

Unveiled: Indian Model BIT

Kluwer Arbitration Blog

January 18, 2016

Ashutosh Ray (Assistant Editor for South Asia) (Peter & Kim)

Please refer to this post as: Ashutosh Ray (Assistant Editor for South Asia), 'Unveiled: Indian Model BIT', Kluwer Arbitration Blog, January 18 2016, <http://arbitrationblog.kluwerarbitration.com/2016/01/18/unveiled-indian-model-bit/>

White Industries woke up India to the realities of Investment Treaty Arbitrations (“**ITA**”) during the end of 2011. Today, India has one of the highest numbers of ITA claims pending against it. The Government of India felt the need to have a new Model BIT to renegotiate existing treaties and to use it as a basis to sign new ones. It, therefore, initiated the process of redrafting its new Model BIT. Earlier this year, the Government had released a Draft Model BIT (“**Draft BIT**”) for public consultation and comments. The Law Commission of India also submitted its report analyzing the Draft BIT and suggesting changes. Finally, last week the Government of India finalized its Model BIT.

On several issues, the Model BIT differs from the Draft BIT. While the Model BIT contains new provisions which did not exist in the Draft BIT, most of the other provisions have been tweaked to make them leaner.

This piece seeks to give an overview of the Model BIT.

Preamble

The Draft BIT had envisaged only “promotion” as an objective. The absence of “protection” was one of the reasons for the criticism of the Draft BIT. The preamble of the Model BIT now includes “protection” of the investment as an objective. This step will be viewed positively not only by the investors who want to invest in India but also by the Indian investors who are now actively investing outside India. Thus, “promotion” and “protection”, considered to be the two cornerstones of a BIT, are now reflected in the Model BIT.

Definition of Investment

The Model BIT adopts an enterprise-based approach which means that an investor would have to be an incorporated legal entity in compliance with the domestic law to qualify as an investment. The Model BIT has, however, omitted the provision in the Draft BIT which required “real and substantial business operations” in the territory of the Host State. The 2003 Model BIT had an asset-based definition of investment, which had a broad ambit. The definition in the 2003 Model BIT was open-ended and could include an array of assets. The purpose of having an enterprise-based approach now is to narrow the scope of investments and likewise reduce ISDS claims against India. Like the Draft BIT, the Model BIT contains a negative list of investments, thus excluding among others: portfolio investments; intangible rights; interest in debt securities issued by a government; and judgment by a judicial, regulatory, administrative, or arbitral proceeding. Exclusion of goodwill and similar intangible rights may be a cause of dissatisfaction for investors as these are closely connected with any industry. Ideally, investors would prefer to have those interests covered by the definition of investment.

Scope

Like the Draft BIT, the Model BIT does not extend to the pre-investment activities including the terms and conditions applicable to them post-investment. The Model BIT also states that measures of local governments will be outside the purview of the BIT, and so will be the taxation measures. This is a result of recent ITA claims initiated by companies such as Vodafone and Cairn Energy. The Government desires to limit taxation related matters to the Double Taxation Avoidance Agreements. Exclusion of taxation measure was not necessary as the power to tax is anyway a State’s prerogative which is recognized well under the international law, unless the tax is arbitrary and blatantly discriminatory.

Full Protection and Security

The Draft BIT did not have “protection” as an objective in its preamble as it did not reflect any provision aiming at investor protection such as Full Protection and Security (“**FPS**”). The Model BIT, however, includes FPS. While defining the term, it limits its obligations only relating to the physical security of investors and investments. It also mandates the tribunal to determine if the local remedies have been pursued before claiming under this provision.

The purpose of clarifying the scope of FPS, stems from a trend in ITA claims, where FPS has been argued to have a broader scope than just meaning physical security. There have been cases where the tribunals, such as in *Azurix*, have gone to opine on FPS that *“it is not only a matter of physical security; the stability afforded by a secure environment is as important from an investor’s point of view.”* The Government of India’s objective to define the term is to make the term clear instead of leaving it to the tribunal to comprehend the meaning which may yield different results.

National Treatment

The Model BIT has a broader scope of National Treatment as compared to the text of the provision contained in the Draft BIT. Actions of the State Governments (i.e Sub-national Governments) were excluded from the purview of National Treatment in the Draft BIT. The Model BIT has taken a different stand and now includes their actions.

The Draft BIT was severely criticized for excluding the applicability of National treatment to the State Governments. There are 29 States in India. Excluding the State Governments from the National Treatment obligation may have severely dampened investor sentiments. India being quasi-federal in nature, the Constitution vests several powers to the State Governments to make decisions independent of the Union Government. Thus, including the actions of State Governments will be positively received by future investors.

Expropriation

The definition of Expropriation has undergone a change and is different from the definition in the Draft BIT. While the Draft BIT excluded non-discriminatory regulatory measures from the purview of expropriation, the Model BIT, in addition, has excluded measures or awards by judicial bodies. India has thus affirmed its stand that any measure by a judicial body aiming to protect public interest will be outside the purview of expropriation. This should not be a matter of concern for the investors, as the maturity and sensitivity of the judiciary in India is well acknowledged internationally.

Also, the Draft BIT had a clause which stated that an arbitral tribunal will not have the authority to review host State’s determination of whether a measure was taken for a public purpose or in compliance with the law. This clause has been removed

to give a more balanced outlook to the Model BIT. A tribunal will thus be able to decide on such measures and review the accuracy of such assertions by a State. This is an important change as the provision in the Draft BIT was seen as retaining being too pro-State regulation. Thus, this change should allay future investor's fears.

Non-Discriminatory treatment

The Model BIT has a new clause on non-discriminatory treatment for compensation of losses. This is a new addition and was not in the Draft BIT. The clause reassures the investors of non-discriminatory just compensation in certain circumstances such as armed conflict, natural disasters and in the state of national emergency.

Subrogation

The Model BIT has a clause on Subrogation, which was not covered by the Draft BIT. It foresees the situation of subrogation of rights to a State or its agency if they have paid the investor under a guarantee or a contract of insurance in respect of the investment. Therefore, a Party (the State of the investor) could exercise its rights against the other Party (the Host State) in terms of entitlement to such subrogated rights. This clause would be viewed positively by the investors as it may enable them to shift the burden on to their State while continuing their business without extreme financial disruptions. It will also encourage Indian investors to make use of this provision while making outbound investments.

Transparency

A new clause on transparency has been added in the Model BIT. This clause is different from the clause on transparency in arbitration proceedings. The Draft BIT did not have any corresponding provision. This provision mandates the Parties to ensure that all the laws, regulations, procedures and administrative rulings of general application regarding matters covered in the BIT are published or are available for interested persons to get acquainted with them. It, therefore, promotes clarity of laws and policies for the investors.

Investor Obligations

The Model BIT is significantly leaner than the Draft BIT in terms of Investor Obligations. The Model BIT requires the investor to comply with its laws. It has

done away with the provisions in the Draft BIT on “Obligations against Corruption” as well as on “Disclosures”. The provision on the former set out that the investor would not indulge in any activity amounting to corruption. The provision on the latter required the investor to maintain all records about its investments. The higher standard of disclosures was beyond the compulsory and minimum disclosures as required by the law of the Host State, much to the inconvenience for the investors. Similarly, the provision on “Home State Obligations” present in the Draft BIT is absent from the Model BIT. That provision required an investor to be accountable to the courts for civil actions in its own State (Home State) for any decisions made there in relation to investments made in the Host State. It placed responsibility on the Home State to ensure that nothing restricted initiation of such actions in the courts.

These obligations would not only have made it difficult for the investors to invest, it would have also made it difficult for their Home States to enter into a BIT in light of such stringent obligations.

Corporate Social Responsibility

The Model BIT has an interesting provision on Corporate Social Responsibility which mandates the investors to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies. It is a welcome step to encourage foreign investors to support various social causes in their Host State.

Conditions Precedent to Initiating Arbitrations

The Model BIT mandates exhaustion of local remedies as well as negotiations and consultations before an investor is entitled to initiate arbitrations against the host State. The limitation for initiating a case in the court of law is one year from the date on which the investor first acquires knowledge of the measure in question and knowledge that the investment has incurred a loss as a result. The Model BIT also leaves room for non-applicability of the conditions precedent if the investor can demonstrate that there are no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure or similar factual matters for which a breach of treaty is claimed by the investor.

General Exceptions

The State measures under the General Exceptions have been reduced in the Model BIT. Noteworthy in the Model BIT is the definition of the word “necessary” added by way of a footnote, for application of such measures. The footnote guides the tribunal to consider whether a measure is “necessary” by questioning if there were no less restrictive alternative measure reasonably available to a Party. This standard was not present in the Draft BIT.

The exceptions apply to measures of general applicability applied on a non-discriminatory basis that are necessary under certain circumstances such as to protect human, animal or plant life or health; public morals or maintains public order, *et al.*

Conclusion

The Draft BIT faced criticism because it was heavily biased in favor of the host State. This posed a problem for India to renegotiate its existing BITs with around 73 countries and for entering into new BITs. Owing to the language and stance of the Draft BIT, it was also perceived to inhibit India to negotiate BITs favorable to its own investors with countries where India was a capital exporting nation.

The Model BIT, to the contrary, has a balanced approach and is clearer. Throughout the Model BIT, usage of the neutral term “Party”, replaces “Host State” and “Home State” which existed in the Draft BIT. A careful reading of the Draft BIT revealed a bias towards the Host State and its right to regulate. The Model BIT does not give that impression outright.

The Model BIT gives a fair amount of room to India to negotiate BITs with different countries on different terms. India has over 40 BITs with countries where it is the capital exporting nation. This includes many African countries. As the appetite of Indian companies grows, in recent years there has been significant Indian investments in countries such as Switzerland, Japan and Australia.

The Model BIT may not be as generous as its 2003 predecessor but is far more balanced than the Draft BIT. To a large extent it has managed to strike a balance between the interests of the nation as well as that of investors, both inbound and outbound. As Government of India resumes treaty negotiations with the USA and EU respectively, it will be interesting to see how far India is able to push through the provisions of its Model BIT. It would also be interesting to see the willingness of other States to negotiate new BITs with whom India has entered into BITs earlier.