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The Sovereign Immunity Defence- Analysing The Juxtaposition Between Sovereign Immunity And The Enforcement Of Arbitral Awards

By Abhishek Sharda and Neetya Panwala

ABSTRACT

International arbitration as an alternate dispute mechanism forum has gained considerable significance in the percept of growing global market and investment treaties. It offers party autonomy vis-à-vis the selection of forum, procedural and substantive law, further, it is also a speedy and less expensive process as against litigation. The ultimate objective of arbitration includes also the enforceability of an arbitral award wherein the same can be frustrated using the plea of sovereign immunity. This doctrine transforms into the conventional wisdom that a state cannot be compelled to submit to the jurisdiction of another without its prior consent, it poses a veritable threat to the successful party towards the enforcement of an award wherein states can most often undermine an unfavourable award under the said doctrine. There, however, lays considerable overlap between the treaty obligations of the state so to protect the rights of foreign investors and the doctrine of sovereign immunity- the research attempts to reflect the limiting scope of the sovereign immunity defence available to the state party i.e. the restrictive approach in light of the recent trends practised globally.

The present article sets forth the conceptual underpinnings to the term ‘sovereign immunity, its application to international arbitration and its interplay with the enforcement of arbitral awards, further, it attempts to clarify the Indian position vis-à-vis sovereign immunity, and lays down certain measures so to disable the state to use the doctrine as an escape provision against the enforcement of awards.

Keywords: International arbitration, enforcement of arbitral awards, sovereign immunity, treaty obligations, waiver

INTRODUCTION

Commercial arbitration in the realm of international law has become an increasingly preferred method for alternate dispute resolution,[1] largely due to party autonomy,[2] its ability to render fast decisions and maintain confidentiality.[3] The very essence of arbitration includes also the enforcement of arbitral awards for the settlement of disputes,[4] albeit, the contours of enforceability is limited via the defence of sovereign immunity[5] in cases where an unfavourable award is passed against the state entity;[6] in other words, the plea of sovereign immunity can defeat the purpose of entering into arbitration with a state entity.[7]

Further, with the growing practice of arbitration in the global market, the same has paved way for institutional arbitration, which includes the establishment of ICSID to regulate investment disputes vis-à-vis the contracting state party and a foreign national.[8] The state party has the right to exercise its regulatory powers legitimately to control resources without compensation within its territory,[9] albeit, it is also obligated under treaty obligations to safeguard the rights of foreign investors.[10] The international law vis-à-vis the enforcement of arbitral awards is premised upon two doctrines-

1. the treaty obligations of the state of *pacta sunt servanda**[11]*** form the base of art. 26 of the Vienna Convention provides that *"every treaty in force is binding on the signatory parties and the same must be carried out in good faith."**[12]*** Thus, a state party to the New York Convention or the ICSID convention is obligated to enforce arbitral awards rendered elsewhere,[13] the non-compliance of the same would attract legal, political and economic implications in the arena of international commercial transactions.[14]

2. the doctrine of sovereign immunity or *par in parem non-habet jurisdictionem**[15]*** states that *"one sovereign state cannot be submitted to the jurisdiction of another without its prior consent, further, no enforcement proceedings can be brought against the properties of one sovereign state in the courts of other states."**[16]***

There subsists a problem in reconciling the conflicting paradigms, further, while determining which doctrine holds precedence over the other in cases of conflict, the same should be guided by the rules of *lex specialis* and *jus cogens*.[17] In light of the above, the research revolves around the main concern- whether the defence of sovereign immunity should be entirely available to the

state party so to refute the enforcement of awards, or whether there should be limits to the doctrine so to secure foreign investments and maintain the sanctity of the arbitration proceedings?

SOVEREIGN IMMUNITY UNDER INTERNATIONAL ARBITRATION-

❖ ABSOLUTE AND RESTRICTIVE THEORIES-

There has been a gradual shift in the approach from the absolute theory to the restrictive theory;[18] the former also known as the structuralist method confers immunity on all actions of the state parties irrespective of the nature and purpose of the underlying transaction.[19] The restrictive or the functionalist approach[20] grants immunity vis-à-vis only the sovereign acts of the state i.e. *Acta jure imperii*, further, the private acts (*acts jure questions*) relating to commercial transactions of the state are not covered under the doctrine.[21] In essence, the absolute theory concerns the status of the party claiming immunity whereas, the restrictive approach relates to the subject matter of the dispute at hand.[22]

❖ APPLICATION OF THE DOCTRINE TO INTERNATIONAL ARBITRATION-

The defence of sovereign immunity can be claimed at two stages- immunity from jurisdiction and immunity from enforcement.

1. Immunity from Jurisdiction-

An arbitral tribunal is a creature of the contract,[23] by implication, the jurisdiction of the tribunal is also determined based on the agreement between the parties; therefore, such immunity can be waived of either in *implicit terms* i.e. an agreement to arbitrate constitutes as a deemed waiver of immunity from jurisdiction,[24] *or expressly* i.e. by an instrument executed by the state to subject itself to arbitration or an express clause in the agreement to that effect.[25] Further, the submission of the state to arbitrate under the ICSID convention deems to be an implicit waiver of immunity from jurisdiction.[26] Accordingly, the court in ***Ipitrade International, S.A. v. the Federal Republic of Nigeria*** also held that the arbitration clause in a contract for the sale of cement providing for the dispute settlement in accordance to ICC, Paris was deemed as an implicit waiver of sovereign immunity.

2. Immunity from Execution-

The waiver of immunity from jurisdiction does not generally extend to immunity from enforcement and execution,[27] by implication, the agreement on part of the state to submit to

arbitration also does not imply the waiver of immunity from enforcement.[28] The same has been underlined by the US supreme court in ***the Argentine Republic v. Amerada Shipping Corp.*** which held that the signing of an arbitration agreement cannot be deemed to mean an implied waiver of immunity from enforcement of the arbitral award,[29] Further, a similar stance has been adopted under the 1958 New York convention and the ICSID convention.[30] However, state practices diverge greatly vis-à-vis the enforcement measures, further, certain jurisdictions percept the immunity from execution against state properties in line with the restrictive approach i.e. it differentiates between sovereign property and commercial property wherein only the former is immune from attachment or execution.[31] Therefore, where the sovereign immunity law differs for jurisdiction and enforcement purposes, and where the restrictive approach is applicable, the 'purpose' test is used to ascertain whether the state property is subject to immunity or not.[32]

SOVEREIGN IMMUNITY AND THE ENFORCEMENT OF ARBITRAL AWARDS

In light of the above discussion, the sovereign immunity defence is a considerable loophole towards the successful enforcement of an arbitral award, the same can be examined in two aspects-

❖ ABSOLUTE OR RESTRICTIVE IMMUNITY?

There is no specific accepted theory vis-à-vis the absolute and restrictive approach, therefore, there is considerable divergence concerning state practice on the subject.[33] In cases where the award is to be enforced according to the absolute theory, the court will limit itself to merely determine whether the contracting party is a state party or not, and if the same is in affirmative, the plea of sovereign immunity may render the enforcement of award to be void.[34] Also, in jurisdictions that have adopted the restrictive theory, there remains the question as to whether the underlying state property originates from sovereign or commercial functions,[35] judicial stance on the same is varied.[36] Accordingly, the UK House of Lords in ***Alcom Ltd. V. Republic of Columbia[37]*** held that the account under the city bank did not qualify as that for commercial purposes on account of insufficient evidence to prove the same, such precedent paves way for the state party to easily refute execution against its property by providing that the same is for sovereign purposes.

In the United States in the pre-FSIA times, the courts generally adopted the two-tier analysis; accordingly, in ***Victory Transport Inc. v. Comisaria General***[38] wherein the dispute concerned the transport of purchased wheat by the Spanish government, the court relied upon the restrictive approach to refute immunity in that the underlying transaction related to a commercial transaction, further, the jurisdiction of the court was held to be properly based on a consent theory.[39] With the enactment of the FSIA, the restrictive and the consent theories have been codified under the legal instrument as statutory exceptions, therefore, expelling the need for the two-tier analysis laid under *Victory Transport*.[40]

❖ WITHDRAWAL OF WAIVER-

While there exists no doubt that an agreement to arbitration by a state party constitutes a waiver of sovereign immunity, albeit, there subsist certain obstacles concerning waiver of immunity by the state party –

1. A waiver of immunity to the jurisdiction cannot be termed as a waiver of immunity vis-à-vis the enforcement of the arbitral award,[41] albeit a contrary position has been held in *Creighton v. Qatar****[42]*** wherein the court held that where the state expressly agrees to arbitration, it includes both the waiver of immunity from jurisdiction as well from enforcement, however, the same is an atypical decision applicable only in the state of France.[43]
2. A mere waiver of immunity does not suffice the cause when the court is faced with an application for enforcement of an arbitral award, as the relevant time for waiver of immunity is when the award is set to be enforced.[44]
3. A state can repudiate the waiver any time before the submission of the suit or its execution.[45] Accordingly, wherein ***Duff Development Co. v. Government of Kelantan****[46]* the parties had submitted themselves for arbitration and also consented to judicial enforcement of the award, the court held that since no submission vis-à-vis the repudiation of waiver of immunity was made to the court, it excluded the court from taking jurisdiction in the subject matter.

SOVEREIGN IMMUNITY VIS-À-VIS THE INDIAN JURISDICTION

India's position on the enforcement of arbitral awards vis-à-vis the sovereign immunity doctrine was first determined by the Government in the *Memorandum of State Immunity in respect of*

*Commercial Transaction**[47]*** submitted to the Asian-African Legal Consultative Committee. It depicts the preference of the government towards the restrictive approach, by implication, the government cannot claim immunity in matters concerning commercial activities. This, however, conflicts with the law adopted in ***Isbrandsten Tankers Inc. v. President of India***[48] wherein the state party was allowed to invoke immunity for its commercial activity, the same was refused by the Indian judiciary in its subsequent judgements.

The Supreme Court in ***DSP Lines, Department of the German Democratic Republic v. New Central Jute Mills Co. Ltd.[49]*** held that the framers of the CPC never intended to give the state or its agencies, any immunity from a contract arising out of any commercial transaction. Further, the Supreme Court in ***Union of India v. Owners of Vessel Hoegh Orchid & their Agents[50]*** refused to accept the contentions put forth by the government representatives that an arbitration clause in a charter agreement takes away the states sovereign status bestowed upon it by the Constitution of India. The Court held that any arbitration agreement so entered through a contract is valid and binding upon the subject matter of the dispute.

CONCLUSION: OVERCOMING THE DEFENCE OF SOVEREIGN IMMUNITY

With the ever-increasing state's participation in the international business, the extent of the State's commitment towards the arbitration agreement and its power to seek immunity from the execution of an arbitral award has been one of the serious concerns present in front of the courts and the tribunals.[51] The other party, therefore, wary of entering into an arbitration agreement, as the state may in case of any dispute arising out of the contract, escape its liability owing to the unenforceability of the arbitration award. To avert a plea of sovereign immunity, the following measures can be taken-

1. **Waiver Clause in the Arbitration Agreement-**

An express waiver clause not only waives the state's right to claim any type of sovereign or diplomatic immunity but also compels the state party to submit to the jurisdiction of the arbitration tribunal. It is important to emphasise that such a waiver clause must include "any" type of immunity to widen the scope of the waiver to include any type of state properties held for sovereign or commercial purposes.[52] The inclusion of such a clause is debatable vis-à-vis the restrictive immunity theory, however, the same holds a significant position in the absolute approach as it binds the state party to the jurisdiction of the arbitral tribunal.

2. Stabilisation Clauses-

It is often observed, that a state party, after a contract of agreement has been made, legislates on a provision in a certain manner that effectively modifies the contract of agreement. The opposite party, to safeguard its interest, can incorporate a stabilisation clause that indemnifies the party from and against the cost of compliance with such laws.[53] The Substitution clause provides an investor to minimise the risk by discussing how such changes in the legislation shall not bind the investor party or the host party may indemnify the other party against the cost of compliance of the said legislation.

3. Sovereign Guarantee-

The non-state party, at the time of signing of the contract, may obligate the state party to execute a sovereign guarantee bond thereby obligating them for the performance of the contract. The guarantee is to be deposited in a foreign bank under which the state party mobilises funds and in case of a breach of contract or a refusal to enforce the arbitral award, the non-state party may claim the said amount as a part of the satisfaction of its claims so derived from the breach of contract.[54]

4. Incorporating BITs-

Bilateral Investment Treaties is an agreement between two countries to promote and protect investments made by the investors in each other's country. BITs enable the state parties to maintain cordial relations with other countries and provide for a conducive environment for the protection of the same.[55] When the parties sign the BITs, they consent to the Investor-State Dispute Settlement (ISDS) provision which provides that in case of a breach of a provision mentioned in the BIT, the affected party may bring a claim against the breaching party and the said party cannot escape the liability in the name of immunity from acting in a specific manner.

5. Forum Shopping-

Forum Shopping is an alternative means under which the non-state party may embark upon a judicial forum that holds a liberal approach to the issue of sovereign immunity by a state party.[56] Under this approach, the non-state party would have to carefully look for a lucrative judicial forum favouring a liberal approach upon the issue of state immunity and the rules and

regulations of such jurisdiction would have to be expressly mentioned in the arbitration agreement.

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