• BRIEFING PAPER •

Renegotiating India's Investment Agreements: A Policy Perspective

There has been an exponential growth in International Investment Agreements (IIAs), signed by countries to protect foreign investments, in the last two decades. IIAs[1] are treaties signed at the bilateral, regional or multilateral level by two or more countries to protect investments made by investors of respective countries.

IIAs protect investments by imposing conditions on the regulatory behaviour of the host state. These conditions include restricting the host state from expropriating investments, barring for public interest with adequate compensation; imposing restrictions on host states to discriminate against foreign investment, barring certain circumstances given in the IIA; allowing for repatriation of profits subject to conditions agreed to between the two countries; and most importantly allowing individual investors to bring cases against host states if the latter's sovereign regulatory measures are not consistent with the IIA to be monetarily compensated. This is known as the investor-state dispute settlement system.

Over the last decade or so, such investor-state disputes have increased manifold where all sorts of regulatory actions (such as urban policy, health policy, monetary measures, taxation and property rules) have been challenged by private investors.

India has entered into more than 80 such IIAs, including Free Trade Agreements (FTAs) with chapters on investment. The list includes almost all countries with major capital exports to India such as the UK, the Netherlands, Germany, France, Australia, Mauritius, Singapore and South Korea. Domestic regulatory measures that impact a foreign investor from any of these countries have to be compatible with the investment treaty; else it would give rise to an international claim. Thus, India has bound itself to international legal regimes to protect foreign investment from many countries.

India started entering into IIAs in early 1990s to attract foreign investments as part of an overall strategy of liberalisation and globalisation of economy. All these IIAs that India has entered into are for a 10-year period and are deemed to be automatically extended after this period unless either State gives notice in writing to terminate the treaty. Further, even if the treaty is terminated, the protection for the existing investments made in India will continue to apply for the next 15 years. So far, India has not terminated any of its IIAs. All IIAs contain investor-state dispute resolution mechanism. Furthermore, foreign investment flows to India have also increased manifold from US$393 million in 1992-93 to $26192 million in the financial year 2011-12 (up to January 2012).[2] Increase in the number of IIAs coupled with increase in foreign investment flows has increased the interaction between different layers of governments, at the centre and state levels, with foreign corporations belonging to one of the IIA partner countries of India and hence the possibility of a conflict due to the exercise of India's regulatory power.

Since February 2012, many foreign corporations have issued arbitration notices to India to commence investment treaty arbitration under different IIAs (see Table I).

Broad Provisions of IIAs

Definition of Investment

All Indian IIAs contain a broad asset-based definition of investment stating that

Table I: Arbitration Notices Served to India under Different IIAs

Company	IIA
Sistema	Russia
Telenor	Singapore
Capital Global and Kaif Investment	Mauritius
Vodafone International Holdings BV	Netherlands
Devas Employees	Mauritius
The Children's Investment Fund	United Kingdom

Source: "Taking Notice of Investment Treaties", *Business Standard*, 14 June 2012.

investment means every kind of asset. This broad definition is then followed by an inclusive or non-exhaustive list of assets, which includes direct investment, portfolio investment, intellectual property rights, rights to money or to any performance under contract having a financial value, business concessions conferred under law or contract. Such a broad definition of investment expands the jurisdiction of IIAs to virtually cover almost all areas of investment.

Fair and Equitable Treatment

Fair and equitable treatment (FET) has emerged as one of the most litigated issues in investment treaty arbitration. At the heart of this controversy is the meaning of FET. Almost all Indian IIAs contain the FET principle without providing much guidance regarding its meaning. Thus, determining the content of FET is left to the discretion of investment treaty arbitration tribunals.

Most Favoured Nation and National Treatment

Almost all Indian IIAs contain the MFN principle. This principle is worded broadly, making it possible for foreign investors to borrow beneficial treaty provisions from other treaties.[3] The only exception recognised to the MFN principle is for the purposes of taxation and obligations imposed by free trade agreements or custom areas.

Similarly, national treatment protection to foreign investment is offered in broad manner. The national treatment provision ensures that domestic and foreign investments are not discriminated. Barring a few IIAs like the India-Mexico IIA, the national treatment provisions in the majority of Indian IIAs do not contain the 'like circumstances' clause, which requires that in order to find out whether national treatment has been provided or not, only investments in 'like circumstances' need to be compared. This arguably broadens the national treatment protection to foreign investments. Further, barring IIAs with Japan, Korea, Singapore and Malaysia, none of the Indian IIAs provide sector specific exceptions to the principle of national treatment.

Expropriation

All Indian IIAs contain provisions on expropriation - very clearly stating that investment shall not be nationalised or expropriated (direct expropriation) or subjected to measures having 'effect' equivalent to expropriation (indirect expropriation) unless or until there is a public purpose, and further that in such cases fair and equitable compensation should be promptly paid to foreign investors. However, none of the Indian IIAs define the meaning of expropriation and hence leave it again to an investment treaty arbitration tribunal to determine whether a sovereign measure is regulation or expropriation.

Monetary Transfer Provisions

All Indian investment agreements contain a monetary transfer provision (MTP), which allows a foreign investor to freely transfer funds in and out of India. In majority of IIAs the provision on monetary transfer is broadly worded and does not recognize exceptions to transfer of funds across borders. In other words, Indian IIAs allow foreign investors to freely transfer funds without any restriction. This is despite the fact that India has not yet fully liberalised its capital account.

Treaty Exceptions

In majority of Indian IIAs exceptions to treaty obligations (Non Precluded Measures – NPM) are very narrowly formulated. In majority of IIAs, the exception is limited to 'essential security interest' (ESI) and, barring very few IIAs such as the India-Singapore and India-Korea, does not cover non-security related interests like 'public order', 'health' or 'environment' or on grounds such as 'to boost certain domestic industries' or 'domestic industries in economically backward regions'. This limits the grounds available to India on which it can deviate from its treaty obligations.

Reformulating Indian IIAs: A Policy Agenda

In order to balance investment protection with India's regulatory power, expropriation provision in all Indian IIAs be reformulated by specifying that expropriation means substantial deprivation of investment so as to make sure that any adverse economic impact on investment is not construed as expropriation.

Further, the reformulated IIA should also make it clearer that this deprivation should be for the investment activity as a whole and not for 'taking' individual property rights so as to make sure that tribunals do not indulge in conceptual severance and India is not penalised for those acts that do not substantially deprive foreign investment as a whole.

As regards, the FET provision, one option that India has is not to have the FET provision in IIAs such as the India-Singapore CECA. In case, India decides to have the FET provision, it should then provide the meaning of the FET provision in order to make sure that arbitral tribunals do not give interpretations that might result in unexpected restrictions on India's regulatory power. In this regard, guidance can be drawn from the ASEAN Comprehensive Investment Agreement, where Article 11 (2) states that "fair and equitable treatment requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process".[4] Thus, a provision like this limits FET to denial of justice.

India could consider having a FET provision which clearly links fair and equitable treatment to denial of justice and gross arbitrariness. This will help India to adequately protect its regulatory power by desisting an arbitral tribunal from adopting an expansive interpretation of the FET provision and at the same time allow foreign investors protection from grossly arbitrary actions of the Indian state.

It is equally important that the MTP should be reformulated to contain the following elements - it should allow the investor to transfer all funds related to investment in a convertible currency at the market rate of exchange; it should recognize clear exceptions to this right by allowing India to impose capital controls on such transfers provided such restrictions are imposed on an equitable and non-discriminatory manner; the grounds for imposing such restrictions should cover – both monetary and non monetary objectives; monetary objectives should include not just severe BoP crisis or external financial difficulty but also other monetary objectives like maintaining a healthy exchange rate or preventing too much volatility in the stock market; such restrictions should be consistent with the IMF Articles to make

Some Myths and Misconceptions about IIAs

India's flawed understanding of the real character of IIAs has given rise to all kinds of myths and half-truths. The first myth is that IIAs can be invoked only against the actions of the government, that is, the executive. On Sistema's notice, for example, the dominant view is that it wouldn't hold water because the licences were not cancelled by the government. This is erroneous. In addition to the executive, sovereign actions of the judiciary and the legislature can also violate international law contained in a IIA, for which India, as a country, will be liable.

A decision of any organ of the state, including the judiciary, can be challenged under a bilateral investment treaty, provided the action is an exercise of sovereign function. A recent case in point is White Industry, an Australian company, successfully pursuing a claim against India on the violation of the India-Australia BIT, involving the Indian judiciary.

The second myth is that IIAs do not apply to issues related to taxation. The IMG constituted in response to Vodafone's notice to the Indian government under the India-Netherlands investment treaty reportedly feels that taxation matters are outside the ambit of IIAs. The fact is they are a part of the host state's sovereign regulatory functions and hence fall within the ambit of IIAs, unless explicitly excluded. There are many instances where foreign corporations have raised matters related to taxation under IIAs. For example, an American company, Occidental Exploration, successfully pursued a case against Ecuador involving a taxation related issue under the US-Ecuador investment agreement.

The third myth is that only foreign direct investment (FDI) falls under the ambit of IIAs. Yet IIAs define investment in an extremely broad manner, covering all kinds of assets. The definition of investment in all Indian IIAs covers investment, portfolio investment, intellectual property rights, rights to money or to any performance under contract having a financial value or business concessions conferred under law or contract.

sure that there is consistency in India's international obligations pertaining to capital transfer; the MTP could create a distinction between portfolio investment and FDI in terms of imposing restrictions because portfolio investments are volatile whereas FDI is more stable though, at times, it might not be easy to distinguish between portfolio investment and FDI.[5]

NPM provision should be reformulated by adding 'non security' related permissible objectives such as 'economic and social development' 'public health', 'environment', 'public order and public interest', and 'economic crises'. Thus, with 'economic and social development' as a permissible objective in the IIA, India will not be worried to show that its NPM for such economic and social development need falls under ESI (which will require a high threshold).

These 'non security' related permissible objectives should not be self judging; though the 'security' related permissible objectives may be made self judging, but not non-justiciable and thus open for a good faith review. Making 'security' related permissible objectives non-justiciable might be misused to the detriment of investment protection.

The Way Forward

Given India's massive IIA programme and in light of the fact that many foreign corporations wish to use IIAs to challenge India's sovereign regulatory measures (e.g., taxation), it is vital that a full review of the Indian IIA programme is undertaken. Such a review is also imperative in light of India's deepening integration with the global economy by entering into more and more IIAs.

Renegotiating IIAs is not as difficult a job as is often made out because most IIA obligations are entered for 10 years with the option of reviewing the IIA after this period. Thus, an opportunity to review a IIA presents itself every 10 years. According to UNCTAD, since 1998 till date more than 130 IIAs, worldwide, have been renegotiated.

Further, renegotiating a bilateral treaty is easier in comparison to renegotiating a multilateral treaty like the WTO, for example. India has a pretty successful track record in renegotiating Double Taxation Avoidance Agreements (DTAAs) in order to address concerns related to tax evasion and black money. Thus, if bilateral DTAAs can be renegotiated, so can bilateral investment agreements.

— Prabhash Ranjan

Prabhash Ranjan is Associate Professor, National Law University, Jodhpur, India.

Notes and References

1. IIAs, used as a generic term in this paper, includes Bilateral Investment Treaties (BITs), Regional Investment Treaties (RITs) and investment chapters in Free Trade Agreements (FTAs) and in Comprehensive Economic Cooperation Agreements (CECAs). In India, IIAs are typically referred to as 'Bilateral Investment Promotion Agreements' (BIPA).

2. Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, "FDI in India Statistics" (available at http://dipp.nic.in/English/Publications/FDI_Statistics/2012/india_FDI_January2012.pdf).

3. *Maffezini v. Spain* (ICSID Case No. ARB/97/7); *MTD v. Chile* (ICSID Case No. ARB/01/7); *Bayindir Insaat v. Pakistan* (ICSID Case No. ARB/03/29).

4. Ewing-Chow, M. and Teck, N. W., (2008), "Caveat Emptor: Three Aspects of Investment Protection Treaties", 14 *Asian Yearbook of International Law*, 27.

5. For more examples of IIAs recognising exceptions to the provisions on monetary transfer, see Gallagher, K. P. (2012), "Capital Account Regulations and the Trading System" in K. P. Gallagher *et al* (*eds.*) *Regulating Global Capital Flows for Long Run Development* (Pardee Center Task Force Report: Boston University).

Briefing Paper # 7

August 2012

Madhyam Briefing Papers present information, analysis and recommendations on various public policy issues.

Madhyam
148, Maitri Apartments
Plot # 28, Patparganj
I. P. Extension
Delhi - 110092
Phone: 91-11-43036919
Email: madhyamdelhi@gmail.com
Website: www.madhyam.org.in

This work is licensed under a Creative Commons Attribution-NonCommercial-NoDerivs 3.0 License. You are welcome to reproduce Madhyam Briefing Papers for non-commercial purposes with due acknowledgments. We will appreciate if a copy of reproduced material is shared with us.

Photo credit: Duncan McLean (Flickr).