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Keeping a Distance: India's Approach towards Investment Treaties

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India's Parliamentary Committee on External Affairs (the "**PCEA**") recently submitted two reports to the Parliament relating to bilateral investment treaties ("**BITs**"). The first report –submitted in December 2021 – contained a broad review of India's engagement with BITs and made several recommendations. The second report – submitted in July 2022 – took note of the replies given and the action taken by the Government in response to these recommendations. The two reports cast much-needed light on India's approach towards investment treaties. This blog post identifies three key concerns expressed by the PCEA and briefly comments on India's approach towards investment treaties based on observations gathered from the deliberations of the PCEA.

1. Key Concerns Expressed by the PCEA

(i) Insufficient Progress in Negotiating New BITs

The first key concern expressed by the PCEA was the insufficient progress made by India in negotiating new BITs after the adoption of its 2015 Model BIT. The PCEA noted with some surprise that India has signed investment agreements with only four countries since 2015: Belarus, Kyrgyzstan, Taiwan and Brazil. It observed that the number of BITs signed after 2015 and currently being negotiated was "*inadequate*" and "*not commensurate with the growth of India's interest in this domain and* [its] *rising stature in global affairs*".

In this context, we note that despite serious concerns about BITs, India has expressed an intention to continue negotiating and signing BITs and to remain a part of the investment treaty system. It is currently negotiating BITs with 37 States and/or blocs – including several key economies.

At the same time, India seems to have adopted an extremely conservative mindset towards BITs. It has terminated all but six of its earlier BITs, and proposes to terminate a further three as soon as possible. India also does not appear to be actively engaged in negotiating new BITs to replace those terminated. India's negotiations with 17 States / blocs – which include key economies such as the European Union, Hong Kong and Australia – remain stuck at the preliminary stage. This slow progress is in stark contrast to the initial period from 1994 to 2011 where India signed multiple BITs almost every year. The Department of Economic Affairs, Ministry of Finance (the "**DEA**") has acknowledged this fact and stated before the PCEA that "[the] *Government of India* *has been lately pursuing a very cautious approach to signing BITs*".

This mindset finds its origins in the aftermath of the *White Industries Award* (the first investment dispute India ever lost) and the subsequent flood of investment claims against India. It appears that while India signed these BITs to attract foreign investment, it only later became aware of the consequences of the broad investor rights and protections granted in them and the consequential limitations on the state's regulatory powers.

(ii) Cost-benefit Analysis of BITs

The second key concern identified by the PCEA relates to the assessment of the costs and benefits of BITs. The DEA argued before the PCEA that the costs of BITs (including exorbitant litigation costs, large awards, loss of reputation, reduced policy space and legal uncertainty) outweighed the benefits (including expected higher foreign investment and legal protection of foreign investment). It also argued that there was no "*direct causal relationship*" between BITs and the inflow of foreign investment. While the DEA noted that a robust BIT regime seems to result in higher investment inflows, it dismissed this as a "*charitable reading*" of empirical data. It then referred to the sharp decline in the number of BITs in force after the termination of BITs by India and noted that such decline had not resulted in a fall in foreign investment. It asserted that the signing of BITs was not "*a necessary condition for investments*".

While the PCEA acknowledged that BITs were not the sole driving factor for investment inflows, it ultimately did not endorse the DEA's negative assessment of the costs and benefits of BITs. It observed that BITs provide greater confidence to businesses while investing — and to that extent — have the potential to attract foreign investment.

In our view, while there is some justification for the DEA's negative assessment of the costs and benefits of BITs, this assessment is not entirely accurate since it does not adequately weigh the benefits of BITs. Firstly, BITs foster the international rule of law by creating norms governing relations between foreign investors and States and holding States accountable for arbitrary, discriminatory or unfair conduct. Secondly, a robust BIT regime assures foreign investors that host States are committed to observing obligations under international law towards them. Thirdly, BITs are critical to protect Indian investments abroad – a key consideration that has received little attention, despite the substantial growth of outbound investments.

(iii) 2015 Model BIT

The third key concern was the need for revisions to the 2015 Model BIT. The PCEA observed that while the 2015 Model BIT strived to "*create a balance between the Government's right to regulate and investment protection*" and was "*an improvement over the earlier and older BITs*", it still needed "*fine tuning*" – particularly concerning dispute settlement, the definition of investment and investors' obligations.

In this context, we note that the 2015 Model BIT is viewed favourably and there is no specific interest in making significant revisions to address major points of divergence from global standards regarding the most favoured nation clause, the fair and equitable treatment clause, the investor-state dispute settlement (ISDS) mechanism, etc. Further, there is no inquiry into whether the 2015 Model BIT adequately serves the interests of Indian investors investing abroad.

Nevertheless, India appears to be facing significant challenges in negotiating new BITs based on the 2015 Model BIT. The Ministry of External Affairs (the "**MEA**") has informed the PCEA that negotiations with the United States have stalled since 2016 because "*both sides had different positions on issues related to Market access, Definition of Investments, Dispute settlement, taxation issues etc*". Two things should be noted here – (i) the negotiations, which were ongoing since 2009, stalled shortly after India adopted the 2015 Model BIT; and (ii) neither the MEA nor the PCEA explore or even acknowledge the possibility of the 2015 Model BIT being an obstacle for negotiating new BITs.

In our view, the 2015 Model BIT is likely to be perceived as excessively State-centric and not providing sufficient protection for investors. It is therefore unlikely to find acceptance amongst key capital exporting economies that place emphasis on investor protection. In that scenario, finding a middle ground is likely to be difficult and negotiations are likely to be protracted.

2. India's Approach towards Investment Treaties

India's approach towards investment treaties is one of consciously limited engagement. While India notionally remains a part of the investment treaty system, it has taken several steps to heavily limit its actual engagement with that system.

The question is whether this approach can adequately serve India's interests – including protecting India from the pitfalls of the investment treaty system. In theory, by heavily curtailing its engagement with the investment treaty system, India could restrict claims from foreign investors and thereby avoid the pitfalls of the investment treaty system. In practice, however, we believe this approach may not be of substantial benefit.

Firstly, by not signing new BITs to replace its earlier BITs, India is likely to be exposed to claims from foreign investors under its earlier BITs – which grant broad investor rights and substantially curtail the state's regulatory powers – for a significant period under their sunset clauses. This problem can only be solved by entering into new BITs that explicitly supersede or terminate sunset clauses under the earlier BITs.

Secondly, by adopting the 2015 Model BIT, which substantially diverges from global norms on several issues, India is likely to face considerable difficulties in negotiating investment agreements or investment protection chapters in trade agreements with key economies. It is likely that the 2015 Model BIT will not be accepted as a starting point for negotiations, and India may have to make significant concessions at the very outset.

Thirdly, by not maintaining a robust BIT regime, Indian investments abroad are likely to be vulnerable to arbitrary, discriminatory and unfair State conduct which could adversely affect India's foreign interests and, as a consequence, its domestic economy.

Conclusion

The investment treaty system today faces a legitimacy crisis as both developed and developing States ask serious questions about the legitimacy and functioning of the system and the outcomes it creates. From that perspective, India's approach of consciously limited engagement is understandable. India is also not alone in distancing itself from the investment treaty system. That said, this approach is unlikely to serve its interests.

Clearly, the better approach is to actively engage with the investment treaty system and to seek reforms by building broad consensus. The reform process is already underway and several proposals – particularly, the proposal for a multilateral investment court – deserve and require India's attention. India can play a significant role in the ongoing reform process, given its position as one of the largest economies in the world and a major recipient of FDI, and should strongly consider doing so.

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