suggest certain changes to the same.

*Student, Symbiosis Law School, Pune.

1. UNDERSTANDING BIT AND INVESTOR STATE ARBITRATION

Bilateral Investment Treaties (BITs) are a prerequisite today because of the growing International Investments and flourishing globalization. Every country while Investing or while doing any kind of Business where there is an involvement of large capital or an inherent threat to the capital invested, considers jotting down the rights and duties of the parties towards each other. This above everything makes the countries feel safer and more secure, and also helps in better functioning of the parties. BITs help in drawing the boundaries perfectly. These are mostly entered by the states for smooth functioning of Business and fool proof investment flow. According to the Law Commission's report 260 BITs are a part of a large trade and investment agenda which helps the Indian Government to boost investor's confidence and increase investment flows into and out of the country.[1] International Commercial Arbitration essentially according to section 2(f) of the Indian Arbitration and Conciliation Act, 1996 means

"An arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is—

(i) an individual who is a national of, or habitually resident in, any country other than India; or

(ii) a body corporate which is incorporated in any country other than India; or

(iii) an association or a body of individuals whose central management and control is exercised in any country other than India; or

(iv) the Government of a foreign country"

It is a prerequisite that one of the parties fulfills abovementioned the 4 conditions, else the dispute can't fall under the ambit of Investor-

[1]Law Commission Report, *Report No. 260*, August 2015.

State Dispute, and if any dispute arises between the parties, the Investor-State Arbitration won't come into picture.

ISA is a treaty-based form of an arbitration by which a state, essentially agrees to be a party or in advance agrees to be an object to a claim in arbitration by a private investor who claims to have suffered financial loss as a result of the conduct of the state, which ultimately resulted in violation of one or more standards that have been laid down in the treaty. The treaty talked about here is generally a Bilateral Investment Treaty[2] but there has been a shift in the recent years and nowadays many provisions for foreign investments are there in the investment chapters of regional trade agreements (RTAs)[3] and mega regional trade agreements between different countries or different blocs of countries.

The next question that comes to mind instantaneously is what exactly is a BIT? A BIT is a treaty of Bilateral Investment that two countries which want to trade with each other enter into. It is generally entered by countries for promotion and protection of the foreign investment or their own investment in foreign countries.[4] All these International agreements such as TTIP, TPP including CETA, BITs and RTAs are collectively called International Investment Agreements (IIAs). In 2015, the United Nations Conference on Trade and Development (hereinafter referred to as UNCTAD) calculated in a report that there are more than 3200 IIAs[5] which were around 2500 in the year 2006.[6] These reports in particular show that there has been a rise in the Investments done in the recent years (particularly from 2006-2015). In the year 2006 only, the total stock

[2]The Canadian Model Foreign Investment Protection (FIPA), Sec C, 2004.

[3]Jurisdiction of ICSID, 2014; CIGI (Armand De Mestral, ISA Series Paper 1, (September2015)).

[4]*Supra* note 2.

[5]UNCTAD, Reforming International Investment Governance, World Investment Report 2015, (Geneva: UN 2015).

[6]Tranz Electric Supply Co. v. Indep. Power Tranz Ltd., 8 ICSID (W.Bank) 227 (2001).

of International Investment shot up to US$ 10 Trillion[7] and hence have quite naturally led to an increase in actual as well as potential conflicts between investors and host countries.[8]

2. TAKE OF DIFFERENT COUNTRIES ON BITS AND ISA

Earlier the trend of these treaties was that these were established between a developed nation and a developing nation for promotion and protection of Investment among the countries concerned. Essentially these agreements helped in achieving 2 things: (1) these subjected the host countries to certain International rules that they must respect in order to deal with foreign investors and their Investments and (2) Investor got a remedy against the host nation to bring a claim in the International Arbitration. This trend is still followed and the latter is considered really harsh on the host nation. The reason being that the power which is delegated on the investors are autonomous and hence the same can bring a claim against the host nation even without the consent or even paying any regard to the wishes of the host nation.ISA has created a huge impact on the economy much after 1970s and the debate about it being brutal on the host nations also came during the same time. Those in favour of the ISA say that it should be seen as a key to protecting the interests of foreign investors and foreign investments against the possible failure of the host country to respect and abide by the treaty standards. It is also contended most of the times that this protection encourages the flow of foreign investments which is actually a very valid point according to the researcher also; but, what is being neglected here is that the arbitrations like these directly question the dispute resolution system of the host country and can lead to disbelief in the mass for the law of the land and the judicial system of a country.

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[7] UNCTAD, *Trade Investment Report, 2006: FDI from developing and Transitional Economies: Implication for Development*, 9, U.N. Doc. UNCTAD/WIR/2006 (Oct. 16, 2006), available at http://www.unctad.org/Templates/webflyer.asp?intItemID=3968&lang=1.

[8] *Ibid.*

BITs were originally designed to deal with capital transfers between capital-exporting (usually First World) and capital importing (usually Developing World) countries.[9] Out of Some 1200 (approx.) very few were concluded between Developed democracies,[10] with Freedom, Commerce and Navigation Agreement (Known as FCN) being an exception. This was concluded between U.S. and Italy and ultimately became the object of the decision given by ICJ. The groundbreaking Agreement which paved the way to ISA was the agreement between Mexico, US and Canada which is regarded as one of the most influential trade agreement called NAFTA in the year 1994.[11] Part B of Chapter 11 of this agreement dealt with investments and was devoted only to ISA taking into account the existing problems in Mexico. This agreement is considered the parent of the ISA but the ground breaking agreement that actually led to ISA was the US and Canada Trade Agreement which came into force from 1988 as the agreement had an Investment Chapter in it (though no express provisions of ISA).

Stating the facts, till 2015 the European Union member states have signed some 1200 BITs with other states and, as a result of the tension between the central European states, there are 190 BITs between the members of EU as well, almost all of them containing Investment Chapters. This particularly shows that the investors don't want to take a chance and always want to be on the safe side when it comes to investment in other countries.

The International Energy Charter Treaty of 1994 was the next major step.[12] This particular treaty was a link to the countries of Western and Eastern Europe, the Caucasus and Central Asia. It led to an absolute multiplication of ISA litigation. According to the UNCTAD, the Energy Charter Treaty is one of the principal

[9]Dolzer&Schreuer at 17ff. UNCTAD World Investment Report 2014.

[10]*Ibid.*

[11]NAFTA, 11 December 1992, 32 ILM 289 at 605 (entered into force 1 January 1994).

[12]Armand de Mestral, Investor State Arbitration Between Developed Democratic Countries, CIGI ISA Paper Series, Paper 1, 6.

sources of global ISA litigation. It is also very important to note that most of the pending as well as decided Arbitrations claimed have been by the investors against the State. Energy Charter Treaty is the most invoked treaty for ISA standing with 19 cases against United States, 31 with Canada making it the most popular ISA invoked nation and 21 against Mexico.[13]

Again the debate remains intact, the increasing number of BITs and RTA investment chapters are being concluded between developed democracies as well which as a direct result, is placing the democracies in a very vulnerable and unexpected position of being sued by foreign investors. Also it should be noted that there was no objections raised against the ISA until the NAFTA agreement.

The American and Canadian negotiators considered it a prerequisite[14] to include ISA in NAFTA to ensure that Mexico doesn't violate the obligations of foreign investments but it came out as a surprise when first Canada and then United States were sued by the Investors under Part B of Chapter 11. Because of this fear of the contestation with the foreign investors some Parliamentarians and Governmental ministries in Germany and France have called for abandonment of ISA from the BITs. Many other states are also considering altering their current BITs. India after the recent arbitral award going against her has even come up with a new Model BIT in 2015.

3. Benefit That it Offers to The Investors

The crux of the need for International Investment laws was based on the basic sense of distrust that was shown by the investors in the law of execution of the Public Authority and the justice delivery system of the host nation.

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[13]Foreign Affairs Trade and Development Canada, "NAFTA– Chapter 11 – Investment: Cases filed against the Government of Canada; US Department of States, "Cases filed Against the United States of America" available at www.state.gov/s/1/c3741.htm.

[14]Guillermo Aguilar Alvarez & William W. Park, "The new face of Investment Arbitration: NAFTA Chapter 11" *Yale Journal of International Law*, 28:2, 365 at 348ff (2003).

Even the CIGI's ISA paper 8[15] that is listening to investors and others: Audi Alteram Partem and the Future of Investment Law by David Schneiderman[16] also raises this concern by stating

"Investments, once made, are subject to host state vicissitudes that are, it is feared, more likely to tilt in favor of local over foreign interest"

The researcher is very much on the same page as what has been contended above. The failure of the states in delivering justice to the investors and that too in time has been the biggest concern and has always been. This is not just restricted to the developing countries where the democracies is still evolving but is there even in the well-established and almost perfectly run democracies. [17] These democracies, because of their inability to provide a fair justice delivery to the investors and because of the ignorance of the public authority when it comes to taking into account the interest of the Investors, has led to the growth in the demand for an ISA.

The rule based International Investment Laws (IILs) [18] essentially offers to go one step ahead and break this barrier. It's the Investor State Dispute Resolution, basically the Investor State Arbitration (ISA) which acts as an alternative remedy offered to both the parties to effectively and with procedural fairness dispose of a particular claim which becomes an arduous task if the justice delivery system of the host nation is followed.

The ISA essentially offers both the parties a right to be heard and there is a minimal possibility of the proceedings being biased towards any of the two parties.

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[15]Armand de Mestral, Investor State Arbitration between Developed Democratic Countries, CIGI ISA Paper Series, Paper 8.

[16]David Schneiderman "Listening to Investors (and Others): Audi Alteram Partem and Future of Inter-national Investment Laws", Investor-State Arbitration Series, July 2016, CIGI Paper No. 8.

[7]Theorde H Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile* (Princeton University Press, 1974).

[8]*Id. at* 29.

There is also a threat of the legislation of the host country changing the investment and tax policies of the country arbitrarily after the investment is done by the Investor.[19] This can lead to huge upsets in the foreign market and also lead to heavy losses to the investors. This is solved by the ISA as the Investors always have an option of bringing a claim against the arbitrary nature of the host nation. For Investors as well as for fair Justice delivery System, ISA is a Boon. Though it is many times argued that most of the judgments or the arbitral awards tilt in the favour of the Investors from capital exporting states[20] and making not much of a difference as compared to the domestic public law and justice system of the host nation but this contention while humbly respecting the view cannot be paid much of an attention as the ISA offers both the parties the right to present their case and also the right to be heard properly. If after the hearing of the case and both the parties an arbitral award is given then the contention of that award being arbitrary should not arise. Though there can be certain amendments that the researcher think can make the present system much more foolproof and that can only happen by giving a right to appeal to the party against whom the arbitral award is given.

4. Appeal Against Award- Public Policy and India's Stand

Article V of the New York Convention which is predominant system of rules for International Arbitration lays down an exhaustive list of 7 conditions under which the recognition and enforcement of the award may be refused. This can essentially be done under 2 sub-sections[21]:

"1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party

[19] *Id. at* 31; World Bank, *The State in a Changing World*, World Development Report 1997, 41 (New York: Oxford University Press, 1997).

[20] *Supra* note 34, at 31.

[21] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Article V, New York, 1958.

furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country."

Article V 2(b), if we try to dig a little deeper, essentially means that if the state feels that the arbitral award if recognized or enforced will be contrary to the Public Policy of the State, then the appeal against the Arbitral award can be maintained and state can set aside such awards. Now Public Policy in itself has a very wide scope of interpretation as there is no such definition of Public Policy or being opposed to the Public Policy in the Indian Arbitration and Conciliation act. Also by giving this particular subsection the ambit of appeal against an arbitral award increases many folds. This essentially helps in submitting that there is a procedural fairness in Investor-State Arbitration and the problem of arbitrary conduct of the public authority and the legislature of the states is solved through ISA.

Though it should also be noted here that in the case of Renusagar Power Co. Ltd v. General Electric Co.,[22] the Supreme Court of India has held that

"...the expression 'Public Policy' has a wider meaning in the context of a domestic award as distinguished from a foreign award."

However Professor Paulsson before the introduction of Indian Arbitration Act raised concern about India's Stand in International law and International disputes with respect to Public Policy and said that:

"...the courts of India have revealed an alarming propensity to exercise authority in a manner contrary to the legitimate expectation of the international community"[23]

The Judgment given by the Supreme Court in the Renusagar Power Co. Ltd case[24] was completely in line with the International Practice

[22]Renusagar Power Co. Ltd v/s General Electric Co., 1994 (2) Arb.L.R.405 (S.C).
[23]J. Gaya, "Judicial ambush of arbitration in India", *Law Quarterly Review*, 571 (2004).
[24]*Id at* 35.

commonly accepted in most developed arbitral Jurisdiction such as France and the United States[25] and the Supreme Court made it very clear that:

"Applying the criteria it must be held that the enforcement of a foreign award would be refused on the ground that it is contrary to the public policy if the enforcement would be contrary to i) fundamental policy of Indian Law; or ii) the interests of India; or iii) justice or morality."

This decision on the face of it proved India's stand that it is only in exceptional circumstances, the national courts will interfere with arbitral awards given by the tribunal on grounds of public policy and also the exhaustive list of exceptional cases was also led down through the judgment.

But, the judgment given in the Renusagar case was completely ignored while giving the judgment in a 2003 case[26] by the Supreme Court and after that also there have been many judgments which have widened the scope of appeal on the basis of violation of Public Policy. The Supreme Court in the abovementioned case of Oil & Natural Gas Corp. v Saw Pipes[27] said that there is a need to give wider definition of grounds on which a particular award becomes contrary to the Public Policy. The case arose out of a dispute relating to supply of equipment for an off shore oil exploration. According to the ONGC, Saw Pipes were supposed to pay liquidated damages to them because of their non-compliance with the said terms of the contract in which timely delivery of the equipment was the essence. The matter was referred for arbitration and the tribunal held that the ONGC was unable to prove the damages suffered by it and hence cannot be awarded any arbitral award. This decision of the tribunal was challenged in the Supreme Court as violative of Public Policy. The Apex Court noted that according to law, ONGC was not at all

[25]Sameer Sattar, "Enforcement of Arbitral Awards and Public Policy". *TDM Journal*, 8(5) (2011).

[26]Oil & Natural Gas Corp. v. Saw Pipes, (2003) 5 SCC 705.

[27]*Ibid.*

required to prove that it has suffered certain loss to bring a claim for liquidated damages and if there has been a breach of contract, then the party will be entitled to damages. Hence the court set aside the arbitral award against ONGC and held that the award which is violative of the law of the country can be treated as an award contrary to the Public Policy. Also substantiating the judgment, SC also held that in addition to the three conditions laid down in Renusagar case,[28] an arbitration award can be nullified on the grounds of public policy if it is patently illegal. Explaining patently illegal SC held that an award is patently illegal if it is contrary to: i) substantive law, ii) the Indian Arbitration Act and/or iii) the terms of the contract. This also included any error of law committed by the arbitrators.[29]

The Supreme Court maintained this stand for a very long time though the decision and interference of India in International Arbitration has been criticized by many distinguished commentators for its wide interpretation of Public Policy defense.[30]

It has been contended by many commentators that the Indian Arbitration and Conciliation Act does not include the error in law as a ground for setting aside an arbitral award and hence there has been a mistake in the Interpretation of Public policy as a ground for setting aside an arbitral award.

Though the decision is in clear contravention of arbitration law and practice[31] but still public policy remains to be a salient weapon for appeal against the arbitral award. Essentially the reason for this is that public policy is highly subjective in nature and till the time an exhaustive list of Public Policy is not prepared and included in any convention, it can give ample ground for making an appeal against the arbitral awards.

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[28]*Supra* note 37.

[29]*Supra* note 40.

[30]S. Kachwaha, "Enforcement of Arbitration Awards in India", *Asian International*, 4 (2008).

[31]Mitsubishi case, (473 US at 638).

Also, in 2010, the Bombay High Court in Western Maharashtra Development Corporation Ltd. v Bajaj Auto Ltd[32] relied on the Judgment in ONGC case and set aside an arbitral award on the grounds of it being patently illegal. In the Judgment the HC stated that the arbitrators failed to apply the provisions of Indian Company law correctly and as a result the award became contrary to the substantive law which is violative of the Public Policy. This decision is also regarded as an undue court influence[33] under the guise of Public Policy.

5. CHANGING TRENDS IN INDIA AND THE MODEL BIT

Due to the developments in the International Investments and International Arbitration Market and the judgments given by the Apex court and the High Court, scholars started considering India a bad market for Investment and International Arbitration. These decision took India back to England's pre 1979 phase when the Courts could interfere and review the merits of an Arbitral Award or arbitral decision for that matter through a procedure thereby reflecting the country's image to bea bad-for-investment country.

India, soon realized that the concerns posed upon her were quite true and there was an absolute need to keep pace with its rapidly growing economy as well as the changing trend in the International market. Hence India decided to bring legislative amendments in order to make the system fool proof and to counter the problems created by the earlier decisions on an International level. Government of India launched a consultation paper in 2010 recommending certain changes to the Arbitration Act in order to minimize the issue of judicial intervention.[34] After certain changes were proposed, Indian Courts started showing due deference to arbitral awards. One of the best examples of the same being Penn Racquet Sports v Mayor

[32]Western Maharashtra Development Corporation Ltd. v Bajaj Auto Ltd., [2010] 154 ComCas 593 (Bom).

[33]*Ibid.*

[34]P Nair's "India at a gateway?", GAR Vol. 6(1), available at http://www.globalarbitrationreview.com/journal/article/28916/India-gateway.

International Ltd.[35] in which the High Court of Delhi held that the arbitral award given by the ICC was not contrary to the public policy. The Court went one step ahead and also held that the ground of public policy should be interpreted much narrowly when it comes to enforcement of a foreign arbitral award.

India till 2015, has signed 83 BITs[36] of which 74 are in force and also many free trade agreements which have investment chapters similar to the BITs (11 FTAs with chapters on Investment).[37] In the year 1994, India started its BIT program and had faced no such harsh arbitral award until 2010; in other words, BITs in India did not attract much of an attention[38] and also, there was almost zero involvement in Investor-State Arbitration in the year 2010, because of the evolution and changes suggested, saw a huge escalation in India's involvement with ITA (Investment Treaty Arbitration)[39] and 2011 was the year when India received its first adverse award in the case of White Industries Australia Limited v. Republic of India.[40] In this particular case the Australian Investors contending the Most Favored Nation clause of India-Australia BIT, argued for the importation of favorable substantive provision related to effective means of asserting claims and enforcing rights given in the India-Kuwait BIT into the India-Australia BIT. As explained in the Law Commission report MFN clauses can be understood with a simple example given in the law commission report:

"Let us assume three States: A (the granting State), B (the beneficiary State) and C (the third State). Further assume that States A and B have entered into a treaty containing the MFN clause. Now, if State A extends certain benefits to State C, State B can invoke the MFN clause in the treaty to ensure that State A extends the same benefits to

[35]Penn Racquet Sports v. Mayor International Ltd., 2011 (122) DRJ 117.

[36]Law Commission Report, *Report No. 260*, August 2015.

[37]Gaurav Banerji, GAR Investment Treaty Know how, India, 2015.

[38]*Supra* note 53.

[39]Prabhash Ranjan, "Can BIT claims be made Against India for the action of the Indian Judiciary?", *National Law University of Jodhpur Law Review*, 1, 87-92 (2013).

[40]UNCITRAL, Final Award (30 November 2011).

her provided the granted benefits to State C falls within the scope of application of the MFN clause of the treaty between A and B. MFN treatment in international investment law aims to create a level-playing field for all foreign investors by prohibiting Host State from discriminating between investors from different countries."

The MFN provision essentially in case of India and Australia is that "A contracting party shall at all times treat investments in its own territory on a basis no less favorable than that accorded to investments or investors of third country. Hence the tribunal allowed Australia to borrow a beneficiary substantive provision from another BIT into the primary BIT which did not have the same provision. After this particular case there has been a huge increase in the number of claims against India from various investors and under various BITs. These claims include challenges to regulatory measures such as cancellation of telecom licenses and retrospective tax imposition. According to the law commission report no. 260, there are fourteen known pending proceedings of claims brought against India. Hence, the question that now arises is whether there is a balance between India's regulatory powers and Investment protection and whether there is a need to make certain changes in its BIT program.[41]

The Government came up with a draft model in the year 2015 for Bilateral Investment Treaty,[42] with an aim to provide protection to the foreign Investors in India and Indian Investors in the foreign country, maintaining a balance between the investor's rights and the Government's obligations. Law commission studied the Model BIT and then came up with a report suggesting certain changes and also suggested the draft for all these sections. The Model BIT now does not contain the Most Favored Nation clause which actually will decrease the number of arbitral awards going against the nation and

[41] *Id.* at 55; Prabhash Ranjan, "India and Bilateral Investment Treaties- A changing Landscape", *ICSID Review*, 1-32 (2014).

[42] Bilateral Investment Treaty Model available at https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf.

will ensure that foreign Investors shall not be able to borrow provisions that strengthen their case from other BITs but does it solve the problem of imbalance between the foreign investors and the Government is still a question left unanswered. Also it is necessary to note here that Government of India has not given any explanation regarding the exclusion of the Most Favored Nation clause but as said above the only possible reason can be to limit the liability of the State. If this draft model is passed then again the foreign investors will be exposed to risk of discriminatory action of the state in application of domestic measures. The solution to this can be an MFN clause where there is a restriction to the treaty shopping or a clause that can limit the extremely wide ambit of the MFN clause.

6. CONCLUSION

The countries because of the globalization and huge capital flow are very much interdependent with each other and hence there is an utmost need to be in good relation with other countries so that they can sustain a symbiotic relation with each other. Through Investor-State Arbitration, not only the relation between the Investor and the host state ruins but the relation and the capital flow between two countries involved gets hampered as well. There are a lot of ways through which an Investor-State dispute can be resolved but mostly the parties choose to go for arbitration intentionally without paying much attention to the huge cost involved in the arbitral proceedings. It's high time that the Government of different countries to take initiatives, and to include in their BITs, certain clauses for alternative dispute settlement so that the relation of the nations involved does not get much affected. Also the BITs are prerequisite in any international investment and it is completely wrong to say that developing countries like India do not need a BIT. It works almost in the same way as a contract between two parties where certain set of rights and duties are laid down and the parties are required to follow and work in the ambit of these rights and duties. Investor-State Arbitration is a concept which is still in its evolving phase and recent developments in ISA show that it plays a pivotal role in every

investment chapter in a treaty. It also helps in finishing the disputes in a fast track manner. India as a country is still not very comfortable with its present draft model and there is a dire need of the hour to make a fool proof and a perfect draft model. The Most Favored Nation Clause removed from the new model can be considered a win-lose situation, win for the host nation and a loss to the foreign Investors, as again, an imbalance is produced between the power of the investor and the host nation and a threat of discriminatory action against the Investor still lies making India a country which is not very fit for making huge investments. Again there are certain amendments to the model suggested by the Law commission and hopefully India will come out one day as a better market for both local and foreign investors.

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