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## Bitten by the BITs, India looks to constrict its Model BIT

Vivek Kapoor (Stephenson Harwood LLP) · Wednesday, October 14th, 2015 · Young ICCA

The engines of economic growth in India are moving towards full throttle. In this resurrection of India as an economic giant, foreign investors are keenly looking at safeguards the Government of India is prepared to offer to ensure that the commercial bases of their investments are protected. The corner stones of investor confidence have always been transparency, predictability and clarity in policies and regulations. Capital preservation has always been as much of a consideration as investment return and capital growth.

The Government has recently released a draft Model Bilateral Investment Treaty (“Model BIT”) for comments. The finalized draft shall be used to negotiate any new BIT entered into by the Government, including the much anticipated US-India BIT. In addition, it would be used to renegotiate the 72 currently active BITs of India.

From the perspective of the foreign investor, the most significant role for this Model BIT should be to inculcate a deep sense of assurance that the Government in India is ready to walk the talk. Woefully, the draft Model BIT does not seem to be making that case.

To start with, the concept of investment that lies at the heart of any investment treaty is surprisingly ill-considered in the case of the Model BIT. The Model BIT has chosen the enterprise-based definition of investment over the widely used asset-based definition. The negative list, which includes intellectual property rights amongst others, added to the foreign direct investment-focused definition, further shrivels the form an investment can take.

From the perspective of a capital-importing country, the definition of investment identifies who the country’s *clients* are for purposes of investment policy – entrepreneurs, industries and groups that the country wants to attract in order to increase foreign investment. Investment of capital takes a multitude of forms in the world today and in recognizing this reality, the definitions of investment in contemporary treaties tend to be broad. A broad definition of investment reflects a desire to encourage foreign investment in all its forms, present and future.

With India looking to bring about a generational change in technology, expertise and enterprise, the present definition of investment needs to be discarded for a more progressive and dynamic one. Concerns of arbitral activism to expand the definition of investment to unexpected areas can be better addressed with the exclusion of specific types of assets (as has been done), or by using a closed-list definition with a wide asset-based list of examples which are exhaustive rather than illustrative, or by tempering the definition with characteristics of an investment established under the investment law jurisprudence.

Further, the crippling of many substantive protections is bound to dampen investor enthusiasm and confidence. The protection of “National Treatment” excludes from its purview laws and actions of regional (1 of the 29 states of India) and local governments, effectively leaving the substantive protection limited to the measures of the Union Government. Even though the Union Government holds the sway, the Constitution of India vests significant powers (various items listed on the State List of the Seventh Schedule of the Constitution of India) to the Indian states which they exercise independent of the Union Government. Local government is similarly empowered (Eleventh and Twelfth Schedules of the Constitution enumerate items on which the rural and urban local governments, respectively can exercise their powers), though on a much smaller scale. This means that there will be no recourse from any actions and policies of the regional and local governments, which may be contaminated with misplaced enthusiasm and wayward nationalism, or subject to the oscillating political cycles of India.

Next, the standard protection of ‘fair and equitable treatment’ has been replaced with leaner, imprecise protections. And the protection of ‘full protection and security’ has been completely left out. Though investments are to be protected from violations of due process and manifestly abusive treatment, but only if the violations of due process are “un-remedied and egregious” and the manifestly abusive treatment is “continuous, unjustified, and outrageous” coercion or harassment. The bar for a remedy, requiring egregious or outrageous state conduct, is high, and seems to suggest that lesser evils shall not be frowned upon. As the NAFTA tribunal in *Mondev International Ltd v USA* very aptly observed “what is unfair or inequitable need not equate with the outrageous or egregious”, and that “a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith”.

It is also difficult to understand what form of coercion or harassment could be justified (as opposed to unjustified) and why a single act of manifestly abusive treatment, that causes significant harm, should be excluded.

With a reputation of being mired in red tape, India is working hard to overcome its governance and ease-of-doing-business credibility crisis. The Model BIT, attempting to exclude “*services supplied in the exercise of governmental authority*”, reflects badly on the government’s resolve to give an efficient investment milieu to foreign investors. It is a clear reaction to the *White Industries* case (the slow, and sometimes inefficient, judicial system, cost India a few million dollars) and the *Louis Dreyfus Armateurs* claim (the Government allegedly failed to provide protection and security to the project, its employees and their families). The incongruity here is that every investor legitimately expects the host government to be warranting robust services, particularly those services which are supplied in the exercise of government authority and cannot be replicated by private service providers. At the top of that list are effective means of asserting claims and enforcing rights, i.e. efficient courts, and safe and secure business environment, i.e. law and order.

The echo of the *Vodafone*, *Cairn Energy* and *Vedanta* claims is glaring in the Model BIT’s exclusion of any taxation measures from its purview. Governments, no doubt, need to have a free hand in their taxation policy without suspecting a lurking investment claim. However, a carve-out for taxation should exclude from its purview retrospective taxation and unambiguous tax sops promised to draw investors. India’s past record in this regard is rather uninspiring.

The trepidations from the battery of recent investment claims filed against India are evident in the Model BIT. The drafters of the Model BIT, cockeyed in their focus, have endeavored to limit protections afforded to inbound investors in India in order to reduce exposure to future investment claims. However, they have ignored that the BIT lays down reciprocal investment guarantees, and

by the same token protections to outbound Indian investors venturing into foreign markets will also be shaved off. This is increasingly significant as India is now not only importing capital, but also exporting it, even though not on a comparable basis. Moreover, with Indian industry's increasing economic engagement on the South – South trackway, a BIT negotiated on this model would leave Indian investors to fend for themselves in case of an embittered investment in another developing country.

If India wants foreign investors not to be unsettled by the exclusion of the Most Favored Nation provision, the absence of market access commitments, the exclusion of an umbrella clause, and a requirement to first exhaust local remedies (though not endlessly), it needs to be seen as forthcoming in providing credible and robust assurances on the whole. In the present form of the Model BIT, essential facets like investment, national treatment, standard of treatment, expropriation, and dispute resolution are handled immaturely and reek of lack of a vision.

The Model BIT needs to adopt a perspective which is more progressive and aligns with the interests of India Inc even after decades. The drafters should be careful of not falling into the pattern of many previous policy reforms which fail to establish their relevance after few years, and in fact threaten the very objective for which they were brought in place. They must find the fine balance between investor rights, investor responsibilities and State's regulatory powers. The Model BIT in its present form resembles a half-baked cookie, which has all the flavors to be a delicacy but leaves a lot to be desired.

Note: an abridged version of this piece was published in the August 2015 edition of *Lex Witness*.

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