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BIT arbitration awards: Enforcement regime in India

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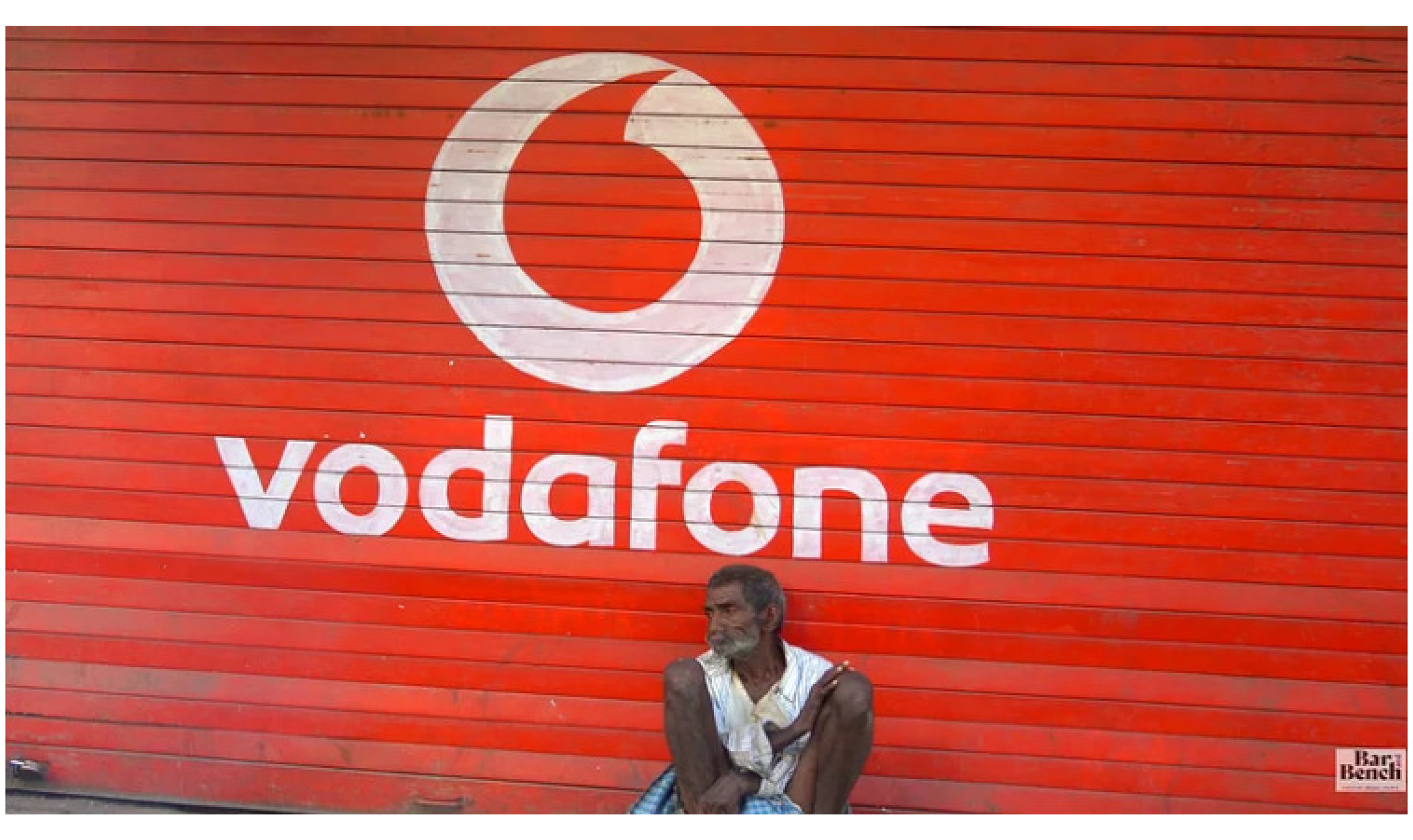

Vodafone

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On September 25, 2020, the Permanent Court of Arbitration at the Hague ruled in favour of Vodafone in its claim against the Government of India challenging its demand of capital gains tax on the basis of a retrospective amendment of the *Income Tax Act, 1961.*

The Tribunal held that the Indian government seeking ₹22,100 crore in taxes from Vodafone, notwithstanding the decision of the Supreme Court discharging Vodafone from this tax liability, using retrospective legislation, was in "breach of the guarantee of fair and equitable treatment" provided under the India-Netherlands BIT. The Tribunal also directed the Indian government to pay Vodafone approximately ₹40 crore towards partial compensation for legal costs.

The reasoning and analysis of the Tribunal's decision on the breach of the 'fair and equitable treatment' (FET) obligation remains unknown, as the award order is not available in the public domain.

However, FET clauses are aimed at protecting investors against serious instances of arbitrary, discriminatory or abusive conduct by host States. The Vodafone award raises interesting questions on the impact of a ruling of an international tribunal on the legislative measures of a host State, and the scope of FET obligations in the context of taxation law, which can only be answered if the award is made available to the public.

Whether the dispute arising from enforcement of tax law be covered under a BIT

It has been widely argued and debated whether the Permanent Court of Arbitration had jurisdiction over the tax dispute under the India-Netherlands BIT. The operative part of the award seems to have concluded that indeed it has the jurisdiction. As the text of the award is not available, it would be mere conjecture to argue whether or not the rationale behind this decision is legitimate and fair. The government may raise the jurisdiction issue before the seat court in Singapore.

It is important to note that tax laws have always been considered to be the sovereign right of a country, regardless of its commitment to meet treaty obligations. The issue here appears to be the change in tax law after the highest court of the country has decided how to interpret the previously existing tax laws. Therefore, whether the sovereign right of a nation extends to overturning a legitimate outcome of the prescribed judicial process in a country remains an issue.

As there are several of these tax cases under BIT arbitration, there is a genuine concern for the government to avoid an unfavourable precedent. India's Model BIT was therefore revised in 2016 to meet the dual objectives of balancing investment protection with host State's right to regulate and reduce the scope of discretion by arbitral tribunals while interpreting the terms of such a treaty. The Model BIT excludes certain regulatory measures from its scope. The decision to exclude any laws or measures regarding taxation from the ambit of future BITs that India proposes to sign is evidently in response to the issues raised by Vodafone against retrospective application of taxation law.

The need of the hour is striking the balance between upholding India's reputation to abide by its international commitments as against its ability to change tax laws to meet its economic requirements, especially in times when India needs to be seen as a preferred destination for foreign investments.

Nevertheless, the Vodafone saga is far from over, unless the government decides to honour the award. As mentioned above, the government has the option to challenge the award by initiating proceedings at the seat court in Singapore. Even if the challenge is dismissed, the next major hurdle for Vodafone may potentially be enforcement of this award in India. In the forthcoming sections, we analyse the prevailing uncertainty in the enforcement regime for BIT arbitration awards in the country.

Issues besieging enforcement of BIT arbitration awards in India

India is not a signatory to the International Centre for Settlement of Investment Disputes (ICSID) Convention. Therefore, it does not have an obligation to recognise and enforce BIT awards as if they were final judgments of local courts. In such a situation, the regime for enforcement of BIT awards in India remains nebulous.

The question of applicability of the *Arbitration and Conciliation Act, 1996* (Act) to arbitrations initiated under BITs is a predominant cause of concern. Conflicting views have emerged from different High Courts on this issue.

In a case dealing with grant of an anti-arbitration injunction preventing the claimant from continuing proceedings before an investment arbitral tribunal constituted under the India-France BIT, the Calcutta High Court proceeded on the assumption that it had the jurisdiction to intervene under Section 45 of the Act.

On the other hand, in two cases before the Delhi High Court, also dealing with grant of anti-arbitration injunctions, applicability of the Act to investment treaty arbitrations has been expressly excluded. The rationale of the Court for excluding the applicability of Part 2 of the Act was the commercial reservation adopted in the definition of a 'foreign award' in Section 44. The Delhi High Court observed that,

"Investment Arbitration disputes are fundamentally different from commercial disputes as the cause of action (whether contractual or not) is grounded on State guarantees and assurances (and are not commercial in nature). The roots of Investment Arbitrations are in public international law, obligations of State and administrative law."

These decisions may have a direct impact on the issue of enforcement of BIT awards under the Act.

Further, a BIT award cannot be treated as a 'foreign decree or judgment' for the purposes of execution in India under Section 44A of the Code of the Civil Procedure, 1908 (CPC), since it is neither a 'judgment', nor has it been delivered by a 'Court' as defined in the CPC. Therefore, if the decisions of the Delhi High Court are followed strictly, award holders in investment treaty arbitrations may only be able to recover the award amount by filing a fresh suit. In such a situation, the arbitral award may only have evidentiary value, defeating the very purpose of speedy resolution of investment treaty disputes by arbitration.

Having said that, the rulings of the Delhi High Court are in conflict with the international position where an investment treaty arbitration qualifies as 'commercial' for New York Convention purposes. To add to the perplexity, courts in India in several cases have emphasised that the term 'commercial' must be given a wide import. Even Article 27.5 of the 2016 Model BIT provides that a claim submitted to arbitration under the BIT shall be considered to arise out of a commercial relationship or transaction for the purposes of Article I of the New York Convention. T

he customary international law principle of *pacta sunt servanda,* as codified in Article 26 of the Vienna Convention on the Law of Treaties (VCLT) has also received recognition in international investment law (albeit with exceptions) so that parties do not act in a way that would defeat the objectives of the treaties they conclude. It may also be relevant to point out that the Delhi High Court in the case of *Union of India v. Vodafone Group PLC United Kingdom & Anr.* has held that bilateral investment treaties ought to be interpreted by invoking the principles of customary international law and VCLT, such that due protection is afforded to the investors. The Delhi High Court relied upon the judgments of the Supreme Court and Delhi High Court, to conclude that although India is not a signatory to the VCLT, principles thereof provide broad guidelines as to the interpretation of a treaty in the Indian context.

In the judgment of *Union of India v. Khaitan Holdings (Mauritius) Ltd.,* the Court has held that it is a principle of public policy that the government has to honour its commitments under a treaty. In *People's Union for Civil Liberties v. Union of India* and *Vellore Citizens' Welfare Forum v. Union of India*, the Supreme Court has also opined that customary international law, if not contrary, shall be deemed to be incorporated in the domestic law.

While the Court in Vodafone (Supra) and Khaitan Holdings (Supra) did not consider enforcement of such an award, the observations made therein may be relied upon to counter arguments resisting enforcement. Therefore, when the question arises, it may be hoped that the courts will hold BIT awards to be enforceable in India under the New York Convention

Conclusion

India was the ninth largest recipient of Foreign Direct Investment (FDI) in 2019. An abundance of natural resources, human capital, infrastructure, technology and practicing democracy indeed makes India an attractive destination for foreign investment. Needless to say, an effective dispute resolution mechanism is key for promoting 'ease of doing business' in the country. The issue of enforcement of a BIT award has not reached Indian Courts yet, however, the mechanism for enforcement cannot be left ambiguous and unattended.

In view of the recent Vodafone decision, and the line of pending investment treaty cases against India, a reformed and a more balanced legal regime for BIT arbitral awards will aid in swift resolution of disputes. The enforcement regime will benefit greatly either if India accedes to the ICSID Convention or brings in amendments to the extant domestic laws to explicitly include investment arbitral awards within the scope of India's commercial relationship reservation to the New York Convention. Further, a liberal approach towards the timelines and pre-conditions for access to the ISDS mechanism under the 2016 Model BIT will help with inspiring investor confidence.

These reforms, if and when brought about, will be in line with the other initiatives of the government to accelerate the growth of an economy reeling from the massive setback induced by the COVID-19 pandemic.

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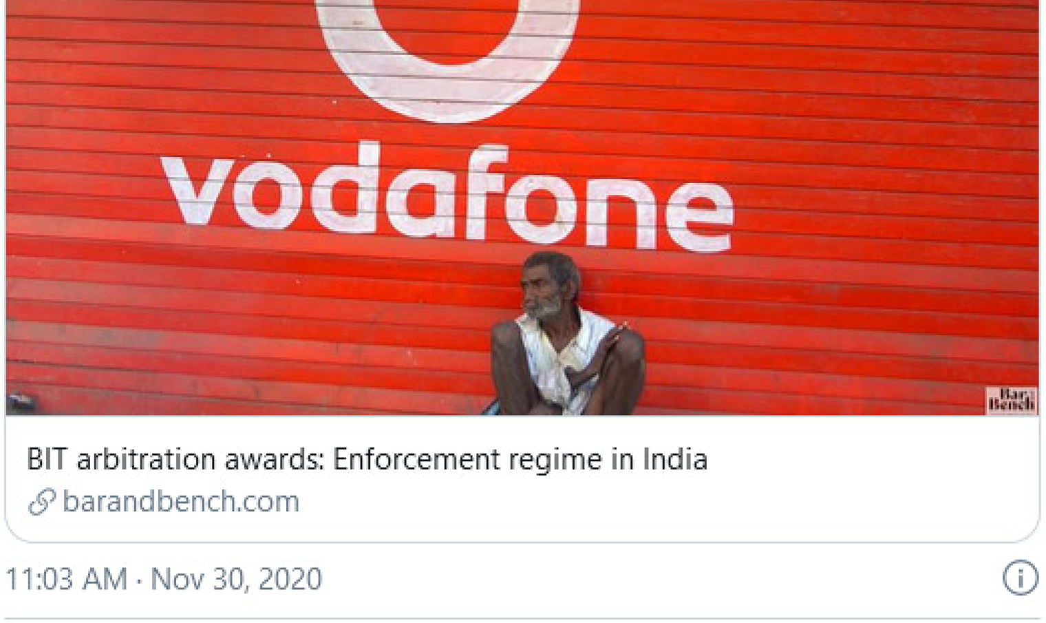

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