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JUDICIAL APPROACH IN APPLYING THE ARBITRATION AND CONCILIATION ACT, 1996 TO INVESTMENT DISPUTES

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Abstract

The Arbitration and Conciliation Act, 1996 is primarily based on the UNCITRAL Model Law on International Commercial Arbitration. However, the problem which arises is that commercial arbitration is not the only kind of arbitration that Indian Parties indulge in. India has entered into several International Investment Agreements (IIAs), in the form of multi-lateral or bilateral investment treaties, with different countries, which makes it essential for India to have a proper legal framework so that it can properly honour its treaty obligations. Policymakers were indifferent to the difference between commercial and investment arbitration because of which there is a complete lacuna in the existing statute to deal with investment disputes. There are stages when the national Courts of a country have an important role to play in assisting arbitrations but in the absence of specific laws to deal with the subject matter, there will always be inconsistency in giving decisions. This paper seeks to identify the existing challenges to investment arbitration in India by closely reviewing in detail the judicial stand pertaining to the same.

I. Introduction

Investors from one country (Home State) invest in another country (Host State) if there exists a multilateral or bilateral investment treaty that is signed by sovereign nations for the protection and promotion of investment in their respective

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territories. It can be said that the dispute resolution clause or the arbitration clause of such investment treaties is a standing offer to arbitrate which can be accepted by any foreign investor in case of non-protection of its investment as per the treaty standards. It is to be noted that commercial arbitrations form part of private law that solves disputes between citizens while investment arbitration is a hybrid law of international law that deals with disputes between a Host State and any private foreign investor.[1]

When a dispute arises between a foreign investor and the Host State, the foreign investor (or the Host State in very rare circumstances) can initiate arbitration against the other party if permitted under the relevant dispute settlement provisions in the subject BIT. Sometimes, Parties connected with the arbitration proceedings under a BIT approach the State Courts to seek a variety of reliefs, such as an anti-arbitration injunction, and enforcement of a BIT award amongst others. In Indian jurisprudence, a common debate while seeking anti-arbitration injunctions or lodging enforcement proceedings relates to whether the Arbitration and Conciliation Act, 1996 ["**Arbitration Act**"][2] would apply to such arbitrations. Courts in India have provided varied interpretations on this issue. While one faction argues that BIT arbitral awards would come under the ambit of foreign arbitral awards as defined under Part II of the Arbitration Act, the other faction refutes this argument by stating that the Arbitration Act applies only to commercial arbitrations, and BIT arbitration is not 'commercial arbitration' in the strict sense.

II. Ambit of "Commercial" Relationship

[1] 22 STEPHAN W. SCHILL, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Stephan W. Schill ed., Oxford University Press 2010).

[2] S. R. Subramanian, *BITs and Pieces in International Investment Law: Enforcement of Investment Treaty Arbitration Awards in the Non-ICSID States: The Case of India,* 14 THE JOURNAL OF WORLD INVESTMENT & TRADE 198 (2013).

The Arbitration Act defines the term "foreign award" in Sections 44 and 53. Interestingly, the definition restricts the applicability of the Arbitration Act to only *commercial relationships*. The issue is that the term *commercial* has not been defined in the Arbitration Act, however, some inference can be drawn from the UNCITRAL Model Law which does provide for a definition. Model Law states that:

"*The term 'commercial' should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.*"

To see whether this definition of commercial encompasses disputes arising from a BIT relationship, we need to analyse the set-up of investment arbitration. Investment arbitration arises out of a relationship between the State and an investor and is governed by Public International Law, which is quite different from a commercial set up. BITs are entered into by the States in their sovereign capacity and there is an obligation on the States to give due regard to the terms of the Treaty. However, the definition of the term 'investment' which finds it place in the India Model Bilateral Investment Promotion and Protection Agreement (BIPA) is in itself very broad. The Model Treaty defines 'investment' as: "*every kind of asset established or acquired and specifically includes "movable and immovable property as well as other rights such as mortgages, liens or pledges; (ii) shares in and stock and debentures of a company and any other similar forms of participation in a company; (iii) rights to money or to any performance under contract having a financial value; (iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party; (v) business concessions conferred by law or under*

contract, including concessions to search for and extract oil and other minerals." Considering this broad definition of 'investment', it might be possible to read it into the definition of 'commercial', given the absence of a clear and unambiguous interpretation of the Court. If investment awards can be squeezed into the ambit of commercial relationship and be seen to arise out of them, they can be construed as foreign awards under Section 44 and Section 53 of the Arbitration Act and thereby, the applicability of the Arbitration Act to investment arbitration proceedings can be justified to some extent.

III. Judicial Approach

A. *Board of Trustees of Port of Kolkata* v. *Loius Dreyfus Armaturs*[3]

This was the first time in India that a domestic Court had given its decision on a BIT claim. In this case, Louis Dreyfus Armaturs SAS, a French company, held 49% shareholding of Asia Private Limited (ALBA), an Indian company. Haldia Bulk Terminals (HBT) was given a contract by the Kolkata Port Trust (KPT) for the operation and management of certain berths in the Haldia Dock Complex. HBT was, in turn, a subsidiary of ALBA and therefore, the investment in the project was indirectly made by Dreyfus.

The contract between KPT and HBT had an arbitration clause for the settlement of disputes. Over the time, disputes arose between KPT and HBT and HBT invoked the arbitration clause in the contract and commenced proceedings against KPT (Commercial Arbitration). This arbitration was seated in India and was also being governed by Indian law. However, while the proceedings of the arbitration were pending, Dreyfus sent a notice of arbitration to the Union government, State of West Bengal and KPT under Art. 9 of the India-France BIT

[3] Board of Trustees of Port of Kolkata v. Loius Dreyfus Armaturs, 2014 SCC OnLine Cal 17695.

(Investment Arbitration). It was alleged by Dreyfus that the Union government, State of West Bengal and KPT have failed to accord full protection and security to HBT personnel and have deliberately tried to obstruct the working of the project in a normal and efficient manner, which has subsequently crippled the entire investment. Dreyfus had claimed the violation of certain substantive provisions of the BIT like failure to provide fair and equitable treatment, failure to give full protection and security and indirectly expropriating the investment. In response to this, KPT filed for an anti-arbitration injunction restraining Dreyfus from proceeding with the BIT arbitration.

KPT gave a two-pronged argument in requesting for an anti-arbitration injunction. Firstly, it stated that Dreyfus did not fulfil the criteria of a valid investor and that the scope of the present dispute is not covered under the BIT; Secondly, it stated that KPT cannot be a party to the investment arbitration proceedings because it is not a party to the arbitration clause in the BIT. It relied on the English case of *City of London* v. *Sancheti* [4], wherein it was stated that under certain circumstances States are made responsible for the action of its local authorities, but that does not make the local authority a party to the arbitration agreement. India can be held liable for the actions of KPT but KPT in no way can be made a party to the arbitration clause under the India-France BIT.

Dreyfus objected to the Court's jurisdiction in granting an anti-arbitration injunction on the grounds that as per Sec. 5 of the Arbitration and Conciliation Act, 1996, no judicial authority should intervene in the arbitration process except as provided by Part I. It stated that courts should adopt a non-interventionist approach and should avoid bringing the arbitration proceedings to a stand-still. The Act does not allow a civil Court to pass any anti-arbitration injunction. Therefore, it argued, that the arbitral

[4] City of London v. Sancheti, [2008] EWCA Civ 1238.

tribunal constituted under the BIT shall have exclusive jurisdiction to deal with matters pertaining to the scope and validity of the BIT.

After hearing both the sides, the Court decided that it had jurisdiction over the present dispute. Sec. 5 was considered to be a general provision and not a mandatory one which would remain applicable on both domestic and foreign seated arbitrations. It further relied upon Sec. 45 of the Arbitration Act to assume jurisdiction. However, it stated that issues relating to arbitrability and jurisdiction should be left for the arbitral tribunal and the supervisory foreign Courts to decide unless there are demonstrable facts that the continuance of foreign arbitration would cause grave injustice. In cases of injustice, domestic Courts will have the power to intervene and assume jurisdiction. Courts need to keep in mind that if there exists a valid arbitration agreement then the parties have to be referred to arbitration for the resolution of their disputes. Injunctions can be granted if the Court is satisfied that the arbitration agreement is null and void, inoperative or if the proceedings might be vexatious or oppressive.

Analysis

The Single Judge bench of the Calcutta High Court took a progressive step by giving out a pro-arbitration ruling. However, since it is a single judge decision, it may possibly undergo further interpretations. It acted as a protector of investment treaty arbitrations against attempts by state instrumentalities to sabotage the entire process under false pretexts. Crucially, it assumed that the Arbitration Act is applicable to investment treaty arbitrations as well. It used Section 45 to grant an injunction which is used for commercial arbitrations only. The injunction issued by the Calcutta High Court in favour of only KPT should not be regarded as an anti-arbitration injunction given by a domestic Court against BIT proceedings but rather shows its maturity

towards understanding international arbitration. It highlights that making India party to an investment arbitration is sufficient and state instrumentalities are not necessary to be included. This is also a welcome clarification as it helps both parties from undue financial burden. It had faith in the tribunal's power to decide on matters of jurisdiction and only ordered that a wrong party should not be made a respondent in the case.

B. *Union of India* v. *Vodafone Group Plc*[5]

The Hon'ble Supreme Court of India ruled in favour of Vodafone in its 2007 Hutch-Essar acquisition case and quashed the tax demands of the government.[6] The aftermath of this case resulted in the retrospective tax amendment by the Union government, which imposed a tax of Rs. 11,000 crores on Vodafone. This forced the Vodafone International Holdings BV to invoke the India-Netherland BIT in 2017 to challenge the retrospective tax amendment. Vodafone Group Plc initiated a second arbitration against India based on the India-United Kingdom (UK) BIT while the first arbitration under the India-Netherlands BIT was pending. A suit was filed by the Indian government before the Delhi High Court for grant of an anti-arbitration injunction against the second investment treaty arbitration initiated under the India-UK BIT. It was contended that the initiation of two separate treaty-based arbitration based on the same claim and in relation to the same subject matter, by entities which were a part of the same group of companies is an abuse of process and should not be allowed. An interim order was issued by the Delhi High Court where it stated that numerous arbitrations based on the same government action cannot be initiated under different investment treaties and curtailed Vodafone's action in respect to the second arbitration under the India-UK BIT.

[5] Union of India v. Vodafone Group Plc, 2018 SCC OnLine Del 8842.
[6] Vodafone International Holdings B.V. v. Union of India, (2012) 6 SCC 613.

Things, however, took a turn after that. After a while, the interim order restraining Vodafone from the second arbitration was vacated and the Delhi High Court applied the principle of *Kompetenz-Kompetenz* and directed the Parties to appoint an arbitral tribunal under the India-UK BIT for the final disposal of issues relating to abuse of process. The Court gave a very reasoned judgment because it was, in a way, overruling the previous judgment of Calcutta High Court.[7] It stated that the Arbitration Act will not apply in the present case because the dispute at hand is not a commercial one.

In addition to that, the court took the position that there is no absolute restraint on national Court's jurisdiction in investment treaty arbitration for non ICSID signatory countries like India. Art. 26 of the ICSID Convention completely negates the jurisdiction of national Courts but non-signatories are not bound by this and have the power to seek interference of Courts for deciding jurisdictional issues. In the current case, the investment was made in the territory of India, economic interests were held in India and even the business was carried out in India, and therefore, the Court will have jurisdiction *in personam*. It also differentiated between the nature of commercial and investment disputes. The former is based on private relationship between individuals while the latter relies on state assurances, which would be governed by international law and not domestic law.

It clarified that multiple claims in the same vertical chain are not per se an abuse of process and went on to state that even when national Courts have jurisdiction over BIT arbitration, they should exercise a reasonable amount of self-restraint while dealing with such cases and grant injunctions only under very '*compelling circumstances*', and only when the Court has been approached in good faith and when there is no alternative

[7] Board of Trustees of Port of Kolkata v. Loius Dreyfus Armaturs, 2014 SCC OnLine Cal 17695.

efficacious remedy available. Non-interference in BIT arbitrations is advisable because in the absence of a designated seat or curial law, the inherent powers of the Courts are unknown.

Analysis

Having placed its reliance in the widely acknowledged *Kompetenz-Kompetenz* principle, the Delhi High Court gave a pro-arbitration stand and harboured the way for all future BIT based arbitrations. It established the jurisdiction of national Courts in treaty-based arbitrations relying on Sec. 9 of the Civil Procedure Code instead of following the footsteps of Calcutta High Court in the *Board of Trustees* case. However, if we look at the jurisdictions of Singapore and UK, they have applied their domestic arbitration statutes in the cases of *Sanum Investments* v. *Laos*[8] and *Ecuador* v. *Occidental Exploration*[9] respectively in treating investment disputes. Therefore, the ambiguity in the applicability of the Arbitration Act on investment disputes still persists because of the absence of a solid legal principle for its interpretation.

C. *Union of India* v. *Khaitan Holdings (Mauritius) Limited*[10]

Khaitan Holdings (Mauritius) Limited was a Mauritian entity that had investments in an Indian entity called Loop Telecom (Loop). The Union government gave Loop a license of 21 Unified Access Services (UAS/2G License) in 2008. However, in respect of the corruption scandal surrounding the allotment of licenses in the 2G case, the Hon'ble Supreme Court cancelled the 2G license in the CPIL case in 2012.[11]

[8] Sanum Investments Ltd. v. Government of the Lao People's Democratic Republic, [2016] 5 SLR 536.
[9] Republic of Ecuador v. Occidental Exploration and Production Co., [2007] EWCA Civ 656.
[10] Union of India v. Khaitan Holdings (Mauritius) Limited, 2019 SCC OnLine Del 6755.
[11] Centre for Public Interest Litigation v. Union of India, (2015) 13 SCC 425.

Loop's request for the refund of license fees was denied by the Telecom Disputes Settlement and Appellate Tribunal (TDSAT). On account of such actions, Capital Global Ltd. and Kaif Investments, which held substantial interests in Loop, invoked Art. 8.1 of the India-Mauritius BIT and sent a notice to India for the settlement of disputes. In the year 2013, Khaitan Holdings merged with Kaif Investments and issued a notice of arbitration to India under Art. 8.2 of the India-Mauritius BIT. Khaitan Holdings claimed that since they have 26.95% equity in Loop, they are entitled for compensation for the cancellation of the 2G license. This was followed by the nomination of the arbitrators by both the Parties. However, issues arose on the nationality of Ishwari Khaitan and Kiran Khaitan, who were the beneficial owners of Khaitan Holdings and it was being contended that this was an abuse of treaty process since both of them are Indian citizens and cannot be taken as foreign investors for the purposes of BIT. They were even charged with criminal conspiracy for securing the license. Another façade was brought to light that alleged Khaitan for just being the front, and the real person behind it was the promoter of the Essar Group of Companies i.e., Ravikant Ruia. In December 2017, the Special Judge of CBI acquitted the accused of all charges. The Permanent Court of Arbitration (PCA) scheduled the first meeting on 28th January, 2019, however, the Union government on 27th January, 2019 filed various suits against Khaitan Holdings, Ishwari and Kiran Khaitan, Ravikant Ruia and Loop seeking reliefs, including a restraint on arbitral proceedings commenced under the BIT.

The Union government raised objections based on nationality of the foreign investor. Since, it was controlled by Indians, the criterion of valid investor was not satisfied under the India-Mauritius BIT. In reply to the government's contention, Khaitan Holdings pleaded before the Court that issues pertaining to a valid investor should be decided by the arbitral tribunal by interpreting

the BIT, and does not come within the jurisdiction of national Courts of India.

An issue that came to the surface for the first time was whether the actions of the judiciary, which is independent from the legislature and the executive, would constitute a treaty violation that can be attributable to the State as per the ILC Draft Code on the Responsibility of States for Internationally Wrongful Acts. The Court held that judiciary is indeed an organ of the State as per Art. 4 of the ILC Draft Code and its actions could constitute treaty violations that are attributable to the State.

It relied on the earlier Vodafone judgment[12] and stated that national Courts have jurisdiction in matters of investment treaty arbitration even if it was a separate specie of arbitration outside the purview of the Arbitration and Conciliation Act, 1996. In the said case, the Court assumed jurisdiction under Sec. 20 of the Civil Procedure Code which gives power to a Civil Court to have jurisdiction in matters where the defendant resides within the Court's local limits. As in this case, the investment was made in India by residents of India, it was well within the powers of the Court to deal with the matter. However, on the contrary, it also stated that BITs are a self-contained legislation and are majorly governed by international law, therefore, its applicability is not subject to adjudication under local laws. Therefore, interference by national Courts on issues of a valid investor as per the BIT would defeat the entire purpose of investment treaty arbitrations. The Court also referred to Art. 21 of UNCITRAL Rules which states that the arbitral tribunal shall have the power to rule on its own jurisdiction. To understand the view of the Court, it is pertinent to refer to the following lines stated by Justice Pratibha Singh:

[12] Union of India v. Vodafone Group Plc, 2018 SCC OnLine Del 8842.

"*The continuation of the arbitral proceedings under the BIT, at this stage, may per se not be contrary to public policy. It is a principle of public policy that the government has to honour its commitments including bilateral ones. The representations made by any State under either a bilateral or multilateral treaty is what holds the community of nations together. The adherence to treaties is therefore not just a contractual stipulation but a solemn commitment by a sovereign nation. Thus, the continuation of arbitral proceedings is the rule and not the exception.*"

The Court decided not to interfere with BIT proceedings and ruled that anti-arbitration injunctions should only be given in rare and compelling circumstances. The Courts have time and again showed that they do not intend on sabotaging BIT arbitrations.

Analysis

The Courts have comfortably started assuming jurisdiction in investment disputes, and therefore, it becomes important to point out that any Order made by them is not binding on the foreign arbitral tribunal. This raises questions regarding the applicability of conflict of laws rules and it consequently, also poses problems at the enforcement stage of arbitral awards. Investment treaty arbitrations have application of public international law while national courts must operate in the domain of municipal laws, therefore, the interplay between both these areas is fundamentally unclear. It is also elemental to observe that Courts have not used the Arbitration Act to assume jurisdiction but have rather relied on CPC for the same. So, the ambiguity in the applicability of the Arbitration Act still persists and this will give rise to impediments in the long run for the investment arbitration framework.

IV. Conclusion

The investment treaty arbitration scenario took a complete turn after the *White Industries* case[13] initiated under the India-Australia

[13] White Industries Australia Limited v. The Republic of India, Final Award, IIC 529 (2011).

BIT. It highlighted the existing loopholes and statutory lacunae in Indian law in relation to the BIT arbitration. India needs to comply with its obligations under IIAs by observing the principle of *pacta sunt servanda* as enumerated under Art. 26 of the Vienna Convention on the Law of Treaties, 1969. Art. 26 states that "*every treaty in force is binding upon the parties to it and must be performed by them in good faith*". Moreover, Art. 51 of the Indian Constitution provides that the State must respect international law and treaty obligations and encourage the settlement of disputes by arbitration. In spite of such obligations, India is not reciprocating as it should.

The progressive and non-interventionist approach of India is commendable in these cases because if India seeks foreign investment in its territory, it will have to relax its interference in disputes arising from the same. However, all the judgments given in respect to investment arbitration are only of different High Courts and no Supreme Court judgment has touched this issue because of which, no solid interpretation can be inferred. India is party to multiple bilateral investment treaties and therefore, it is necessary that it provides an exclusive legal framework for BIT arbitration where investors are able to enforce foreign arbitral awards without having to go through long drawn complex litigations. It is time that Indian policymakers understand the standing difference between commercial and investment arbitration. Their indifference is evident from the ministry reports on amendment of the Arbitration Act, which only talk about commercial awards and did not even once mention foreign investment awards. There is a dire need for legislative action in this sphere, either in form of a separate code or in the form of certain crucial amendments to the existing Arbitration Act for more clarity. Investors should approach the Indian Parliament and seek the amendment of the foreign award definitions given in Sections 44 and 53 of the Arbitration and Conciliation Act, 1996, and make them to expressly include investment arbitral

awards within the scope of foreign awards. Only when these necessary steps have been taken, can investor confidence be firmly established in the Indian legal system.