STATE COURTS AND STATE RESPONSIBILITY: A RESPONSE TO PROF. PRABHASH RANJAN’S “CAN BIT CLAIMS BE MADE AGAINST INDIA FOR THE ACTIONS OF THE INDIAN JUDICIARY?”

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This piece is a response to an article that appeared in the first issue of NLUJ law review by Dr. Prabhash Ranjan in his paper entitled “Can BIT Claims Be Made against India for the Actions of the Indian Judiciary? The author attempts to analyse the crucial question of the role of national courts in complying with international norms in the backdrop of the Supreme Court of India’s order cancelling the 2G spectrum licenses. This piece discusses the inherent asymmetry in Investment Treaty Arbitration, which grants investors rights but not obligations, while imposing upon the states obligations unaccompanied by rights; the need for balancing the competing interests taking into consideration state sovereignty which signify the ability of states to regulate for the benefit of public welfare. It is discussed that a potential review by a tribunal cannot merely decide on the basis of a single court decision, rather they must see whether a reasonable opportunity of getting their loss redressed, is foreclosed. Lastly, the author explores the question of arbitrability in cases of public corruption involved in the investments and concludes that the claims, if at all possible, would not be successful before an ITA tribunal.

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I. INTRODUCTION

An article that appeared in the first issue of NLUJ law review is the genesis of this piece. Dr. Prabhash Ranjan in his paper entitled “Can BIT Claims Be Made against India for the Actions of the Indian Judiciary?” has argued that the actions of the Indian judiciary shall be attributed for state responsibility under international law and therefore, shall become a potential claim before an international arbitral tribunal. He develops this argument on the basis of a statement made by the Attorney General of India (AG) in the light of the Supreme Court order, in which while cancelling the 2G spectrum licenses the Court held that, an “alleged loss which emanates out of orders passed by the court does not constitute a cause of action against the government.”

This assertion of the AG and the response made by the author posits two dimensions of the problem. First, whether judicial actions can be attributed to the State and whether it can be subjected to a review by an international investment arbitral tribunal? Second, whether this claim would be successful before the tribunal? In this note, I discuss the first aspect of the problem; i.e., whether, a BIT claim can be brought against India for the actions of the Indian judiciary. I argue this in the affirmative. While largely agreeing with this point that national judiciary comes under the rubric of a ‘State’ under international law, in this paper, I would like to focus more on the second aspect, looking at the ‘reviewability’ of a national judicial action by an international arbitral tribunal and make a contrary opinion. To put it

1 Prabhash Ranjan, Can BIT Claims Be Made against India for the Actions of the Indian Judiciary, 1(1) NLUJ LAW REVIEW 87 (2013).
2 Centre for Public Interest Litigation and others v. Union of India and others, AIR 2012 SC 3725 (Supreme Court of India).
different, I am more interested in the subtler question, whether all investment-affecting actions of national courts would be arbitrable?

As a prelude, in its first part, the paper tries to bring some light on the first dimension by contemplating on the possible reasons on why the AG thought that the court orders are not attributable to the government. Here, the discussion is based on the relevance of state courts in international law. The second part of this note would deal with the asymmetric structure of Investor-State Arbitration and underlines the importance of dealing with ‘public interest’ matters. The third part addresses the nature of the Supreme Court’s decision in order to see whether it constitutes either a denial of justice or judicial expropriation. The final part looks at the question of arbitrability, taking into account the alleged illegality and corruption involved in the investments. It further argue that the claims, if at all possible, would not be successful before an ITA tribunal.

II. ROLE OF STATE COURTS IN THE INTERNATIONAL LEGAL ORDER

Although the following discussion majorly pertains to the international legal order, it is important to start from the domestic legal context in order to examine the logic of the AG’s arguments.

A. NATURE OF JUDICIARY AS ‘STATE’ UNDER THE CONSTITUTION

The general political science theory enlists the legislature, executive and judiciary as the three organs of a State. These three organs have to function within their own spheres demarcated under the Constitution as recognised by the principle of separation of powers. However, under Article 12 of the Constitution, the judiciary has not been explicitly included under the definition of ‘State’. Nevertheless, this definition is only an inclusive one and moreover limited to purposes of Part III of the constitution. Further, it is to be noted that judicial independence, a fundamental requirement for the effective functioning of a democracy, is well asserted by the Supreme Court of India as a part of the basic structure of our Constitution. In this light, a technical interpretation of the statement, of the AG makes some sense; a judicial order does not constitute a cause of action against the Government which represents the executive. Perhaps, his argument is tenable for a political scientist as the

4 Kalyani Ramnath, Guarding the Guards: The Judiciary as State within the meaning of Article 12 of the Constitution, 18(2) STUDENT BAR REVIEW (2006).
5 Id. (The AG had further said that claim of damages from the Indian government by these companies was based on a complete misunderstanding of the constitutional position prevailing in the country).
executive and judiciary are sub-ordinates of a generic concept of ‘State’. Yet, for all practical purposes it is presumed that the Government means the State only.

B. DOMESTIC JUDICIAL ACTIONS UNDER INTERNATIONAL LAW

Domestic courts are often asked to apply and interpret international law in a variety of domestic proceedings. This application of international law by the domestic courts varies in different jurisdictions depending on whether a particular jurisdiction follows a ‘monistic’ or a ‘dualistic’ theory, which is germane to the domestic judicial function of a State court. However, here, the important question is whether the domestic courts play any international judicial function in the international plane. In other words, the question is whether the distinction between ‘domestic’ and ‘international’ judicial function is crucial in determining the State responsibility arising out of national judicial actions.

The core judicial function of any legal order (domestic or international) would be the resolution of disputes and the development of jurisprudence through the principle of *stare decisis*. If there is a violation of international law, who decides that the state court erred in its international judicial function? An immediate or first-instance judge would be the State itself; as the judicial organ of State. Moreover, by virtue of international law, the state courts will test the legality of the State measure. All the same, in the absence of any centralised international appellate body, the State Courts as the natural judges have to apply the international norms at their own risk, and it may be challenged before an international tribunal. However, unlike a court sitting on appeal, an international tribunal does not enjoy any kind of supervisory powers. Their role is subsidiary as compared to the primary role assigned to domestic courts as enforcers of international law. This is evident in various spheres of international law. Similarly, the Principle of ‘Margin of Appreciation’ emphasises the secondary importance of international tribunals in relation to domestic courts.

Perhaps, domestic courts are entrusted with the enforcement of international obligations due to its independency and apolitical role towards other organs of the State. But,

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8 Supra note 7. (He cites examples like, Rome statute of the ICC, GATT, etc.)

a strong case of conflict of interests and apparent bias would be expected when State courts act as settlers of international law that involves their own state. It is to be admitted that the national courts would be subdued in the strict applications of international norms which are against the interests of the State.\textsuperscript{10}

From the standpoint of international law, the judicial organs of a State must interpret and apply the international norms in its strict sense. Any less vigorous application of these norms to accommodate the governmental interests would call for international responsibility of the state.\textsuperscript{11} It does not mean that the domestic courts must deviate from its primary duty of upholding the domestic norms in order to preserve its obligations. Therefore, the crucial point is whether the national court, while failing to comply with an international norm upholds domestic constitutional norms, especially when the domestic norms are ‘internationalised’\textsuperscript{12} or form part of ‘international public policy’.

\textbf{III. ASKEWNESS OF INVESTMENT TREATY ARBITRATION}

Before the advent of investment treaty arbitration (ITA), settlement of investment disputes was through diplomatic protection at the discretion of the home state of the investor. In the new investor-state dispute resolution, the host state is always the respondent that tries to avoid state responsibility under international law. Hence, Bilateral Investment Treaties (BITs) are (in)famously asymmetric. They grant investors rights but not obligations, while imposing upon the states obligations unaccompanied by rights.\textsuperscript{13} The very objective of Investment Treaty Arbitration is to ensure that the states do not misuse their sovereign powers and harm foreign investment. In doing so, the system puts an extensive limitation on the host state’s sovereignty with respect to a wide range of matters which are traditionally reserved to a domestic jurisdiction.\textsuperscript{14} For instance, the customary principle of ‘exhaustion of


\textsuperscript{11} \textit{Id}.

\textsuperscript{12} \textit{Supra} note 7.


local remedies’ have been compromised by the international adjudicators including the International Court of Justice in order to give more favourable treatment to investment.\(^{15}\)

The competing interests of the two players in this setting, namely, the Investor and the Host State need to be more balanced in order to enhance the legitimacy of the investment treaty arbitration. National judiciary may, as an apolitical and independent body from other organs of the State, play a significant role in this balancing act by identifying the common interests. However, it is a fact that national courts tend to be sympathetic to their own governments. In this regard, it is also important to see whether the national (public) interests of the host state have been protected rather than just governmental (executive) interests. Thus, State responsibility is attributable to judicial actions if there exist coercion with the government machinery.

**A. PUBLIC INTEREST**

State sovereignty encompasses the ability of States to regulate activities within their jurisdiction for the benefit of public welfare.\(^{16}\) Moreover, it is an accepted principle of international law that a state is not liable for economic injury which is a consequence of bona fide regulation made within the accepted police power of states.\(^{17}\) Accordingly, the state can use its police powers to make regulatory measures as an expression of its sovereignty in pursuance of public policy making. However, ironically, the respondent State has an onus of pleading the ‘public interest’ before an international private tribunal, whose mandate is to see whether the State has violated the treaty obligations. Despite the efforts from the transparency movement in investment arbitration, the public interest involved in the investment disputes is not generally dealt by the investment tribunals.\(^{18}\) Here, an important question remains; in the absence of an assured mechanism of judicial review for the purpose of public interest, what is the alternative?

The natural choice for the state populace would be the judicial organ of the State for the enforcement of their rights. In addition, it is an established fact that national authorities

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\(^{15}\) *Elettronica Sicula S.p.A (ELSI) (United States of America v. Italy)*, 1989 ICJ Reports, 15, ¶61, 62 (International Court of Justice) as cited in id., at 734.


have better knowledge of their society and its needs, and are therefore “better placed than
[an international [court] to appreciate what is in the public interest”.19 Traditionally, judicial
review has been the main tool for examining the decisions of executive to ensure that the
public officials act lawfully. Although the courts derive this power from the national
constitution, this is enshrined in the international legal order as well. In a recent decision in
the case of Kadi,20 the European Court of Justice, by emphasising the rule of law upheld the
significance of a right to effective judicial review by the national/regional courts.

In order to comply with its bilateral and multilateral treaties post liberalisation, the
Indian legal system has adopted a progressive regime giving expanded protection to the
property and investment of aliens.21 According to the existing constitutional regime, the
right to property available to both the ‘citizens’ as well as ‘persons’ are subject to reasonable
restrictions on the basis of ‘public interest’, and further provides that private property could
be forcefully acquired by State only for ‘public purpose’.22 Customary international law also
allows expropriation of foreign investment subject to certain conditions and it includes inter
alia public purpose.23

IV. ORDER OF THE SUPREME COURT- DENIAL OF JUSTICE OR
JUDICIAL EXPROPRIATION?

The Supreme court of India, after an eventful year of serious allegations of
corruption involving the then minister and corporate heads of the Indian telecom sector with
respect to the granting of 2G spectrum licenses, on February 2, 2012 through its judgment in
Centre for Public Interest Litigation and others v. Union of India and others,24 cancelled 122 licenses
issued by the Department of Telecommunications. The Court held that the allotment of
licenses were arbitrary and illegal and noted that 2G spectrum is a natural resource and that

Rights) as cited in id., at 791.
20 Joined Cases, Kadi & Al Barakaat v. Council of the European Union and EC Commission, Judgement, C-
21 Rajesh Babu, Constitutional Right to Property in Changing Times: The Indian Experience, 6(2) VIENNA
JOURNAL ON INTERNATIONAL CONSTITUTIONAL LAW 213 (2012).
22 Id.
23 OECD, “Indirect Expropriation” and the “Right to Regulate” in International Investment Law, (Working Papers
available at http://dx.doi.org/10.1787/780155872321.
24 Centre for Public Interest Litigation and others v. Union of India and others, AIR 2012 SC 3725
(Supreme Court of India).
“the State is the legal owner of the natural resources as a trustee of the people and although it is empowered to distribute the same, the process of distribution must be guided by the constitutional principles including the doctrine of equality and larger public good”. Applying the doctrine of ‘public trust’, the court noted that the Government is obligated to protect the resources for the enjoyment of the general public rather than to permit their use for private ownership or commercial purposes. According to customary international law, the ownership regime related to natural resources rests upon the concept of sovereignty and seeks to respect the principle of permanent sovereignty over natural resources.

Further, the apex court opined that the ‘doctrine of equality’ that emerge from the concepts of justice and fairness guide the State in determining the actual mechanism of distribution of natural resources. The doctrine regulates the rights and obligations of the State vis-à-vis private parties seeking to acquire/use the resource and demands that the procedure adopted for distribution is just, non-arbitrary and transparent and that it does not discriminate between similarly placed private parties. The order states the importance of judicial review and branch autonomy in the following words, “when it is clearly demonstrated before the Court that the policy framed by the State or its agency/instrumentality and/or its implementation is contrary to public interest or is violative of the constitutional principles, it is the duty of the Court to exercise its jurisdiction in larger public interest and reject the stock plea of the State that the scope of judicial review should not be exceeded beyond the recognised parameters”.

Here the main consideration would be the proper characterisation of the nature of the Court’s order, as to whether it amounts to judicial expropriation or denial of justice. Saipem v. Bangladesh, case is a better example for this categorisation relating to judicial

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26 Centre for Public Interest Litigation and others v. Union of India and others, AIR 2012 SC 3725 (Supreme Court of India), ¶64; International Court of Justice in the case opposing the Democratic Republic of Congo to Uganda. Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda), Judgment, I.C.J. Reports 2005, p. 168, ¶244.

27 Centre for Public Interest Litigation and others v. Union of India and others, AIR 2012 SC 3725 (Supreme Court of India), ¶69.

actions becoming the reasons for investment treaty arbitration. In this case, an ICSID tribunal held the host state (Bangladesh) responsible for expropriation due to unnecessary interventions of its domestic courts in the arbitration proceedings instituted by the investor (an Italian corporation Saipem). The tribunal declined the argument of exhausting the local remedies as a prerequisite in all the cases where actions of the judiciary gave rise to the claim. Distinguishing the case from the characterisation of the claim as denial of justice as held in *Loewen v. USA*, the arbitral tribunal treated it as a case of judicial expropriation.

Over the recent past, international investment disputes on ‘taking’ have largely taken the form of indirect expropriation replacing the cases on direct expropriation characterised by the nationalisation and termination of concession agreements of industries in the second half of the 20th century. Contemporary disputes on indirect expropriation are mostly applicable to the regulatory measures of the State aimed at protecting the natural resources and other welfare interests of the society. The question that arises is to what extent a government may affect the investors’ interests and the value of a property by regulation made for a legitimate public purpose, without effecting a “taking” and having to compensate for it.

As Prof. Ian Brownlie states, “state measures, *prima facie* a lawful exercise of powers of governments, may affect foreign interests considerably without amounting to expropriation. Thus, foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation”.

However, the existing investment arbitration jurisprudence does not seem to be helpful in ascertaining a precise theory of defining what constitutes a regulatory or indirect expropriation. Nevertheless the doctrine of ‘police powers’ of the state, a widely accepted principle of customary international law, permits the state to make regulatory measures in the public interest. Moreover, it provides that “A state is not responsible for loss of property or

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31 Centre for Public Interest Litigation and others v. Union of India and others, AIR 2012 SC 3725 (Supreme Court of India).

for other economic disadvantage resulting from *bona fide* regulations or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory”.

Moreover, as part of the normal judicial activities of the host state, the mere fact that an investor suffers a deprivation as a result of the court action will be insufficient to ground an expropriation claim. In these types of proceedings, some form of deprivation may well be a normal part of the proceedings. Having seen that expropriation is possible for a public purpose, the next question is what if the Supreme Court’s order has been categorised as a denial of justice?

As stated by Prof. Jan Paulsson, the content of denial of justice cannot be reduced to a set of predictable or objective criteria. Neither can denial of justice be easily categorized, since the ‘patterns of behaviour said to comprise denial of justice are often kaleidoscopic’. He argues that denial of justice is always a matter of procedure and reasons that international responsibility arises as a result of the failure of a national legal system to provide due process. According to Paulsson, the denial of justice should not be a form of international judicial review of the substance of a national court decision and therefore not require the compliance with the principle of exhaustion of local remedies.

If denial of justice results from the failure of a national legal system to provide justice, then it invariably calls for the State’s obligation to create a system of justice that allows errors in the administration of justice to be corrected. A systematic approach would call for all the possible remedies available in that state including legislative and executive branches of the State. Hence the main obligation is to provide a remedial system of fair and effective means of justice, which means that the potential review by a tribunal cannot merely decide on the basis of a single court decision, rather they must see whether a reasonable opportunity of getting their loss redressed is foreclosed. Looking at the order of the Supreme Court, it is

36 *Id.*, at 68. (There may be extreme cases where the proof of the failed process is that the substance of a decision is so egregiously wrong that no honest or competent court could possibly have given it. Such cases would sanction the state’s failure to provide a decent system of justice. They do not constitute international appellate review of national law).
clear that the requirement of ‘judicial finality’ rule,\textsuperscript{37} has been complied with and more importantly, it also orders the executive branch to initiate fresh proceedings for grant of licence and allocation of spectrum by a transparent auction.

V. CORRUPTION DEFENCE AND NON-ARBITRABILITY

The defence of Corruption has been emerging as a tool for the respondent (host) states appearing before international investment tribunals. Traditionally, international commercial arbitral tribunals have declined jurisdiction in cases of contracts involving corruption, on account of the non-arbitrability of the dispute.\textsuperscript{38} National courts have also used the doctrine of ‘unclean hands’ to deny jurisdiction for a disputant involved in public corruption.\textsuperscript{39} In such cases, courts and arbitrators have held that corruption is contrary to international public policy and criminalisation of bribery and corruption make the subject matter incapable of settlement by arbitration.

\textit{Hub Power Company Limited (HUBCO) v. Pakistan WADPA & the Federation of Pakistan,}\textsuperscript{40} is an illustration to demonstrate the non-arbitrability of the disputes arising out of a contract obtained through corruption. Here the main dispute involved a private company incorporated in Pakistan and the national power and development authority of Pakistan (WADPA) in connection with a construction contract. The Supreme Court of Pakistan decided that where there was \textit{prima facie} evidence that state contracts were obtained through fraud, it would violate public policy to allow the dispute to be resolved by an arbitral tribunal.

In effect, the corruption defence, as recognised by the investment tribunals, imposes an obligation on the private investors to stay away from any kind of corrupt practices in the course of making a BIT protected investment in the host state. In a recent investment dispute between Siemens AG and the Republic of Argentina, the ICSID tribunal awarded a

\textsuperscript{37} Here, a comparison of the SC order with Lowen v. USA case would suggest that when the decision is made by the highest court of the country (as compared to a lower court decision in Lowen) the judicial finality requirement seems to be complied with.


\textsuperscript{39} Adler v. Federal Republic of Nigeria, 219 F.3d 869 (9th Cir. 2000). (The court defines the unclean hands doctrine as “clos[ing] the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief, however improper may have been the behaviour of the defendant.”).

\textsuperscript{40} L. Barrington, \textit{Arbitral & Judicial Decision: HUBCO v. WAPDA: Pakistan top court rejects modern arbitration, 11 American Review of International Arbitration 385 (2000).}
huge sum in favour of Siemens for Argentina’s expropriatory measures against the investment covered under the German-Argentina BIT. But later, when the national anti-corruption agencies brought out the evidence against Siemens AG regarding their involvement in public corruption, the investor instead of getting the award enforced, preferred a settlement. However, it is important to note that, the ICSID tribunal had not dealt with the issue of corruption in the arbitral proceedings.

In the investor-state context, there is little guidance as to how the investment tribunals deal with the corruption defence. Nevertheless, it does not mean that the future tribunals are not bound by the defence of corruption.

The only available investment treaty award in which an ICSID tribunal considered the question of corrupt practices involving public officials and the private investor was World Duty Free Co. Ltd. v. Republic of Kenya. In the absence of an underlying BIT, the tribunal accepted its jurisdiction on the basis of an arbitration clause that formed part of the concession agreement between the parties. During the course of the proceedings, it was revealed that the claimant obtained the contract by bribing the then President of Kenya. Hence, the tribunal dismissed the case. Interestingly, the tribunal upheld the validity of the arbitration agreement which was included in the tainted main contract on the ground of doctrine of separability. However, it held that the matter is inadmissible on the ground of violation of international public policy.

Similarly, the tribunal noted that, under the applicable (national) laws, the claimant was “not legally entitled to maintain any of its pleaded claims” on the ground of ex turpi non oritur action (from a dishonorable cause an action does not arise). Similarly, the principle of ‘good faith’ is a well-established legal principle, which cannot be ignored in international law. It has been stated by the Permanent Court of International Justice in 1934 that, “contracting parties are always assumed to be acting honestly and in good faith.”

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41 Francioni, supra note 14.
43 For the distinction between jurisdiction and admissibility, see Jan Paulsson, Jurisdiction and Admissibility in GLOBAL REFLECTIONS ON INTERNATIONAL LAW, COMMERCE, AND DISPUTE RESOLUTION: LIBER AMICORUM IN HONOUR OF ROBERT BRINER, 601 (Gerald Aksen et al. eds., 2005). Prof. Newcombe argues that, rejecting the claim on admissibility ground is a preferred approach.
44 Id., at 732.
According to Professor Andrew Newcombe, this misconduct of an investor may take different forms (such as illegality and corruption) and may arise at different stages of the investment process. Depending on the stage and nature of the misconduct the legal consequence of the claim submitted before the investment tribunal may vary. In the absence of an appeal against ITA, it is desirable that the tribunal treat the claim involving public policy questions (like fraud, illegality and corruption) as inadmissible.

VI. CONCLUDING REMARKS

Investment treaty arbitrations challenging the actions of domestic courts have become a fascinating area of research in international law. Even when domestic courts function as ‘good institutions’ from a political science point of view, they may find their decisions reviewed by international tribunals empowered under BITs signed by other branches of the State. After the White Industries award for the delays of national courts, judicial intervention in cases like Antrix v. Deva, brought India into the limelight of investment treaty arbitration. The facts that separate the possible claims against India for the Supreme Court’s cancellation of telecom licenses from the above mentioned cases are majorly based on public interest and the involvement of corruption by public officials. Applying the defence of corruption and its violation of international public policy, to the possible investment arbitrations against India in the wake of the Supreme Court’s order, it can well be assumed that the chances of claims being successful is very weak.

A comparable situation comes from the courts of Moldova. In 2009, the national courts of Moldova held that the granting of license to Mr. Fanck Arif, a French investor, for


46 A. Newcombe, Investor Misconduct: Jurisdiction, Admissibility or Merits?, in EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 187 (Chester Brown & Kate Miles eds., 2011).

47 Id., at 191.


the operation of duty-free shops at the airport was illegal. Equating the case in point with the allocation of 2G spectrum licenses by the Indian government, the executive branch of the Republic of Moldova did not follow the required competitive tender process, preventing other investors a fair participation in the bidding. Aggrieved by the order of the Moldovan court, the French national initiated an arbitration proceeding under the France-Moldova BIT. Although the ICSID tribunal in this case,\textsuperscript{50} held against the State (on the ground of fair and equitable treatment), the order of the court was exalted. This case is indicative of the fact that obligating the State for every action of the judiciary would be difficult.

By this piece, I neither intend to join the legitimacy-critiques' bandwagon nor argue against the system of investment treaty arbitration. The only suggestion I wish to make is, due to the one sided advantage given to the investor (ironically by the host state itself in the form of a BIT) the host state should not always be forced to take a defensive stand. As a “Quantum of Solace”\textsuperscript{51} to the host state, the future tribunals must make the standard of review more lucid as against broad and vague treaty standards like the fair & equitable treatment.


\textsuperscript{51} This is the title given by Prof. Andrew Newcombe (inspired from a James Bond movie) on his ongoing research project on investor misconduct in international investment law.