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SETTLEMENT OF INVESTMENT DISPUTES BETWEEN INVESTER AND STATE - UNDER THE AUSPICES OF ICSID CONVENTION

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Introduction

Nations around the world are in competition to attract foreign investments, more particularly the developing countries in the world. In developing countries, the major infrastructure projects and exploitation of natural resources are often based on foreign investment. In order to create favorable climate for foreign investment, States enter into Bilateral Investment Treaties or "BITs" with each other[1]. Further, to facilitate the ongoing development through foreign investment, there has been considerable growth of international organizations, international Conventions and treaties for providing a legal framework for investment and settlement of investment disputes[2].

According to the law of treaties, every treaty in force is binding upon the parties to it and must be performed by them in good faith[3]. Most of the treaties contain an agreement on the part of the States concerned to arbitrate any dispute between the host State and Investors of another State. In BITs, the State makes a standing offer to arbitrate any dispute that might arise in the future but in some treaties, before submitting the dispute to arbitration, there may be some pre-conditions for arbitration to be fulfilled. In order to facilitate the dispute settlement, the representatives from developing countries began to participate more actively in international arbitral institutions such as International Chamber of Commerce (ICC), The International Centre for Settlement of Investment Disputes (ICSID), London Court of International Arbitration (LCIA) and formulation of new procedural rules such as

1. The ICSID data base collects the information from the Governments on BITs entered by them. The number of BITs entered by some of countries are as follows; United Kingdom (102), France (103), United States of America (48), Egypt (91), Czech Republic (79), Sweedon (66), Italy (83), Malaysia (67), Turkey (73) and Netherlands (105). For more information, www.icsid.worldbank.org/icsid/Front_Servelet.

2. For example, North American Free Trade Agreement NAFTA, Energy Charter Treaty. NAFTA was entered into in 1993 by the United States, Canada and Mexico. The Energy Charter Treaty was entered into in 1994 by 49 countries from Eastern, Central and Eastern Europe, Japan and Australia.

3. Article 26 of the Vienna Convention of the Law of Treaties, 1969.

those of the United Nations Commission on International Trade Law (UNCITRAL)[4].

The BITs and Investment Laws of States contain the provision of advance consent for settlement of disputes under the auspices of International Centre for Settlement of Investment Disputes (ICSID)[5]. The arbitration provision in BIT is referred as "Investor-State Arbitration". As on November 10, 2011, one hundred and fifty seven (157) States have signed, of these 147 States have also deposited their instruments of ratification, acceptance or approval of the Convention on the Settlement of Investment Disputes between States and investors of other States[6]. The ICSID Convention is designed to facilitate the settlement of investment disputes between States and nationals of other States. It is not meant for disputes between States and their own nationals[7]. The ICSID was established *inter alia*, to promote a climate of mutual confidence between States and investors that would be conducive to an increasing flow of resources to developing countries[8].

Object of Paper

In the light of dramatic increase in the number of BITs and the emergence of clearer legal principles through case law, the number of investor-State arbitrations has mushroomed[9]. The list of cases pending before ICSID are one hundred thirty seven (137) and it has concluded two hundred and twenty eight (228) as on November 10, 2011[10]. The ICSID Convention has not provided any definition for "legal dispute" or "investment", therefore, in many cases the question for consideration before ICSID is that whether there is a legal dispute between the parties, the investor's assets qualify as "investment" under the BIT. In the light of these developments highlighted the salient features of ICSID Convention, which is exclusively meant for settlement of investment disputes through conciliation and arbitration. The paper is also attempted to present the most controversial areas of dispute in ICSID Convention, with a focus on interpretation of BITs, investment disputes under national investment laws, conditions to be fulfilled for arbitration in ICSID.

International Centre for Settlement of Investment Disputes (ICSID)

International Centre for Settlement of Investment Disputes (ICSID) is an institute of World Bank Group, established by the Washington Convention of 1965[11], in pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, 1965. The ICSID was created as an impartial international forum providing facilities for the resolution of legal disputes through conciliation or arbitration procedure. Following are the salient features of ICSID with regard to arbitration:

1. Object of ICSID is to promote a climate of mutual confidence between States and investors that would be conducive to an increasing flow of resources to developing countries.
2. The services of ICSID are available only for arbitrations concerning investment disputes between States parties to the ICSID Convention and nationals of another contracting party.

4. William W. Park, Page 326.
5. Including NAFTA -A disputing investor may submit the claim to arbitration under the ICSID Convention, or the UNCITRAL Arbitration Rules, Article 1120.1); The Energy Charter Treaty if the investor opts to submit the dispute to arbitration, the investor than has the further choice between an arbitration under the rules of ICSID or UNCITRAL or the Arbitration Institute of the Stockholm Chamber of Commerce, Article 26(3)(a).
6. http://www.worldbank.org/icsid.
7. Christoph H. Schreuer, *The ICSID Convention; A Commentary* 290 (2001).
8. http://icsid.worldbank.org/ICSID.
9. Michael Reisman, Page 240.
10. Alan Redfern and Martin Hunter, page 565.
11. March 18, 1965, 575 U.N.T.S. 159.

3. The ICSID Additional Facility Rules, 1978 authorizes the ICSID Secretariat to administer certain types proceedings between States and foreign nationals which fall outside the scope of the Convention.

4. The ICSID provisions contain rules relating to jurisdiction of the Centre, composition of the tribunal, the proceedings, the tribunal's powers to grant interim relief and substantive rules of law;

5. The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State and a national of another contracting State which the parties have given their consent and no party may withdraw its consent unilaterally[12];

6. ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries;

7. Recourse to ICSID conciliation and arbitration is entirely voluntary; Parties once consented for arbitration under ICSID, not allowed to withdraw unilaterally;

8. The mere ratification of the ICSID Convention is not in itself consent to arbitration by a State. The jurisdiction of ICSID arises when the parties concerned to the dispute gives consent in writing to submit the dispute to the Centre.

9. The necessary consent may be contained in an arbitration agreement concluded between the State and the investor within the framework of the investment contracts or after the dispute has arisen.

10. The State in practice often declares its consent to ICSID arbitration in its investment legislation or in BITs. This is considered as an standing offer by the State to arbitrate, this may be accepted by the investor at any time, including after the dispute has arisen by filing a request for arbitration;

11. The ICSID arbitration proceedings are governed by ICSID Convention and the ICSID Arbitration Rules in force at the time of the parties consent to arbitration[13]. The ICSID maintains a panel of arbitrators and conciliators. When the Secretary-General of ICSID appointing arbitrators he is under obligation to select the arbitrators from the members of the list.

12. Under the ICSID Convention, the award of an arbitration tribunal is final and binding on the parties[14]. The award is not subject to review by any national Court[15]. However, on certain grounds on which a party may seek annulment of an award[16];

13. It is obligatory for all ICSID contracting States to recognize and enforce ICSID arbitral award, whether they are parties to the dispute or not. The ICSID award cannot be submitted to the scrutiny of national Courts for annulment or enforcement. ICSID rules provide that no State can invoke its sovereign immunity in order to challenge the jurisdiction of the tribunal.

14. The parties by inserting a clause in their agreement may agree that an ICSID arbitration can only be brought after the means of recourse against a decision available under national law

12. Article 25 ICSID.

13. Article 44 of ICSID Convention.

14. Article 53.

15. Article 52.

16. Article 52(1).

have been exhausted. Further, either party may request annulment of the award by an application in writing on any of the grounds recognized under Article 52(1) of ICSID.

15. According to provisions of ICSID, investment disputes fall within the ambit of the ICSID Convention if the following conditions are fulfilled: (a) If there is a legal dispute; (b) the parties must have agreed to submit their dispute to ICSID; (c) the dispute must be between a Contracting State or its sub-divisions and a foreign investor from another Contracting State; and (d) it must arise out of direct investment.

Dispute must be related to "investment" and a dispute must be between a Contracting State and a national of another Contracting State:

The jurisdiction of ICSID is extended to any legal dispute arising out of "investment". In respect of parties to the dispute, Article 25(1) of the Convention requires, for the tribunal's jurisdiction, that the dispute be between a Contracting State and a national of another Contracting State. However, the ICSID may have jurisdiction over the dispute if the parties agree that "because of foreign control" the entity in question "should be treated as a national of another Contracting State for the purpose of this Convention[17]. If the investor is a natural person, the Convention requires him to fulfil the following jurisdictional requirements:

- He must be a national of a Contracting State other than the Host State both on the date of consent and on the date of the registration of the request for conciliation or arbitration; and
- He may not on either of these two dates also have the nationality of the Host State;
- If the private party is a juridical person, it must have the nationality of a Contracting State other than the Host State on the date of consent;
- If the investor is a juridical person and on the date of consent has the nationality of the Host State, ICSID may have jurisdiction if the parties agree that because of foreign control the entity in question should be treated as a national of another Contracting State for the purpose of the Convention[18].

In *Liberian Eastern Timber Corporation (LETCO) v. Liberia*[19] the Liberia is a party to the ICSID Convention and LETCO is a company incorporated and registered within the Republic of Liberia but it has provided the evidence that there was a French control at the time the Concession Agreement was signed between LETCO and State of Liberia. Therefore, on this basis LETCO argued that it must be treated as a national of another State. The tribunal concluded that it has jurisdiction over the dispute within Article 25 of the Convention.

In *Tecnicas Medioambientales Tecmed Sa v. The United Mexican States*[20], the tribunal made a distinction between application of a BIT to investments made prior to the BIT coming into effect and its application to alleged breaches which occurred prior to such date. The tribunal held that whilst the concerned investment was eligible for protection under the BIT, the BIT could not have retrospective application to Host State actions prior to the effective date of the BIT.

In *Fedax NV v. The Republic of Venezuela*[21], the arbitral tribunal held that promissory notes

17. Article 25(2)(b) of ICSID.

18. Article 25(2)(b) of ICSID

19. 13 Yearbook of Commercial Arbitration, 37-41 (1988).

20. ICSID Case No.ARB(AF)/00/02, Award 29th May 2003, (2004) 43 I.L.M. 133.

21. ICSID Case No.ARB/96/3, July 11, 1997, 5 ICSID Reports 186.

issued by Venezuela, and acquired by the claimant from the original holder in the secondary market by way of endorsement, were "investment" under the Netherlands-Venezuela BIT.

In *Ceskoslovenska Obchodni Banka AS v. The Slovak Republic*[22], tribunal held that a loan may constitute an "investment" if it contributes substantially to the economic development of a State. In *Lanco International Inc. v. Argentina*[23].

In *American Manufacturing & Trading Inc v. Republic of Zaire*[24], the jurisdiction of the ICSID tribunal was challenged by the Republic of Zaire on the ground that AMT, a US company, had not made any direct investment in Zaire and could not rely on the US-Zaire BIT. The Republic of Zaire argued that AMT had merely participated in the share capital of a Zairian company. The arbitral tribunal held that investment through share capital of a local entity was eligible for protection under the BIT.

In *Saipem SPA v. The Republic of Bangladesh*[25], Saipem is a company incorporated under the laws of Italy, entered into a contract with Petrobangla[26], to build a pipeline to carry condensate and gas in Bangladesh. The present proceedings before ICSID were brought by Saipem on the basis of the "Agreement between the Government of the Republic of Italy and the Government of the People's Republic of Bangladesh on the Promotion and Protection of Investments" of 20th March 1990. The Claimant requested the tribunal to declare that Bangladesh has expropriated Claimant of its investment without paying compensation and it has breached its international obligations under the BIT. The Bangladesh objected the jurisdiction of the tribunal, contented that there is no real legal dispute between the parties and Saipem has not made an investment with Article 1(1) of the BIT.

In order to determine whether Saipem has made an investment within the meaning of Article 25 of the ICSID Convention, tribunal has applied the well-known criteria developed by ICSID in many cases[27], which is known as "Salini Test" according to such test, the notion of investment implies the presence of the following elements: (a) a contribution of money or other assets of economic value; (b) a certain duration; (c) an element of risk, and (d) a contribution to the Host State's development. The respondent Bangladesh has not disputed the fact that Saipem made a significant contribution in terms of both technical and human resources. Therefore, the tribunal held that the present dispute is within the jurisdiction of the Centre and the competence of the tribunal.

In *Tokios Tokeles v. Ukraine*[28], the claimant, Tokios Tokeles, is a business enterprise established under the laws of Lithuania. Tokios has created Taki spravy, a wholly owned subsidiary established under the laws of Ukraine. The claimant alleged that Governmental authorities in Ukraine engaged in a series of actions with respect to Taki spravy that breach the obligations of the BIT between Ukraine and Lithuania (Ukraine-Lithuania BIT). The claimant initiated proceeding with ICSID along with its wholly owned subsidiary, Taki spravy. The respondent argued that the Claimant is not a "genuine entity" of Lithuania first because it is owned and controlled predominantly

22. ICSID Case No.ARB/97/4, May 24, 1999, 14 ICSID Review.
23. Preliminary Decision on Jurisdiction, December 8, 1998, (2001) 40 ILM 457.
24. Award, February 21, 1997, 5 ICSID Reports 10.
25. ICSID Case No.ARB/05/07.
26. Bangladesh Oil Gas and Mineral Corporation, a State entity.
27. *Salini Construttori S.P.A. and Italstrade S.P.A. v. Kindgom of Morocco*, ICSID Case No.ARB/00/4. This test was followed in *L.E.S.I.-Dipenta v. Algeria*, Award of 10 January 2005; *Impregilo v. Pakistan*, ICSID Case No.ARB/03/3; *Bayindir v. Pakistan*, Decision on jurisdiction on 14 November 2005; *Jan de Nul N.V. v. Egypt*, Decision on jurisdiction 16 June 2006.
28. ICSID Case No.ARB/02/18.

by Ukrainian nationals. The respondent argued that the Tribunal should pierce the corporate veil of the Claimant because allowing an enterprise that is established in Lithuania but owned and controlled predominantly by Ukrainians. The tribunal referred the *Oppenheinm's International Law*[29], where it is usual to attribute a corporation to the State under the laws of which it has been incorporated and to which it owes its legal existence. Therefore, the tribunal concluded that the Claimant in this case is an "investor" of Lithuania under Article 1(2)(b) of the BIT and a "national of another Contracting State", under Article 25 of the Convention.

Arbitration under Bilateral Investment Treaties

In a commercial arbitration, the source of the consent is the arbitration clause in contract whereas in investment arbitration, the consent of the State is traced in a treaty concluded with one or more States. Bilateral Investment Treaties (BITs) may contain the substantive rules and also dispute resolution provisions. In some BITs, all types of disputes be settled through arbitration, others may cover only certain types investments and some times exhaustion of local remedies is made a prerequisite for the right to arbitration. BITs may also provide provision for negotiations, conciliation and arbitration as a final remedy for settlement of disputes. There are many cases filed by the foreign investors by relying on BITs, some of them have been discussed in following paragraphs.

In *Ceskoslovenska Obchodni Banka AS v. The Slovak Republic*[30], the relevant treaty had never entered into force but the parties had provided in their agreement that it should be governed by the treaty. The tribunal held that it is sufficient to establish its jurisdiction as the parties had made the article part of their contract.

In *Vivendi Universal v. Argentine Republic*[31], the French investor had entered into a concession contract with Tucuman, a province of Argentina. The contract did not make any reference to the BIT between Argentina and France. It provided that disputes relating to the interpretation and application of the contract should be submitted to the exclusive jurisdiction of the administrative Courts in Tucuman. Vivendi started ICSID proceedings against the Republic of Argentina, which had neither been a party to the concession nor participated in the negotiations. Vivendi argued that the actions of the Tucuman authorities constituted a breach by Argentina of the provisions in the relevant BIT, according to which investors are guaranteed fair and equitable treatment and prohibited expropriation. Therefore, its claims against Argentina were covered by Article 8 of BIT providing for ICSID arbitration. The arbitral tribunal assuming jurisdiction held that there is a need to distinguish between contractual claims against Tucuman and the claims for breach of the BIT brought by the investor against Argentina and held that dispute could be referred under the ICSID Convention.

In *Amco Asia Corporation and others v. Republic of Indonesia*[32], the tribunal held that it was not necessary to expressly give this status to the local company. It was sufficient for the State party to know that the local company was owned by an investor from a different Contracting State.

In *SOABI v. Senegal*[33], the arbitral tribunal held that the purpose of the final clause of Article 25(2)(b) was to allow the foreign investor access to arbitration despite being required to carry out the investment through locally incorporated companies. It is irrelevant whether the investor was a direct shareholder

29. Oppenheinm's International Law 859-60.
30. ICSID Case No.ARB/97/4, May 24, 1999, 14 ICSID Review.
31. ARB/97/3, 21 November 2000, 40 ILM 426 (2001).
32. Decision on Jurisdiction, 23 ILM, 351 (1984) 359.
33. 6 ICSID Rev-FILJ 217 (1991) 225, para 35 et seq.

of the local company or channelled its investment through intermediary companies, exercising the same control over the local company.

In *Vacuum Salt Production Limited v. Government of the Republic of Ghana*[34], the tribunal confirmed that foreign control within the context of Article 25(2)(b) does not require or infer a particular percentage of share ownership.

In *Southern Pacific Properties Ltd (Middle East) et al v. Arab Republic of Egypt*[35], arbitration was initiated by the SPP under Article 8 of Egyptian Investment Law[36], which provides that "investment disputes in respect of the implementation of the provisions of this law shall/are to be settled in a manner to be agreed upon with the investor. The Government of Egypt has raised objection with regard to jurisdiction of the tribunal on *inter alia* that the Claimants had not consented to ICSID's jurisdiction since it first initiated ICC proceedings. The tribunal rejected the objection and held that by sending a request for arbitration and an earlier letter to the minister the investor consented to ICSID arbitration.

Interpretation of BITs

In *CMS Gas Transmission Company v. The Republic of Argentina*[37], CMS is a US Company, having minority shares in Argentinean Company TGN [Transportadora de Gas del Norte] brought its claim under the US-Argentina BIT-1991, on the ground that it has made a protected investment in Argentina. The tribunal supported the CMS view and held that rights of the Claimant can be asserted independently from the rights of TGN, the present dispute arises directly from the investment made and that therefore, there is no bar to the exercise of jurisdiction on this Court.

In *SGS Societe Generale de Survellance SA v. Republic of the Philippines*[38], the ICSID tribunal has reached the conclusion based on the meaning of the umbrella clause and proceeded with the case to interpret Switzerland-Philippines BIT. In *Alcoa Minerals of Jamaica v. Government of Jamaica*[39], the Government of Jamaica has changed its legislation relating to the production of bauxite and the imposition of a production levy and informed ICSID that it had withdrawn certain classes of disputes from the ICSID Convention. On the basis of this declaration, the Government of Jamaica contested the jurisdiction of the ICSID tribunal. The tribunal held that Jamaica had consented to arbitration in the investment agreement with Alcoa and could not unilaterally withdraw from that agreement; hence, Jamaica's declaration could only be effective to future agreement.

The ICSID tribunal while interpreting BITs in respect of exercises of jurisdiction in some cases[40], observed that: BIT terms should be read in such a way as to enhance mutuality and balance of benefits; it is legitimate to resolve uncertainties in the interpretation of a BIT so as to favour the protection of covered investments; A tribunal cannot read into a BIT words of limitation that are not found in the text; provisions granting rights to investors should be read in the way that is most favourable to the investor; BITs must be applied and interpreted having regard to the...

34. 4 ICSID Reports 320, BYBIL 227 (1971-75) 264-265.
35. XVI YBCA 16 (1991).
36. Law No.43 of 1974.
37. 17 July 2003, 42 ILM 788 (2003).
38. www.worldbank.org/icsd/cases/SGS.v. Phil-final.pdf.
39. IV YBCA 206 (1979) 207.
40. *CMS Gas Transmission Company v. The Republic of Argentina* [17 July 2003, 42 ILM 788 (2003)]; *SGS Societe Generale de Survellance SA v. Islamic Republic of Pakistan*, [6 August 2003, 18 ICSID Rev-FILJ 301 (2003)]; SGS *Societe Generale de Survellance SA v. Republic of the Philippines*, www.worldbank.org/icsd/cases/SGS.v. Phil-final.pdf]; and *Tokios Tokeles v. Ukraine*, www.worldbank.org/icsd/cases//tokios-decision. Pdf.

Conclusion

A State enjoys immunity, in respect of itself and its property from the jurisdiction of the Courts of another State[41]. However, if a State engages in a commercial transaction with a foreign natural or judicial person, the State cannot invoke immunity from that jurisdiction in a proceeding arising out of that commercial transaction[42]. If a State enters into an agreement in writing with a foreign natural or juridical person to submit to arbitration differences relating to a commercial transaction, that State cannot invoke immunity from jurisdiction before a Court of another State….[43]. In *Kuwait Airways Corporation v. Iraqi Airways Co.*[44], Lord Mustill of House of Lords observed that; "where a sovereign chooses to doff his robes and descent into the market place he must take the rough with the smooth, and having condescended to engage in mundane commercial activities he must also condescend to submit himself to an adjudication in a foreign Court on whether he has in the course of those activities undertaken obligations which he has failed to fulfil". The growth of submission and settlement of disputes by ICSID between the States and investors though arbitration and the growing involvement of States in commercial activities led to a progressive erosion of the Sovereign Immunity doctrine and States are actively participating in commercial activities.

It is evident from the increase in number of BITs between the States; the States are interested in attracting foreign investments, enacted specific investment laws to provide the necessary legal certainty sought by investors. In order to attract the more foreign investment, investment treaties required the Host State to accord "fair and equitable treatment" to investors of the other Contracting State and also full protection and security. It is also obligation on the Host State not to impair the management or operation of the investment by arbitrary and discriminatory measures.

The study of ICSID Convention and some of the decided cases of ICSID arbitration centre demonstrates that ICSID has been playing a leading role in settlement of investment disputes between the "investor" and States. The ICSID has decided many cases filed by the "investors" relying on BITs and in some cases the tribunals of ICSID required to interpret the BITs to decide the issue of exercise of jurisdiction. It is also evident from the study that there are number of instances where States have challenged the jurisdiction of the tribunals in arbitration proceedings initiated on the basis of investment protection laws. In order to resolve such cases, the ICSID tribunals have successfully evolved a test[45], to determine that whether an investor has made an investment within the meaning of Article 25 of the ICSID Convention. The increasing membership of ICSID, filing of numerous cases for arbitration before ICSID is a clear proof of its major role in settlement of investment disputes, international investment and economic development.

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3. William W. Park: Arbitration of International Business Disputes, Oxford University Press, 1st Edition, 2006.

41. Article 1 and Article 5 of the United Nations Convention on Jurisdictional Immunities of States and Their Property, 2004.
42. Article 10.
43. Article 17 of the United Nations Convention on Jurisdictional Immunities of States and Their Property, 2004.
44. [1995] 1 WLR 1147, 1171 (HL).
45. Salini Test, ibid 24.

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STATUS OF NON-BANKING FINANCIAL COMPANIES IN INDIA

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Introduction

The Indian Financial System has as its integral part the Non-Banking Financial Institutions, inasmuch as they have been providing finances to various bodies, individuals as well institutions for their varied activities, In order to procure the necessary funds, they have been taking investments in the form of various schemes such as 'NIDHI' or other schemes by distinct names. In the recent period, there has been a mushroom growth of NBFC and several instances had come to notice that a few pensioners invested a major part of their retiral benefits with the hope of getting double or triple the investments and were taken for a ride when they found that the institutions had cheated them with no remedy to recover their money. Some of the NBFCs initially created confidence in the members of the public but later duped them. The 'nidis or mutual funds on private investments were guaranteed by their own certificates or bonds. It may be also true that some of the NBFCs earned uneviable reputation for their honesty and integrity but they could only be quoted as rare institutions[1].

In fact the Governmental authorities encouraged NBFCs and their growth in view of their prime position in the economic development of the private sector and in a way the development of the society. In view of the policy decisions of the Government, NBFCs had acquired the status of the financial institutions and they were able to secure huge resources and these institutions were poised for a large growth during the period December of 1997[2].

The business of a Non-Banking Financial companies means carrying on the business of a financial institution[3], and includes the business of non-banking financial company[4]. The

1. Concepts, Practices and Procedures of NBFCs- Dr. *J.C. Verma* p.5
2. Khanna Committee Report on growth of NBFCs-1995.
3. Section 45(1)(c) of Reserve Bank of India Act, 1997.
4. Section 45(1)(f) of Reserve Bank of India Act, 1997.