INVESTMENT TREATY ARBITRATION AND DEVELOPING COUNTRIES: WHAT NOW AND WHAT NEXT? IMPACT OF WHITE INDUSTRIES V. COAL INDIA AWARD

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For the first time in its long history of having signed more than 80 Bilateral Investment Treaties ("BITs"),[1] the Government of India has paid due to an arbitration award, brought by a private party, White Industries, of Australia, under the India-Australia BIT.

The ground for the award was that India did not comply with its obligation under the BIT to provide "effective means of asserting claims and enforcing rights" due to judicial delay of about eight years in respect of an arbitration award obtained by White Industries. The award was under challenge and an issue arising there from was under consideration of the Supreme Court of India.[2]

It is reported that the Government of India has agreed to "honour the award" and pay. It is, however, not known if the Government of India has appreciated the significance of the award nor if it is reviewing the existing BITs to ensure that there will not be repetition. In absence of transparency, everyone can only speculate.

However, careful analysis is required not only for its implications on other BITs but also for its effect on separation of powers provided for in our Constitutional polity. How far delays in courts could make the executive branch of the government responsible for its failure to provide "effective means to assert claims and enforce rights".

Although White Industries was the first case that gave a jolt to the Government of India, more jolts are on the way. After the Supreme Court cancelled 122 2G licences issued by the government,[3] private parties like *Telenor of Norway* and *Sistema of Russia*, relying upon the BITs that India has with their countries, have commenced or threatened to commence BIT arbitrations.[4]

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[1] *Available at:* http://finmin.nic.in/bipa/bipa_index.asp.

[2] The case was disposed of, as a part of a group of cases, by the Supreme Court in September 2012, along with the Bharat Aluminium case reported in (2012) 9 SCC 552.

[3] Centre for Public Interest Litigation v. UOI, (2012) 3 SCC 1, ¶ 60.

[4] *Available at:* http://rusembassy.in/index.php?option=com_content&view=article&id=5279%3Arussia-threatens-arbitration-on-2g-license-cancellation-for-

The effect is not just large economic loss. The effect is also political, and affects our political relations with not one but a circle of countries.

For example, in the *Sistema 2G* case, the Russian Embassy issued a statement on October 30, 2012 that stated that Russia is "very upset" about the Supreme Court decision on Sistema and that if the issue is not resolved, then it would have 'great repercussions' on Indo-Russian bilateral cooperation. Strong words, indeed.

This is ominous, as unlike some other cases, Sistema declined to apply for a fresh licence process. Sistema has sent a formal notice to Indian authorities, claiming that cancellation of the licence is contrary to India's obligation under the Indo-Russia BIT.

What are the lessons for India? There is little doubt that India needs Foreign Direct Investments ("FDI"). However, it should take decisions on FDI only after knowing its costs. Before we discuss the costs, it is useful to understand the background of how these BITs came about.

I. HISTORICAL BACKGROUND

The history of international investment law is a story of two competing objectives: one, protecting private property rights, and two, advancing social objectives. When, for example, a nation begins its economic development, it needs liberalisation in the sense that it follows the policies of welcoming FDI. A stage may be reached, when the State may conclude that the continuation of FDI is contrary to its social, economic or environmental objectives. The State may also conclude that it is essential in social interest, to exercise greater control over the investment than was being done so far. The State thereupon exercises its power in some way that affects the investment of the foreign investor for which the foreign investor does not get adequate compensation, which the foreign investor describes as expropriation.[5]

The classical way in which the international investment law dealt with this was that the countries providing FDI would require the countries to follow a

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sistema&catid=16%3Apress-on-bilateral-relations&lang=en.

[5] For a recent example, see the dispute between Chevron, a US company and Ecuador. There, Ecuador claims that Chevron's FDI led to serious environmental concerns and therefore it nationalised partly its subsidiary. Chevron claims compensation for nationalisation and Ecuador claim compensation for damages to environment; *Available at:* http://www.ft.com/cms/s/0/364e2f30-751d-11e2-8bc7-00144feabdc0.html#axzz2Pzm8zUC.

minimum standard of treatment.[6]

However, no "*minimum standard of treatment*" was universally accepted. Hence, the remedies ranged from either giving up the matter altogether (as for example, what happened to Coca Cola in India in 1977)[7] or topple the government by force (as happened in the case of Iran in 1952, when the Anglo-Persian Oil Co was nationalized).[8]

In 1980s, when many countries in the world accepted globalisation, the "*minimum standard of treatment*" began to be spelled out in the form of BITs and Free Trade Agreements ("FTAs").

In principle, the BITs and FTAs originally provide for investor rights, including, in particular, (a) a right to fair and equitable treatment and (b) a right to compensation upon expropriation and, (c) investor-State arbitration mechanism. The modern BITs often provide for greater protections, as will be discussed later in this article.

The objective of providing these rights is, generally speaking, two-fold: (a) to enable the developed countries to secure rights for their investors in markets offered by developing countries; and (b) to ensure that developing countries secure such rights of investors so as to attract necessary investment.

For developing countries, however, the dilemma is: they want foreign investments but wish to keep power to take decisions on how far in public interest the investments should be allowed to go; For developed countries, the dilemma is that they want markets for products and services, but do not want to be stopped in the middle because of perceived public interest.

In absence of a clear definition or acceptance of the concept of 'public interest', situations of conflict are bound to arise. For example, a country A may want to develop transport sector and for that purpose enters into a BIT with a country B. B's investors may make substantial investment and due to its modern management techniques may lead to near monopoly situation. The government of A may want to or need to regulate the expansion by claiming it to be in public interest. The foreign investor may disagree.

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[6] This concept is found in several investment agreements. It means that the host country will accord treatment to investments of foreign investors in accordance with the international norms.

[7] *Available at:*
http://www.nytimes.com/2006/08/07/business/worldbusiness/07cnd -soda.html?_r=0.

[8] *Available at:*
http://www.iranchamber.com/history/oil_nationalization/oil_nationalization.php.

The BITs are drawn up on the basis of these compromises. The situation stated in the previous paragraph can be imagined in advance and planned for by those writing the BIT.

However, there are innumerable situations in which this does not happen. For example, in February 2012, Indonesia passed a law requiring foreign mining companies to divest 51% of their holdings to an Indonesian partner after ten years. The government wants more money from mining of the rich deposits to build better infrastructure. Not everybody agreed. "The government regulation ... is impossible for foreign mining investors. It's impossible if in only 10 years after production they have to divest 51 percent of their stake in the mines," said the mining association's Abubakar. India's Adani Enterprises had also invested in mines in Indonesia. That soon after the news, the share value of Adani Enterprises fell by 9% shows the effect of such announcements.[9]

Another example: In May 2012, Argentina expropriated half of Spanish oil giant Repsols investment in YPF, leading to what is known as Shale wars. Argentina claimed that Repsols failed to keep its investment promises and instead funnelled profits out of the country through dividend payments. Repsols, which had 57% stake in the Argentianian subsidiary, found its 51% taken away by what it claimed was expropriation. Repsols demanded €8 bn (equal to around INR 4,800 crores) as compensation, while Argentina not only rejected the figure, but also claimed compensation for environmental damage.[10]

These conflicting versions would have to be resolved peacefully, for which the BITs or Regional Treaties (such as NAFTA) or Multilateral Treaties (such as ICSID or the proposed Trans-Pacific Partnership or TPP) provide for International investment arbitration. The question is whether this is a fair and just solution.

II. WHITE INDUSTRIES V. COAL INDIA BIT AWARD

In the *White Industries* case,[11] the brief facts were these: In 1989, White Industries Australia Ltd. entered into a contract with Coal India for supply of equipment to and development of a coal mine in India, which contained an ICC arbitration clause.

Disputes arose between the parties leading to, in 1999, arbitration in London.

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[9] *Available at:* http://www.mineweb.com/mineweb/content/en/mineweb-political-economy?oid=146885&sn=Detail.

[10] *Available at:,* http://www.forbes.com/sites/afontevecchia/2012/04/17/shale-gas-wars-on-argentinas- nationalization-of- repsol-ypf/.

[11] *Available at:* http://ilcurry.files.wordpress.com/2012/02/white-industries- award-ilcurry.pdf.

The arbitration led to an award in May 2002. The award was granted by a majority (the arbitrator appointed by Coal India, Mr. Justice B P Jeeven Reddy, dissented). On September 6, 2002, Coal India applied to Calcutta High Court for setting aside the award, in accordance with Section 34 of the Arbitration and Conciliation Act, 1996 ("the Act"), as it was entitled to do at the time in view of the law laid down by the Supreme Court of India in the *Bhatia International* case.[12]

On September 11, 2002, White Industries, not knowing about the petition before the Calcutta High Court, applied to the Delhi High Court for execution of the award as a decree in accordance with section 49 of the Act. White Industries then petitioned to the Supreme Court for transfer of the Calcutta case and also questioned the jurisdiction of the Calcutta High Court to examine the matter. As the matter made no progress until 2010, White Industries initiated BIT arbitration.

The BIT tribunal gave an award on November 30, 2011 in favour of White Industries, directing India to pay AU$4.08 mn to White Industries plus interest and costs.[13] Briefly, the findings of the Arbitral Tribunal were as follows:

- What White Industries had done under its contract with Coal India was 'investment' as defined in the India- Australia BIT.
- India had not failed to fulfil the legitimate expectations of White Industries of Indian judiciary in not entertaining the application of setting aside the international award made in favour of White Industries, as those expectations were not legitimate, because the Indian courts were regularly entertaining the issues arising out of its enactment pertaining to the New York Convention.[14]
- The Arbitral Tribunal also found that White Industries knew or ought to have known that the Indian courts are overburdened and therefore there was no 'denial of justice' or absence of 'fair play'.
- The India-Australia BIT contained the Most Favoured Nation clause ("MFN"). This meant that White Industries was entitled to the same treatment as other investors under other BITs.
- India was guilty of violating the India-Australia BIT because India did not provide "effective means of asserting claims and

[12] Bhatia International v. Bulk Traders, S A (2002) 4 SCC 105.

[13] *Available at:* http://ilcurry.files.wordpress.com/2012/02/white-industries- award-ilcurry.pdf.

[14] That was an error as, if the New York Convention applied, Part II, and not Part I of the 1996 Act would apply. The issue was whether Part I, in which s. 34 is situate, would apply because of Bhatia's case. Ultimately, White Industries won a pyrrhic victory, as court overruled Bhatia but applied it prospectively. Effectively, therefore, White Industries lost.

enforcing rights", which the slowness of Indian judicial system made it impossible to comply.

- To the argument of India that India made no such commitment in India-Australia BIT, the Arbitral Tribunal's answer was to find that standard of "effective means of asserting claims and enforcing rights" was found in India-Kuwait BIT in its MFN clause.[15] Since in one means MFN in all, it applied to the case in hand.
- For determining the meaning of "effective means" standard, the Arbitral Tribunal relied upon the controversial arbitral award of 27 August, 1993 of *Chevron-Texaco v. Ecuador*. There the standard laid down was that the State that agrees to provide such a standard "*requires that the host State establish proper system of laws and institutions and that those systems work effectively in any given case*."

This finding is extraordinarily damaging to India. The judiciary in India is completely independent and separate in India from the executive branch. The Constitution of India does not confer power on either the executive or legislative branches to direct the judiciary to "work effectively in any given case". It is difficult to believe that these facts were not known to the arbitral tribunal that consisted of three well-known arbitrators, all from common law jurisdictions and obviously familiar with India's Constitutional structure.

White Industries could not have complained that other similar cases were being given preference over its case. Each Contracting State shall provide effective means of asserting claims and enforcing rights with respect to investments and ensure to investors of the other Contracting State the right of access to its courts of justice, administrative tribunals and agencies and all other bodies exercising adjudicatory authority, accompanied with the right to employ persons of their choice, for the purpose of the assertion of claims and the enforcement of rights with respect to their investments.

In fact, the case of White Industries was awaiting trial as it was referred to a larger bench of the Supreme Court, was heard along with a similar case where the petitioner was Bharat Aluminium, and was decided on September 6, 2012 along with the case of Bharat Aluminium.[16]

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[15] Article 4(5) of the India-Kuwait BIT provides: "Each party shall … provide effective means of asserting claims and enforcing rights with regard to investments …". Each Contracting State shall maintain a favourable environment for investments in its territory by investors of the other Contracting State. Each Contracting State shall in accordance with its applicable laws and regulations provide effective means of MFN.

[16] *See,* Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc., (2012) 9 SCC 552. It was pleaded by both Bharat Aluminium and White Industries that Bhatia International had to be overruled. The court accepted the contention but applied it

As the Tribunal's ruling stands, the only solution appears to be that India should review the MFN provisions in its BITs and provide for exception in relation to the time taken by the courts.

There is another important point to be made. The Arbitral Tribunal held that all contractual rights, tangible or intangible are capable of being expropriated.[17] More importantly, in its view, the tribunal held that the foreign arbitral award itself is capable of being expropriated. There are cases that both support and oppose this statement of principle.[18]

It is true that the Tribunal refused White's plea that India had violated any of contractual rights and also that the award was expropriated as the case was pending in the court, nevertheless, these are warning signs for the government to take appropriate action to review other BITs.

It is regrettable that instead of challenging the award and publicly examining the potential effects of the findings of the Tribunal, the government of India is reported to have accepted the award and agreed to pay according to its terms. The effect on other investors is that they are emboldened to make similar claims of far larger amounts. Public Citizen, a US blog, in a somewhat but not materially different context said that the dispute resolution system in such BITs "exposes signatory countries to vast liabilities, as foreign firms use foreign tribunals to raid public treasuries"[19]

An open letter signed by former judges, law professors and prominent lawyers warns: "The foreign investor protections included in some … BITs, and their enforcement through Investor-State arbitration… threaten to undermine the justice systems in our various countries and fundamentally shift the balance of power between investors, states and other affected parties in a manner that undermines fair resolution of legal disputes".[20]

The final words of these former judges, law professors and prominent lawyers were:

"WE THEREFORE CALL UPON all governments engaged in the TPP

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prospectively to agreements entered into on or after September 6, 2012, thereby effectively rejecting the White Industries case that the foreign award could not be set aside under Part I.

[17] The Award, ¶¶ 12.3.1 - 12.3.2.

[18] For one view, see Saipem S p A v. Bangladesh, ICSID Case no. ARB/05/07, (March 21, 2007) and for an opposite view see GEA Group Aktiengesellschaft v. Ukraine, ICSID Case no. ARB/08/16, (March 31, 2011).

[19] *Available at:* http://www.citizen.org/documents/Leaked-TPP-Investment-Analysis.pdf.

[20] *Available at:* http://tpplegal.wordpress.com/open-letter/.

> negotiations to follow Australia's example by rejecting the investor-state dispute mechanism and reasserting the integrity of our domestic legal processes."

It is ironical that India's first experience of BIT, in which an Australian company won, was Australia's last.