



Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2022 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

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India and the BITS - An Analysis

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Received 22 April 2022; Accepted 13 May 2022; Published 18 May 2022

Bilateral Investment treaties (BITs) protect investments by imposing conditions on the host state's regulatory behaviour. This prevents unwarranted interference with foreign investor rights. India was one of the most sued countries during the period 2015-2016. By the end of 2015, around 17 investor-state disputes had been filed against the country. New BIT became effective on April 1, 2017, and new investments into the country must be treated according to the revised guidelines. The scope of rights and obligations under the BIT will depend on what the definition of 'investment' is. India will be able to narrow the scope of investments that can be protected. This will reduce the number of ISDS claims that it can make against foreign firms. India has removed the MFN clause from its new Model BIT. This puts foreign investors at risk of discriminatory practices by the host country. In contrast, the Canada Model BIT stipulates that investing states will not be discriminated against and that all investing states ought to be treated equally. India's Investor-State Dispute Settlement (ISDS) agreement protects investors from being entangled in legal proceedings in an alien jurisdiction. Foreign investors must exhaust local remedies for a minimum of five years before India consents to ISDS. This is not an investor-friendly measure and would discourage investment. The 2016 ModelBIT stipulates that foreign investors and investments will receive full protection and security. The Indian Model BIT's clarity will curb arbitral discretion on the actual scope of the FPS provision. It enables investment protection to coexist with the regulator's power in the host state. A new model BIT adopted by India in the wake of the White Industries Case should be welcomed. Many of the Model BIT's contents vary from country to country, complicating International Investment Law. In order to attract foreign investors to India, the Indian Model BIT needs to be revisited urgently.

Keywords: BIT, foreign investors, MFN provision, UK model BIT.

INTRODUCTION

Bilateral Investment treaties are bilateral investment agreements between two countries that aim to protect the investments their investors make in each other's countries. Investment protection agreements such as BITs protect investments by imposing conditions on the host state's regulatory behaviour. This prevents unwarranted interference with foreign investor rights. For the last 20 years, the number of BITs has steadily increased -- from 500 in the 1990s to more than 3,330 at the end of 2018. In addition to this increasing number of BITs, a wide variety of sovereign regulation measures, including environmental policy, water-supply regulation, monetary policy, and trade policy are now subject to investor-state disputes in international investment law. Investors have also challenged tax regulations and health regulations as possible breaches of BITs. When disasters such as COVID-19 have damaged the World Economy massively, it is likely to present major challenges for the states with regard to the revival of the economy. This is the second time in a row that India has failed to rank in Kearney's Foreign Direct Investment (FDI) Confidence Index, which measures FDI flow confidence. India ranked 16th last year, after being ranked 11th the year before. The previous year, India was ranked eighth. Bringing Foreign Investment into India has been a major topic of discussion in the recent past, keeping in mind that Foreign Investment is a major factor in economic development. India has recently revised its BIT model to take this into consideration.

HISTORY OF THE INDIAN BILATERAL INVESTMENT TREATY

BITs with 84 countries have been signed since India signed its first BIT in 1994 with the United Kingdom.¹ In December 2015, the Indian Cabinet approved the BIT model for the country. The draft Model BIT was circulated in March 2015, and comments on the draft were sought. The

¹ Prabhash Ranjan, 'India's Model Bilateral Investment Treaty: Is India Too Risk Averse?' (Brookings, 1 August 2018) <<https://www.brookings.edu/research/indias-model-bilateral-investment-treaty-are-we-too-risk-averse/>> accessed 12 April 2022

draft Model BIT drew considerable attention, including a full report by the Law Commission of India.²

TREATY ON BILATERAL INVESTMENT WITH INDIA, A NEW MODEL

In 2016, the government introduced a new Model Bilateral Investment Treaty (BIT) (often the year 2015 is also mentioned). The new BIT became effective on April 1, 2017. With these changes, new investments into the country must be treated according to the revised guidelines, and negotiations with partner countries need to be initiated. Bringing forth the Model BIT was largely prompted by the constant suits filed against the country. India was one of the most sued countries during the period 2015-2016. International organization UNCTAD tracks global investment trends. By the end of 2015, around 17 investor-state disputes had been filed against the country by foreign investors. Nine of these disputes have been settled, six are still pending and two of the arbitrations have resulted in losses for the country. In both cases, White Industries was successful in winning arbitration against the country, while Dabhol Power Projects made substantial news. In response to a flood of arbitrations, the policymakers reframed the BITs. These arbitrations included Sistema, Vodafone, Children Investment Fund, Vedanta, Cairn Energy, etc.³

INVESTMENT UNDER BILATERAL INVESTMENT TREATY

The scope of rights and obligations under the BIT and who can petition the ISDS tribunal will depend on what the definition of 'investment' is in the BIT. Instead of its previous 'asset-based' definition, the BIT now has an 'enterprise-based' definition. As such, only companies legally incorporated in India can make BIT claims. Through a shift from an asset-based approach to an enterprise-based approach, India will be able to narrow the scope of investments that can be protected, which will reduce the number of BIT claims that can be made against it. To qualify as foreign investment, an enterprise must meet a duration requirement, but the duration hasn't

² Law Commission of India, *Analysis of The Draft Model Indian Bilateral Investment* (Law Com. No. 260 2015) <<https://lawcommissionofindia.nic.in/reports/Report260.pdf>> accessed 12 April 2022

³ Tojo Jose, 'What Is Model Bilateral Investment Treaty (BIT) 2016?' (*Indian Economy*, 29 July 2017) <<https://www.indianeconomy.net/splclassroom/what-is-model-bilateral-investment-treaty-bit-2016/>> accessed 13 April 2022

been specified in the investment definition. Furthermore, there are no instructions or methods on how to identify an investment as significant for development in the definition of foreign investment. Likewise, investment significance is listed as one of the criteria for qualifying as a foreign investment.

THE MOST FAVOURABLE NATION CLAUSE

According to the Most Favourable Nation provision of the BIT, the host state is prohibited from discriminating against investors of different nationalities, so that foreign investors are treated equally. To put it simply, the clause seeks to ensure that the relevant parties behave at least as they would if they were third parties.⁴ The White Industries case made it clear to India that the MFN clause violates the various bilateral treaty negotiation objectives in the realms of strategic, diplomatic, and political considerations. In response to this, India has removed the MFN clause from its new Model BIT. Yet this law puts foreign investors at risk of discriminatory practices by the host country and is against their interests. In contrast, the Canada Model BIT contains the Most Favoured Nation clause, which stipulates that investing states will not be discriminated against and that all investing states ought to be treated equally. The UK Model BIT contains a similar clause as well as the National Treatment clause that prohibits discrimination between foreign investors and nationals of that country.

FAIR AND EQUITABLE TREATMENT

There is no FET provision in the 2016 Model BIT. India decided against including a provision for FET due to the tendency of ISDS tribunals to interpret FET too broadly. Model BIT provision 3.1 provides that a country may not restrict foreign investment in a way that constitutes a violation of customary international law. The due process can be violated through both judicial and administrative processes depending on whether there is a denial of justice, inability to obtain justice, or blatant discrimination based on unfounded grounds, such as gender, race, or religion.

⁴ 'Most-Favoured-Nation Treatment In International Investment Law' (*OECD Publication*, November 2004) <http://www.oecd.org/daf/inv/investment-policy/WP-2004_2.pdf> accessed 13 April 2022

By linking Fair and Equitable Treatment to international law, the Model BIT averts any chances of a broad interpretation or misuse of the law. Additionally, customary international law, created by state practice, provides a minimum standard of investor protection. In any of the provisions concerning the denial of justice, the breach of due process, etc., the violation of customary international law must be proven for the claim to have merit. By attaching FET to international law, the Model BIT provides governments and regulators with greater creative freedom to investigate.⁵

ACQUISITION

Direct and indirect acquisitions are covered in the 2016 Indian Model BIT. Interestingly, it provides a similar understanding of what constitutes direct and indirect expropriation. The acquisition is the process of transferring ownership directly or indirectly. Ultimately, an investor's right to use, enjoy, and dispose of a property in its investment is taken away through indirect means whenever a measure (or series of measures) is taken that prevents the investor from using, enjoying, and disposing of the property without transfer of title. Additionally, the law specifies that indirect expropriation can be assessed based on the indirect effect, duration, and character of the measure. A series of measures are also included in indirect expropriation, thus covering creeping expropriation as well.

In terms of legality of expropriation, the 2016 India Model BIT stipulates that the Host State, except in instances where it serves a public purpose, must comply with due process and pay adequate compensation if it expropriates investments. The 2016 India Model BIT provides guidance on expropriating land by India as well as content regarding the denial of arbitrariness or discrimination. Also noteworthy is the exclusion of global exceptions such as non-arbitrariness or non-discrimination. Any measure of expropriation undertaken by India under its Land Acquisition Law shall be for the purpose set out therein, and any questions as to public purpose and compensation should be addressed in accordance with the law

⁵ Tojo Jose (n 3)

provided. As a result, a more detailed understanding of the standards that should be applied for determining the expropriation of land and compensation is provided.⁶

SETTLEMENT OF INVESTOR DISPUTES

BITs commonly incorporate investor-state dispute settlement. When an arbitral tribunal decides against the host state under ISDS, the host state is under an international obligation that cannot be cancelled under domestic law.⁷ By containing this clause, investors are protected from being entangled in legal proceedings in an alien jurisdiction. Prior to starting international arbitration, foreign investors must exhaust local remedies for a minimum of five years before India consents to ISDS in the 2016 Model BIT. A local remedy can only be employed for a period of five years and arbitration may only be used in cases where the dispute has been arbitrated. In such a case, the arbitral tribunal cannot assess whether the time limit is reasonable since India could argue that it has not exhausted its local remedies. In the case that an investor asserts that no local remedy is available in the dispute, the investor must prove that the same exists. As part of the effort to reduce the number of arbitration cases against India, this step was taken to allow for reduced disputes in the arbitration tribunal. However, in light of India's slow judicial process, ultimately this is not an investor-friendly measure and would discourage investment. Within three years from the date when the investor first acquired the investment, the Canadian Model BIT⁸ directs the investor to go directly into arbitration or knowing of the alleged breach and knowing that the investor has suffered losses or damages should have first been acquired. Similarly, under the UK model BIT, when local remedies are not successful at resolving the dispute, the dispute can be taken to a tribunal after a period of three months.

FULL PROTECTION AND SECURITY

"Full protection and security" (FPS) is another key provision contained in most BITs. As part of this provision, host states are required to provide FPS to foreign investments. The 2016

⁶ *Ibid*

⁷ Vienna Convention on the Law Of Treaties, 1969

⁸ Canada Model BIT, 2021, art. 22

ModelBIT stipulates that foreign investors and investments will receive full protection and security.²¹⁷ In addition, the 2016 Model mandates that foreign investors and investments are restricted to physical security only and do not include other obligations. The Indian Model BIT's clarity will curb arbitral discretion, given the arbitral confusion on the actual scope of the FPS provision. It enables investment protection to coexist with the regulator's power in the host state. In one sense, it requires that the host state provide physical security for foreign investments, and in another, it ensures that the host state adopts regulatory measures that ensure the foreign investment is protected and protected from threats. Such regulatory measures may be subject to challenge under other BIT provisions, but they cannot be challenged under FPS as violations. In the India Model BIT, the clear limiting of the scope could curb arbitral discretion, and it would also balance the rights of investors with the regulatory powers of host states. Essentially, it makes the host state legally and physically responsible for the security of foreign investment, while also ensuring that regulatory moves that may affect the business or legal environment cannot be challenged.FPS, though other BIT provisions may permit challenging such a regulated action.⁹

MONETARY TRANSFER PROVISIONS

Regulation of money transfers related to investment in and out of a country is made possible by the Monetary Transfer Provisions (MTP) of BITs. As part of BITs, MTPs cover transfers from investments already made, such as allowing inflow of capital for augmenting existing investments or releasing income generated by the investment. In the case of a transfer of capital, gains, dividends, interest payments, etc., an investor is permitted to transfer all the funds associated with their investment provided that three conditions are met. As mentioned in Article 6.1, the investor must comply with the laws of the host country regarding his or her right to transfer funds. A significant piece of legislation in India was the Foreign Exchange Management Act (FEMA) enacted in 1999 but includes a provision subjecting these

⁹ Nishith Desai, 'Bilateral Investment Treaty Arbitration And India With Special Focus On India Model BIT, 2016' (*Nishith Desai*, February 2018)
<https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Bilateral_Investment_Treaty_Arbitration_and_India-PRINT-2.pdf> accessed 13 April 2022

transactions to Section 6(2)¹⁰. A license granted to the Reserve Bank of India (RBI) by the central government includes the power to specify any class or classes of capital account transactions that are permitted, as well as the limits up to which foreign exchange may be used for such transactions. A number of capital account transactions can also be prohibited, restricted, or regulated by the RBI per Section 6(3)¹¹. It may also be necessary to restrict capital movement in circumstances where it could cause or threaten to cause "serious difficulties for macroeconomic management." However, it is still unclear which situations would qualify as a serious balance of payment difficulties under this formulation, which aims to strike a balance between the investor's right to transfer funds and the host state's regulatory power.

TAXES

Under Article 2.4 (ii) of the treaty, it applies to 'all laws and measures relating to taxation, including those for the enforcement of taxation obligations.' A regulatory measure relating to taxation may be determined by the host country, either before or after the arbitration commences, without troubling the judicial bodies. An arbitral tribunal shall not have the authority to review such a decision. Vodafone and Cairn filed BIT claims against India with regard to the retrospective application of taxation law, clearly motivating the decision to exclude taxation from India's future BITs. A state's freedom to enact its own tax laws leaves the international arbitral tribunal out of taxation law-making processes to a considerable degree, so that any abuse, whether arbitrary or discriminatory, would fall outside the scope of the state.¹²

CLAUSE DENYING BENEFITS

Investor-State dispute provisions can either be limited or expanded based on the denial of benefits mechanism in treaties. Investors can also limit their access to dispute resolution provisions in investment treaties by putting a denial-of-benefits clause in the treaty as well as restricting definitions of investment and investors. Parties whose business activities are not

¹⁰ Foreign Exchange Management Act, 1999, s 6(2)

¹¹ Foreign Exchange Management Act, 1999, s 6(3)

¹² Tojo Jose (n 3)

substantial in their home state can be denied benefits under the denial of benefits clause. They can also lose benefits if they are owned and/or controlled by nationals and/or entities of an unauthorized state.¹³

UMBRELLA CLAUSES

In a few BITs, the contracting parties agree to observe their obligations regarding investments made by investors of the other contracting party. In addition, a contracting party is required to "adhere to any obligations contracted with"; or "constantly ensure adherence to its commitments", when it comes to investments. By virtue of the aforementioned "observance of obligations clause" in the BIT, a State who does not observe its contractual obligations can be found liable for treaty breaches. These clauses are commonly known as umbrella clauses because they transform contract claims into treaty claims. A BIT includes clauses for the enforcement of obligations undertaken by the host state. These clauses are often interpreted as catchall provisions that, in theory, allow investors to bring a claim under the investment contract when the host state breached the BIT. It is an important provision, given that BITs are agreements made between two sovereign states and investment contracts are concluded between investors and states.¹⁴

CONCLUSION

A new model BIT adopted by India in the wake of the White Industries Case should be welcomed, with the aim that it ensures that the host state has the right to regulate. Indian authorities realized that the previous model BIT was vague and overstepped the government's regulatory authority once foreign investors sued India under different BITs. Despite this, India's new BIT, which keeps foreign investors' right to challenge the country's regulatory measures across borders, shows India's continuing involvement in the ISDS system, unlike countries such as South Africa and Latin America. In addition, many of the Model BIT's contents vary from country to country, an issue complicating International Investment Law. There is a lack of a proper dispute resolution system, as it is often seen that ISDS has failed to

¹³ Nishith Desai (n 9)

¹⁴ *Ibid*

formulate a principled approach to dispute resolution and that judgments are often inconsistent. One way of addressing these issues is by bringing uniformity through the acceptance of an international investment treaty. Additionally, establishing a global investment court is another way to ensure certainty by setting general standards for international investment law. Thus, the model BIT of India does not correspond to incremental reforms of Indian policy but rather to a radical departure from it. In order to be able to attract foreign investors to India, the Indian Model BIT needs to be revisited urgently. Even after three years of its existence, the Indian Model BIT has only been ratified by one state, which probably explains why this is not regarded as an investor-friendly BIT. The COVID-19 pandemic is clearly going to have a significant impact on many countries' BIT agreements and therefore, it would be a good idea to re-write the Model BIT in a way that will help his economy establish a foundation for growth by attracting foreign investment.