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Whither India's Bilateral Investment Treaty Framework?

In October 2013, Khaitan Holdings Mauritius Ltd (KHML), a Mauritius-registered company owning 26 percent equity in Loop Telecom, slapped an international arbitration notice against the Indian government seeking a compensation of US\$1.4 billion over the cancellation of its 21 telecom licenses by the Supreme Court of India on February 2, 2012. The Supreme Court had cancelled 122 licenses of 22 telecom operators as it found the allotment of spectrum was “unconstitutional and arbitrary” and directed the government to conduct fresh auctions for sale of the spectrum within a span of four months.

The claim issued by KHML consists of \$140 million invested by it in Loop Telecom in 2008 with 12 percent interest till the claim is received, loss of \$1 billion in shareholder revenue and loss of \$300 million in the market value of 21 licenses. The KHML has invoked the India-Mauritius Bilateral Investment Promotion and Protection Agreement (BIPA) which was signed on September 4, 1998 and became effective from June 20, 2000.

Except Mumbai, Loop Telecom switched off its all services in the country within weeks of court verdict. In April 2012, Loop's majority investors (Mauritius-based Capital Global and Kaif Investment) had jointly served a first notice to the Indian government for resolving dispute as per the terms of the India-Mauritius agreement. Consequently, Loop Telecom held a series of discussions with the Indian officials but both parties failed to work out a mutually acceptable solution. Loop Telecom

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also refused to take part in the subsequent spectrum auctions conducted by the Indian government to adjust the investments made by telecom companies affected by the court verdict. Despite being a small player in the Indian markets, Loop Telecom has been in news headlines for its alleged violation of foreign exchange laws and ownerships restrictions.

The Final Notice

The final notice is served by KHML which is also representing Capital Global and Kaif Investment. The KHML has reportedly filed arbitration under United Nations Commission on International Trade Law and offered to conduct arbitration proceedings outside India in London or Dubai.¹ Francis Xavier of Rajah & Tann, a Singapore-based law firm, has been nominated as its arbitrator. As per the terms of India-Mauritius BIPA, India should appoint its arbitrator within two months of notice served by the KHML. The response of the Indian government on the final notice has not yet been made publicly known.

Meanwhile, other foreign telecom companies (such as Sistema and Uninor) that had earlier served notices to the Indian government under different bilateral investment treaties have not followed through with the international arbitration after buying back spectrum through government-held auctions.

India's Ambitious BIPA Program

India's first BIPA was signed with the UK in 1994. As on July 2012, India has signed BIPAs with 82 countries (out of which 72 BIPAs have come into effect) and till recently the government was negotiating agreements with 20 countries including the US.² The growing numbers of BIPAs make India more vulnerable to investment claims initiated by private investors under the investor-to-state dispute settlement mechanism. As per the international law, the Republic of India is liable for all acts carried out by any of its organs including state governments, municipalities and local bodies. Hence, a foreign investor from a country that has signed BIPA with India can invoke the provisions of agreement and demand compensation for policies and regulations imposed by a municipality which affected its investment rights. In a large country like India with thousands of municipalities and local bodies, one wonders whether the true ramifications of investment protection provisions could ever be fully comprehended by such bodies.

In addition to BIPAs, investment protection measures are also covered under India's Comprehensive Economic Cooperation Agreement (CECA) with Singapore (2005), South Korea (2009) and Japan (2011). The investment protection provisions are included in the ongoing negotiations on bilateral free trade agreements with the EU, ASEAN, EFTA and Canada. It is important to note that BIPAs only deal with

protection of investment whereas CEAs cover investment liberalization and protection, trade in goods and services, intellectual property rights, government procurement, etc. A foreign investor from a country (e.g., South Korea) that has signed both BIPA and CECA with India can invoke either agreement for the settlement of disputes.

The Review of Model BIPA: Behind Closed Doors

In the light of several notices invoking provisions of India's bilateral investment agreements and demanding billions of dollars in compensation, the Indian government decided to put all ongoing BIPA negotiations on hold and initiated a review of model BIPA (which was approved in 1993) in 2012.

The review process of India's bilateral investment agreements is highly problematic due to a complete lack of public consultation and participation. Outside the government, no one knows the procedure and status of the review process. According to an official document accessed in March 2013, the Ministry of Finance has prepared and circulated a revised text of model BIPA for comments within official circles. It is beyond doubt that the review of model BIPA was carried out by bureaucrats without any consultative meetings with other stakeholders including domain experts, think-tanks and civil society groups. By not engaging with domain experts and other stakeholders, the government has lost an opportunity to benefit from their expertise on a highly complex policy matter.

What is even more disturbing is the fact that the revised text of model BIPA is not accessible to the public. This is despite the demand put forward by civil society groups that the draft text of model BIPA should be posted on the official website for wider public discussions. Even the revised text of model BIPA has not yet been shared with the concerned Parliamentary Committee.

In contrast, South Africa carried out an open multi-stakeholder review of its bilateral treaty program over a period of three years. Based on its review, the South African government released the draft Promotion and Protection of Investment Bill for wider public comments on November 1, 2013.³ Before the Bill enters the parliamentary process for ratification, it is open for public comments for a period of three months. If South Africa could undertake an open, all-inclusive and transparent treaty review process, why can't India – the largest democracy in the world?

BIPA Framework Needs an Effective Overhaul

The existing policy framework of India's BIPAs is highly biased in favor of protecting foreign investors' rights, as exemplified by a recent arbitral

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tribunal award (*White Industries Limited v. Republic of India*). The arbitral tribunal ruled in favour of White Industries and the Indian government paid a monetary compensation of Rs.258 million. This first ever investment agreement arbitral award against India has debunked the long-held official position that country's BIPAs maintain a fine balance between investor rights, investor responsibilities and regulatory space. Some of expansive provisions of India's existing BIPAs could open the floodgates for similar claims by foreign investors and the Indian government may end up paying full compensation.

Current approaches advocating international investment agreements are grounded on several myths.⁴ To begin with, there is no conclusive evidence that investment agreements lead to increased foreign investment. Nor does it boost the prospects of obtaining investment in future. On the contrary, there are ample cases where substantial foreign investment in the absence of any bilateral investment agreement. Though the US happens to be one of the largest foreign investors in India, there is no bilateral investment treaty between the two countries.

At the broader policy level, the Indian authorities need to recognize that foreign direct investment is not a panacea for development. There is hardly any reliable cross-country empirical evidence to support the claim that FDI per se accelerates economic growth. In the present circumstances, it is quite difficult to establish direct linkages between FDI and economic growth if other factors such as competition policy, labor skills, policy interventions and comprehensive regulatory framework are not taken into account. Further, in the absence of performance requirements and other regulations, many of the stated benefits of FDI would not occur.

The New Model BIPA: Key Policy Recommendations

Since there are conflicts between the BIPA's obligations and legitimate public policy objectives, a carefully and well-worded investment agreement could avoid potential disputes. There are myriad policy options available to the Indian authorities when it comes to drafting a new model BIPA or guiding the interpretation of existing agreements. To begin with, a notification could immediately be issued by New Delhi giving its interpretation of various standards contained in the existing bilateral investment agreements.

Secondly, India should preclude those ambiguous and controversial treaty provisions which could be interpreted in a very expansive manner by foreign investors and tribunals. Provisions such as fair and equitable treatment, free transfer of capital and umbrella clauses should preferably be dropped or at least incorporated with explicit qualifications. A narrow definition of investment (excluding portfolio investments and intellectual property rights) should be incorporated in the new model BIPA.

Thirdly, to prevent “treaty shopping” by foreign investors, policymakers should altogether remove the MFN clauses in the new model BIPA or at least prohibit the possibility of importing such clauses from earlier agreements signed by India.

Fourthly, India should not allow investor-state dispute settlement mechanism which gives rights to foreign investors to initiate international arbitration. This issue becomes even more serious as currently there is no provision of appeal against the awards of the international arbitration tribunal in the Indian courts. In 2011, Australia announced its decision to not include investor-state dispute mechanisms under its trade agreements with the developing countries. South Africa has recently introduced a Bill which does not provide foreign investors with recourse to international arbitration.

Fifthly, the main objective of BIPAs should not be investment protection alone. There are legitimate policy objectives (such as sustainable development and financial stability) which should also be incorporated in the bilateral investment agreements.⁵ Policymakers should ensure that the state's power to regulate business activities in the public interest is explicitly mentioned in the new model BIPA's preambles and other sections. No clauses should be included in the model BIPA which could bar the state from pursuing regulatory and other measures to pursue legitimate policy goals. There are some exception clauses (such as national security clauses) which are exempt from the agreement's obligations. India should enlarge the list of exception clauses by incorporating other policy priorities (such as taxation and financial stability) in the model BIPA.

Sixthly, New Delhi should set up a centralized mechanism to address all investment matters related to BIPAs and CECAs for better policy coordination and coherence within the government. Currently, there is a lack of policy coordination on bilateral investment agreements. The BIPAs are negotiated by the Ministry of Finance while CECAs are handled by the Ministry of Commerce and Industry. Only in the case of investor-state disputes, the government has recently established an Inter-Ministerial Group chaired by the Secretary of the concerned Ministry.

Lastly, the government should regularly inform Parliament and public on all major developments related to India's engagements with bilateral investment and trade agreements. Given the increasing complexity of international investment issues and their wider implications on economy and public at large, the government should incorporate a higher degree of transparency and initiate wider consultations with other stakeholders. Civil society groups have demanded that the government should appoint an independent commission to conduct comprehensive assessments of India's obligations under BIPAs and CECAs on pursuing a socio-economic development policy.

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More importantly, there is growing evidence to prove that BIPAs constrain the policy space and regulatory autonomy to pursue legitimate public policy objectives. Hence, the government should undertake an effective overhaul of the policy framework guiding the design and implementation of BIPAs. Perhaps India needs to learn lessons from South Africa which has fundamentally changed its approach towards BIPAs, despite tremendous external pressures.

— Kavaljit Singh

Notes and References

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Briefing Paper # 15

December 2013

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This Briefing Paper is prepared and published by Madhyam in cooperation with SOMO (The Netherlands).



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