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Implications of Bilateral Investment Treaties on Indian and Global Markets

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ABSTRACT

A Bilateral Investment Treaty is established through a formal agreement and sets out the terms and conditions for private investment between entities of two countries. The objective of BITs is to protect the investments made into the host country. Through imposing certain restrictions on the regulatory set up of the host country, BITs seek to protect the rights of the investor from any unreasonable interference. Beginning from November 25, 1959, when the first BIT was signed between Germany and Pakistan, till date, BITs have acted as a rather significant factor in shaping the foreign investment policy of many countries and the way investment and trade takes place amongst them.

This research concerns itself with the study and analysis of the Bilateral Investment Treaties, their growth and development through periods of economic and political instabilities and their impact on shaping the global economies such as Japan and France. The paper also focuses on the growth and development of BITs from the perspective of Indian economy, analysing important development in this regard and then proceeds to elaborate upon the outlook of the Courts, both domestic and International, in cases of dispute under such treaties.

I. INTRODUCTION

The making of rules in relation to international investment, is a multi-level task. Meaning, the task takes place at multilateral levels, bilateral levels and inter-regional and regional levels. The policy makers and other stake holders need to be well aware of the international investment contracts, the FDI policy and its impact on the participating nations. Acting as a means of protection or aegis to the rights of the overseas investor, over the recent decades, the Bilateral Investment Treaty have gained popularity and become integral to foreign investment. When it comes to multi-national investment talks, they have become sort of an underlying principle or norm. A Bilateral Investment Treaty or BIT is an agreement which establishes the terms of investment by entity of one country or state into the other state. The concept of BIT is often in news. BITs facilitate a number of guarantees or assurances such as,

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protection from expropriation, equitable treatment, free of cost transfer of means, etc., to the investor of one State into the territory of the investee state. While BITs are formally known to facilitate and "promote" investment and "protect" the rights of investor, it is very rare that they provide for "promotion" of foreign investment. In cases where a BIT is found to contain any such provision, it is of non-binding nature. However, under BIT, since the contracting state formally agrees to protect the rights of investor, it is said to work in furtherance or promotion of international investment. The type of investment under BIT is a Foreign Direct Investment. BITs are trade pacts with a major distinctive feature that allows for the settlement of disputes in an alternative manner, that is, through arbitration. Under this mechanism any investor whose rights as provided under the BIT have been violated, can reach out to international arbitration.

Over a period of time, the BITs have largely affected a country's planning and approach towards its inward and outward foreign investment policies and both past and modern governmental regimes of any country have been giving due regards to investment modernisation by bringing substantive reforms to their bilateral investment mandate. For instance, after receiving nod from the Union Cabinet, India reformed its BIT text in December 2015, and thus put forth the Indian Model BIT text[2] in 2016.

II. Growth and development

From being signed for the first time in 1959, to now spanning over 173 nations, which also includes members of OECD and more than 2700 agreements[3], the BITs have taken a crucial position in the current international investment market. This prominent growth in the BIT regime has can be divided into different periods which tell us about the development of the International Investment Agreements (IIAs). IIAs have been known as the backbone in emergence of BITs.

Two major factors led to the development of IIAs- collapse of multilateralism and conflict between the doctrine of sovereignty and nationality. On one hand, the sovereignty principle talked about absolute right of the state to all the claims that arose within its territorial jurisdiction, while on the other hand the nationality principle stated that every state has the right to protect and promote the propriety of its own national. This conflict between the principles led to a lot of tension between the contracting states, in the backdrop of which multilateralism seem to become a failing idea.

[2] F. No. 26/St20t3-IC

[3] UNCTAD, Annual Report 2011

1. The Pre-World War Era

Before World War II, the major, and perhaps the only instrument governing international investment was the national policy of a country. Any arising dispute majorly related to expropriation, like buildings or change in the territorial sovereignty. IIAs were existent at the international level, but instead of investment they focused on trade. For instance, the US signed FCN on a bilateral basis in the 1800s. The FCNs included the favoured nation clause, national treatment clause, expropriation compensation, etc. These treaties had a restricted scope as they focused only on property and not on the concept of investment which brings within it a larger concept of international relations. In case where there was no treaty, international law was relied upon.

After independence, Mexico undertook land reforms, which resulted in seizure of property that belonged to the Unites States. This gave birth to the Hull Rule which doctrine “prompt, effective and adequate” payment of compensation, by the host state to the investee in case of expropriation. Around the turn of the century, investments started to become controversial. This happened mainly due to:

a. Increasing governmental measures interfering with the foreign investment.

b. Nationalization of natural resources by nations.

c. Land reforms resulting expropriation.

These events also highlighted that the international law was in fact weak and merely persuasive in nature. Also, the Calvo Doctrine, later coming into existence, emphasized that international disputes be strictly kept within the domain of the legal system of the country.

2. The Post World War Era

The crisis that led to a total collapse of international trading system and financial institutions, the focal point of the post-world war world was reconstruction. Institutions were established to de-barricade international exchange and facilitate free flow of capital. Multilateralism became a foundation stone for reconstruction. For instance, the Havana Charter of 1948 was the first step to bring about rules for international investment. However it faced a lot of opposition as it afforded weak protection to foreign investor and was later abandoned.

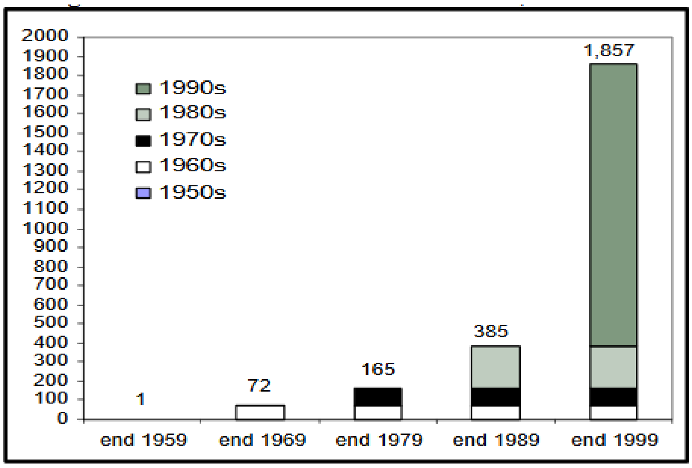
Decolonization resulted in a number of new developing countries which were entrenched with the fear of exploitation and as a result they framed policies to exert sovereignty upon commercial channels as well as political channels. Nationalization of natural resources was on the rise. Development models that emphasized towards the growth of domestic markets/industries were adopted, in place of models for promotion of imports. These approaches endangered the foreign investors. Expropriations were common.

In 1957, the Society to Advance the Protection of Foreign Investment was established by West German businessmen who proposed protection of rights with respect to private property in a foreign state. This was revised into the Draft Convention on Investment Abroad in 1959. The efforts to facilitate and promote investment came to a climax in 1974 with the New Economic Order[4] (NIEO) and Charter of Economic Rights and Duties[5] (CRED). NIEO achieved two main things- (1) barred use of international sanction on states in event of expropriation, and (2) de-recognized repayment in case of expropriation. On the other hand CRED emphasized the states to have full authority over national resources. Another attempt was made towards a multilateral agreement with respect to international investment was made with the Convention on the Protection of Foreign Property, but it did not open for signature. These failed attempts ultimately led to the development of bilateral investment treaty. It had two significant aspects:

1. Provision for compensation in case of expropriation.
2. Successful negotiations between participating nations.

After defeat in World War II, Germany experienced huge loss in foreign investment and therefore, was the first country to enter into BIT, with Pakistan in 1959. During 1960s, it was the decade where the BIT regime began and 49 treaties were concluded during this period with Germany concluding 21 out of the 49, followed by Switzerland with 14 treaties.

Fig. 1: Growth of BITs (1959-1999)



Source: UNCTAD[6] Report on BITs

[4] UNGA Res 3201 (1 May 1974)
[5] UNGA Res 3281 (XXIX) (12 December 1974)
[6] UNCTAD/ITE/IIA/2

III. BITS – SHAPING INVESTMENT REGIME OF COUNTRIES AROUND THE GLOBE

The post- world war period saw a number of reforms and initiatives being undertaken by the developing world to reinstate the economic order and promote international trade and investment. Since then, considering BIT as an integral instrument for inward and outward foreign investment, participating countries' policy makers and stake holders started framing the policy in a manner facilitative to the foreign investment. Let us understand the impact of BITs on shaping economy of some of its participating countries.

1. Japan

Recognizing the intense competition for energy and natural resources in the international arena, Japan diversified its destinations for investments such as, Middle East, Eastern Europe and Africa. The official stand of the Government of Japan can be concluded from an excerpt from its "Economic and Fiscal Reform 2008 (Basic Policies)[7]", which read as under:

"With regard to BITs, (the GOJ) will proceed swiftly and flexibly with negotiations to meet the actual needs. It will also decide in a strategic manner the priority for entering into new BIT negotiations."

In order to enter into negotiations, Japan has categorized countries into two parts. First, countries with investment risk, for example, lack of transparency, unstable regime, etc. Negotiations with such countries shall be based only if at least one of the following stipulations is being satisfied:

a. There is an existing Japanese investment stock of substantial amount.

b. Potential for growth in future.

c. Produces resources such as natural gas, exotic metals and oil.

d. Can act as entry point to destinations such as Africa & South America.

Second, countries with which relatively low effort is needed to produce a high quality agreement mainly because of a positive stance. The Government also considers request from industry for the purpose of deciding over new targets for negotiations.

The Japanese BIT regime focuses on "Improvement of the Business Environment" whereby it has set up committee to facilitate Government and investors to work in unison and improve the business scenario. The investors can directly discuss their issues with the government officials. These discussions may relate to infrastructure, administrative procedures,

[7] Ministry of Economy, Trade and Industry, *Economic and Fiscal Reform 2008 ("Basic Policies")*

Intellectual Property Rights, public safety or any other relevant issue.

2. France

It would be both risky and excessively ambitious to follow back the precursors of the advanced French Model BIT, which is the result of past historical events. Following World War II, as the United States were trying to support and encourage private global investment through FCN deals with more than two dozen nations, FCN arrangements got one of the fundamental kinds of intergovernmental contracts utilized for the assurance and advancement of FDI in developing nations. On 25 November 1959, France finished up a COE with the United States. The Preamble of the COE explicitly alludes to the "*strengthening [of] the ties of peace and friendship traditionally existing between the two countries and of encouraging closer economic intercourse between their peoples, conscious of the contribution which may be made to these ends by arrangements that provide in each country reciprocal rights and privileges on behalf of nationals and companies of the other country, thus encouraging mutually advantageous investments and mutually beneficial commercial relations*"[8].

France has now concluded 121 BITs, out of which 96 are in force. Opposed to the free trade agreements, the French Focus has been on the concluding the investment treaties. As part of expansion of France's BIT network globally, it has undertaken various negotiation models. The adoption of different models is necessary to keep in line with the new and upcoming economic and foreign policies and also, to clarify the existing policy scenario. The 2006 Model BIT is the latest text. It defines investors, covered investments, scope, application of treaty etc.

Under the French BIT regime, the decision to enter into negotiations is taken by the Ministry of Foreign Affairs and the Ministry of Economic Affairs in a joint manner. The primary responsibility to conduct the negotiations is of the Ministry of Economic Affairs, while the other departments and offices of the Government act as ancillary support to facilitate the negotiation. The responsibility for publication and ratification is upon the Ministry of Foreign Affairs. Article 53 of the French Constitution requires that all BIT related ratifications shall be subject to the parliament's approval.

3. United Kingdom

The BIT model is a key concern in UK's foreign investment regime. When it comes to the landscape of global development, the United Kingdom is seen as a key player having 105

[8] Convention of Establishment between the United States of America and France (Paris, 25 November 1959), TIAS No 4625, 11 UST 2398, 1960 WL 57354

BITs (2nd highest in EU). The UK BIT model allows the investor, to sue the government in case where they are of the opinion that the policy change is detrimental to their interest as an investor. UK is responsible for 8% of the total litigation in the world. Many have argued that the UK BITs enlist a number of clauses that can potentially damage and have consequences which are not intended for. The clauses under the treaty are worded in a vague manner, thus leaving gateway for a very wide interpretation by the arbitrators.

Commitments have been made by the UK government, ensuring that UNGP on Business and Human Rights will be strictly adhered to. Despite this, a review action plan is still what is called for.

IV. India's BIT mandate (1994-2016)

India's participation in the international investment market started in 1990's after the economic liberalization in 1991. Pre independence India did not have a foreign investment policy. It was only after the end of the British Raj, the foreign investment came into consideration. In 1951, the Industrial Development and Regulation Act was enacted which focused majorly on protecting domestic industries from abroad by putting import controls and high import duties. This policy was dominated by licensing constraints, through which strict entry barriers were created. It focused on the principles of Socialism, prevalent in the USSR at that time.

Experiencing huge economic loss due to the 1962 and 1965 wars with China and Pakistan, the R.K. Hazari Committee was established on 1st July 1966 for formulating new industrial policy and consider the need for technological advances. The findings of the committee and further deliberations led to the enactment of the MRTP Act, 1969 and the FERA, 1973. Both these Acts primarily focused to ensure that the interests of domestic players are protected and the foreign shareholding in an Indian company is under check.

Eventually, because of huge balance of payment crisis, it became necessary for the Government to take loan from the IMF, and India was forced to look "outward" from the perspective of foreign investment. As a result, the New Economic Policy of 1991, based on "Privatization, Globalization and Liberalisation" was recommended. Under the policy FERA was scrapped, realizing that the role of the Government with respect to foreign investment should be that of a "Manager" and not "Regulator". Ultimately the Foreign Exchange Management Act was enacted. It focused to facilitate foreign investment and lessen the Governmental interference.

1. 1994, India-UK BIT

India's first BIT was signed with the United Kingdom in 1994. The text of this BIT was more inclined towards protecting the foreign investment, and not towards the regulatory powers of the Government. This BIT became a point of reference for India and laid the foundation for future bilateral negotiations**.** In fact, one can observe a close resemblance of the 2003 Indian Model BIT with the 1994 BIT with UK.

2. White Industries Fiasco

The Australian mining company, White Industries, entered into a mining contract with Coal India (an Indian, State-owned co.). Disputes arose relating to payments, penalties and quality between the parties. White industries approached the ICC Tribunal, and subsequently in May 2002, the tribunal awarded a sum USD 4.08 million to the latter. To set aside the award, Coal India approached the Calcutta High Court and simultaneously, White Industries approached the New Delhi High Court for the enforcement of award. A stay was put on the enforcement proceedings, while decision remained pending on setting aside. White Industries then approached the Supreme Court where the matter remained pending for 9 years. Ultimately, it invoked proceedings under the India – Australia BIT, where India was held to be violating its duties under the BIT as it failed to provide investor with means to assert his claims and enforce his rights, and compensation of USD 4.08 million was awarded to White Industries.

3. Aftermath

A series of disputes between the investor and state trailed after the White Industries all the more especially because of administrative and authoritative regulations embraced by the Government of Indian in the following years[9]. These events forced the policy makers to bring about an instrumental change with respect to their stance in international investment. With the object to balance the regulatory requirements of the State and the rights of the investors, a review process was initiated under the Central Government Working Group in 2012. It aimed to set up dispute resolution mechanism. This led the regime to introduce a new model BIT, i.e., the Indian Model BIT of 2016.

4. Indian Model BIT, 2016

The Preamble of the 2016 Model BIT includes both promotion of investment and protection of investor's rights as its main objectives. This not only has a positive and welcoming impact on potential investors but also puts the Indian investors in a better light. The Model Bit has an enterprise based approach, meaning, the investment entity should be a legal entity,

[9] Vodafone v. India, UNCTIRAL, (Apr. 17, 2014); Deutsche Telekom v. India, ICSID Additional Facility, (Sept. 2, 2013); Cairn Energy PLC v. India (UNCI-TRAL)

incorporated under the domestic laws. This approach is different from the 2003 Model BIT, which had an asset founded approach and it thus widened the scope of investment. The current approach narrows the investment scope thus has the potential to reduce investor state disputes and claims. Some key features of the 2016 Model BIT are:

1. Full Protection and Security (**'FPS'**) entrenched in Preamble
2. Widened the scope of National Treatment
3. Change in definition of Expropriation
4. Inclusion of Non-discriminatory treatment clause
5. Transparency
6. Corporate Social Responsibility Clause
7. Mandatory exhaustion of remedies provided under local laws before initiating arbitration.

V. DISPUTE RESOLUTION AND JUDICIAL APPROACH

Across the globe there are a number of institutions that deal with international investment disputes. Institutions which are generally preferred by the parties in case of dispute are-

a. International Centre for Settlement of Investment Disputes
b. International Court of Arbitration
c. International Chamber of Commerce
d. Stockholm Chamber of Commerce

However, it is mandatory for the party to exhaust local remedies, before approaching the international arbitration mechanism. In the matter of *AMT vs. Democratic Republic of Congo*[10], the tribunal that under the duty of fair and equitable treatment, the investments must be secured by the national laws and the national laws shall be in conformity with the international laws. Merely saying that country's national laws exonerate it from all obligations relating to reparation is not enough.

In *Azurix corp. vs Argentine Republic*[11], where the Argintinian authorities allowed the political interest to impede the country's tariff regime, the tribunal favoured the Azurix Corp. and stated that the actions undertaken by the Argentinian Government were arbitrary and were in gross violation of the principle of fair and equitable treatment.

[10] ICSID Case No. ARB/93/1
[11] ICSID Case No. ARB/01/12

The Courts in India have shown a dynamic approach towards BIT dispute resolution, over the years, balancing the state's regulatory authority and the facets of the bilateral investment treaty.

In a significant judgment the Delhi High Court declined the Government's application obtain anti arbitration injunction[12]. The move was made against *Vodafone PLC*. Vodafone initially approached the arbitration process under the Indo-Netherland BIPA but after the Government of India raised questions upon the claim's jurisdictional viability, a subsequent arbitration followed under Indo-UK BIPA. The Delhi High Court also set out certain guiding principles on approach towards Bilateral Investment Protection Agreements. The judgment sets out a few points of reference to domestic laws and international treaty based arbitration, such as:

1. Sui generis and beyond the scope and ambit of the Arbitration and Conciliation Act.
2. Indian courts have inherent powers to restrict the investor from initiating arbitration if it was vexatious in nature.
3. Domestic courts to observe self-restraint, if treaty has its own dispute resolution system.
4. Principle of *Kompetenz Kompetenz* realised under Indian laws.
5. Interpretation of the investment treaties must be done in accordance with the international law and not the domestic or municipal law of the State.

In another case, where notice of dispute under the India – Mauritius BIT was issued by *Khaitan Holdings*,the Government again moved the High Court of New Delhi seeking an anti-arbitration injunction. Relying on the Vodafone PLC case[13], the Delhi High Court said that only the arbitral tribunal can determine if Khaitan Holdings qualified as investors under the India- Mauritius BIT[14].

VI. Conclusion

From the discussion above, it can be said that economies have not remained untouched from the growing impact of Bilateral Investment Treaties. Bilateral Investment Treaties exist on the premises that one country needs another in order to withstand forces of the changing world order and continuous economic growth and development. In order to become investor friendly and to increase influx of foreign capital, nations are relying more and more on BITs and this reliance seems to be expanding with the ever growing areas of trade, shipment and

[12] Union of India v. Vodafone Group PLC United Kingdom & Anr., 2018 SCC OnLine Del 8842
[13] *Ibid*
[14] Union of India v. Khaitan Holdings (Mauritius), 2019 SCC OnLine Del 6755

transport technologies and investor relations.

BITs' role in integrating the world economies is remarkable. Post-world war, there was a global need for reconstruction of finance and economy. For example Germany needed to get back into market, protect its foreign investments and thus entered into BIT with Pakistan. Globalization has been increasingly impacted with the advent of BITs, because increasing investor relation with foreign states has been objective almost all countries, for instance, India's economic policy of 1991 had Globalization as one of three fundamental premises.

The "standard of protection" provided by the BITs to the investor have not only built confidence in investment but also shows the extent to which the investee state is obligated to protect the interest of the investors. BITs have also successfully incorporated the two major international investment law doctrine the Calvo Doctrine and the Drago Doctrine. By providing protection to investors and prohibiting the use of military or diplomatic power by the investor state, BITs have achieved a balance between the rights of either parties. This also limits the interference by other states and thus upholds the principle of state sovereignty.

The dispute resolution mechanism has played its role in deciding conflicts in a significant way. The criteria that the parties need to first exhaust all local remedies before reaching any international dispute resolution organ, upholds judicial sovereignty of the nation and reduces the chances of vexatious and ill reasoned arbitrations. It is however required that the state must uphold the principles of BIT and provide the investor all forums and platforms to assert his rights locally. Negotiations have been made easy and simplified by the bilateral investment, as it solves number of problems posed by multilateralism.

Around the globe, multiple countries are shaping their foreign investment regime to become more and more investor friendly, amending their BIT model and entering into new BITs.

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