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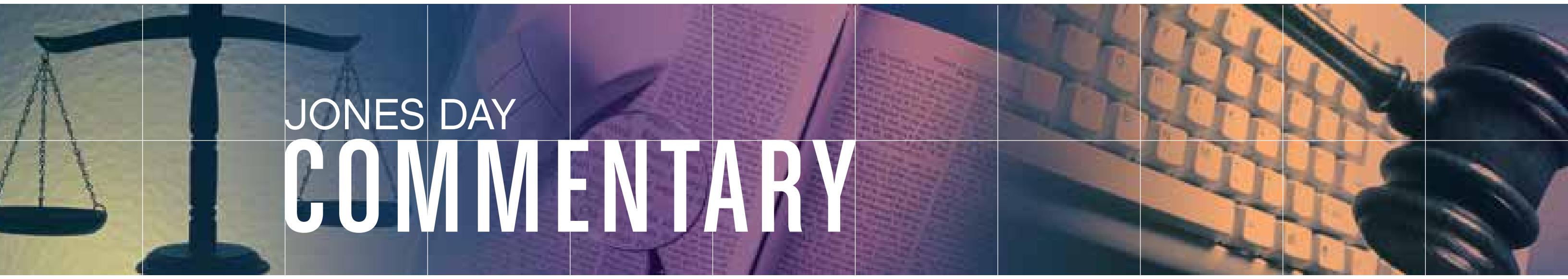

BIT PROTECTION OF FOREIGN INVESTMENTS IN TIMES OF VOLATILE CURRENCY, SLOW GROWTH, AND POLITICAL UNCERTAINTY IN INDIA

A depreciating rupee, slowing growth, and high inflation are some of the many risks confronting foreign investors in India. With elections due to take place in less a year, political uncertainty is also likely to afflict the country, which is home to 1.3 billion of the world's population. After the rupee reached record lows in August, the battered currency regained some ground in the last few weeks following announcements of planned reforms by the new head of the Reserve Bank of India, Dr. Raghuram Rajan. While reforms would be welcome by India's foreign investment community, experience indicates that government measures enacted in response to currency and economic crises, while intended to promote the general welfare, often result in unfair or discriminatory treatment of certain investors. Consequently, for example, the Asian economic crisis in the late 1990s spawned several high-stakes arbitrations by foreign investors against Indonesia. Similarly, more than a dozen foreign investors commenced international arbitration proceedings against Argentina following measures taken by the government to deal with the financial crisis in 2001. While no one is claiming India is in the middle of a full-blown crisis or would even necessarily take measures that would adversely affect foreign companies, investors should nevertheless be stepping cautiously.

Bilateral investment treaties ("BITs") have emerged as a mechanism to protect foreign investment in light of the palpable risks that foreign investors face in many parts of the world, including cancellation of concessions, leases, or licences; expropriation of shares; windfall, royalty, and other taxes; exchange rate risks; prohibition on the repatriation of profits; political interference; environmental regulation and remediation responsibility; land rights issues; riots; and protests, to name but a few. Faced with such risks, and given the possibility that national courts and laws may not provide an effective and unbiased means of resolving investment disputes, BITs provide foreign investors with an additional level of protection under international law. Moreover, BITs are not designed merely to encourage Western companies to invest in developing countries but are important for the protection of investors from developing states as they increasingly invest overseas.

In particular, BITs generally oblige the treaty parties to treat foreign investments in accordance with, at the very least, minimum international standards, and they bar expropriation without compensation or other arbitrary or discriminatory measures. Foreign investors may seek damages from the host state for breaches of the treaty's provisions and general principles of international law. Perhaps most importantly, BITs also provide for the resolution of disputes through arbitration before a neutral international arbitral tribunal. The advantage of arbitration is that, unlike judicial dispute resolution, the parties can appoint the members of the tribunal, the procedure is generally more flexible than in litigation, and the arbitral award may more easily be enforced internationally than court judgments.

India has signed 82 BITs, of which 72 are in force.[1] Among the countries with which India has concluded BITs are Australia, Belgium, Cyprus, France, Germany, Indonesia, Italy, Korea, Kuwait, Malaysia, Mauritius, Netherlands, Qatar, Russia, Sweden, Switzerland, and the United Kingdom. While not all have been popularly received, the protections contained in them are likely to stand for years, if not decades, to come and should be part of any investor's arsenal.[2]

This *Commentary* provides a brief overview of BITs; discusses India's recent investor–state arbitration experience and its evolving BIT policy; considers two of India's dozens of investment treaties—the Netherlands–India BIT[3] and the Singapore–India Comprehensive Economic Cooperation Agreement[4] (the "CECA"); and discusses enforcement of arbitral awards.

BRIEF OVERVIEW OF BITs

BITs are designed to promote and protect investments by investors of the other state party to the treaty. The investor's nationality is typically determined by the domestic law on citizenship in the case of individuals and by the state of incorporation and/or the seat of company management in the case of companies. Some BITs also provide that juridical persons incorporated in the host state but controlled by nationals of the other contracting state may be treated as foreign nationals. Treaties also may seek to exclude certain investors from the treaty's coverage through so-called "denial of benefits" provisions. These provisions are normally aimed at excluding "mailbox" companies with no substantial business activities in the state of incorporation, although they sometimes will also exclude entities controlled by nationals of the host state or a third country. Similar to tax planning, companies operating in foreign countries increasingly structure their investments through an entity incorporated in a state having a favourable investment treaty with the host state or restructure existing investments before a dispute is foreseeable so as to take advantage of treaty protections, if necessary.

Most investment treaties protect a broad range of investments, which encompass all assets, including but not limited to, moveable and immoveable property; company shares, stock, and debentures; claims to money or to any performance under contract; intellectual property rights, goodwill, and know-how; and business concessions conferred by law or under contract, including natural resources concessions. Of particular significance, most BITs permit investors to make claims for both indirectly and directly held investments.[5] Thus, in investment arbitration, parent companies or individual shareholders are often able to assert rights relating to an investment held through a subsidiary or holding company, including where that entity is organized under another country's laws. This is important because investments are frequently made through multiple layers of holding companies for tax, investment protection, or other reasons. Despite the breadth of the definition of investment, BITs would not protect investments procured through misrepresentation or bribery. Further, one-off sales transactions, passively held portfolio investments, or pre-investment expenditures will generally not qualify for protection either.

The key investment protections offered by BITs are usually (i) fair and equitable treatment; (ii) expropriation; (iii) protection and security; (iv) arbitrary or discriminatory measures; (v) "umbrella clauses"; (vi) national treatment and most-favored-nation ("MFN") treatment; and (vii) transfer of funds.

Fair and Equitable Treatment. The fair and equitable treatment standard has generally been defined to include (i) protection of legitimate and reasonable expectations that have been relied upon by the investor to make the investment; (ii) good faith conduct; (iii) conduct that is transparent, consistent, and not discriminatory; and (iv) conduct that complies with due process and the right to be heard. The investor's legitimate expectations are based on the host state's legal framework, contractual undertakings, and any undertakings and representations made explicitly or implicitly by the host state. Changes in the legal framework would not be considered as breaches unless they represent a reversal of assurances made by the host state to the foreign investor. For example, a tribunal found a breach of the standard by Ecuador where, in making the investment in Ecuador's hydrocarbons sector, the investor relied upon the availability of tax refunds and the state subsequently denied the refunds and provided unsatisfactory explanations.[6] The investor was awarded compensation in excess of US$70 million plus interest.

Expropriation. BITs usually require that the expropriation of foreign-owned property must be (i) for a public purpose, (ii) nondiscriminatory, (iii) in accordance with due process, and (iv) accompanied by prompt, adequate, and effective compensation usually equivalent to the fair market value of the expropriated investment. An expropriation may result from either direct transfer of title from the investor, or an indirect taking (e.g., a cancellation of a license) that substantially deprives the investor of the economic value, use, or enjoyment of its investment. Further, an expropriation may occur through a series of government acts, i.e., a creeping expropriation.

A government measure would constitute an expropriation if it effectuates a permanent loss of the economic value of an investment and falls beyond the government's powers to regulate the general welfare. On the other hand, the imposition of more onerous environmental regulations that, for example, increase environmental remediation costs but do not destroy the economic value of an investment, would not be considered an expropriation. Thus, in *Glamis Gold v. United States*, the tribunal dismissed Glamis's claims that the U.S. expropriated its rights to mine gold by regulatory measures that reduced the value of the mining project from US$49 million to US$20 million.[7] In contrast, in *Vivendi v. Argentina*, the tribunal found a creeping expropriation despite the fact that claimants continued to control the physical assets where Argentina had unilaterally modified tariffs, used its oversight power to afflict upon claimants unjustified accusations, used the media to create hostility toward the claimants, incited the claimants' customers not to pay, and forced the claimants to renegotiate the concessions.[8]

Protection and Security. The protection and security standard requires host states to take reasonable measures to prevent the physical destruction of an investor's property, including by third parties. For example, in *Wena Hotels v. Egypt*, the government breached the standard when it knew of, but failed to prevent, looting and forced seizure of the investor's hotel by employees of a state entity.[9] Some tribunals have extended the standard to legal as well as physical security, particularly where BITs provide for "full" protection and security.[10]

Arbitrary or Discriminatory Measures. Treaties usually impose a legal obligation on the host state not to impair the management or operation of the investment by "arbitrary or discriminatory measures." An example of a breach of the standard was found where, without justification, a state entity refused to pay a contractually agreed double tariff for electricity supplies to the producer operated by the investor while it continued to pay such tariffs to two locally owned producers.[11]

Umbrella Clause. An umbrella clause is a provision in an investment treaty that guarantees the observance of obligations assumed by the host state vis-à-vis the investor. Umbrella clauses thus may turn a host state's breach of contract or other commitment into a breach of the treaty. Umbrella clauses can be particularly useful to companies, since the host state often assumes obligations vis-à-vis investors in the form of concessions, leases, or licenses. Investors, however, should be mindful of the limitations of these clauses. If a contract contains an exclusive dispute resolution provision, some tribunals have held that the claimant must comply with the provision and the umbrella clause claim is inadmissible. Another possible limitation of umbrella clauses is that they may require privity of contract between the state and the foreign investor, thus leaving outside their scope contracts between the state and a locally incorporated company. For example, the *CMS v. Argentina* award was annulled in part on the basis that the obligations of Argentina under the license were obligations owed to the domestic enterprise in which CMS held shares and not to the investor CMS.[12]

National Treatment and MFN Treatment. National treatment clauses require the host state to treat foreign investors at least as favorably as it treats its own nationals. Conversely, pursuant to MFN treatment clauses, the state is obliged to treat foreign investors at least as favorably as it treats nationals from any country. An MFN clause ordinarily grants a claimant the right to benefit from substantive guarantees contained in other treaties to which the host state is a party (for example, to benefit from a fair and equitable treatment standard if one is not contained in the applicable treaty). On the other hand, attempts to use MFN clauses to extend the tribunal's jurisdiction generally have failed.

Transfer of Funds. Most treaties also provide that the investor has the right to carry out a transfer of funds in a freely convertible currency without delay and that the transfer takes place at the official rate of exchange of the host state on the date of the transfer. The schemes on transfer of funds vary between treaties, and it is thus crucial to examine the wording of the relevant treaty in order to determine the types of transfers that are permitted.

INDIA'S RECENT INVESTOR–STATE ARBITRATION EXPERIENCE AND ITS EVOLVING BIT POLICY

Although reports have suggested that India has been a party to at least nine unreported investment arbitration cases in the past,[13] India did not experience its first publicized loss in an investor–state arbitration until *White Industries Australia Ltd. v. India* in November 2011.[14] In *White Industries*, an Australian mining company that had suffered long delays in the Indian courts as it sought to enforce a commercial arbitral award against an Indian state-owned company initiated arbitration under the Australia–India BIT, arguing that India's inordinate delays resulted in a breach of India's investment protection obligations under the BIT.[15] The tribunal held in favor of the Australian investor, ruling that the investor's rights under the ICC award qualified as an investment under the BIT, and awarded it around US$5 million in damages.[16]

Additionally, in the past few years, India has seen a rising tide of investment arbitration cases brought against it.[17] Many of these claims, though by no means all, arose from the 2G license auctions conducted in 2008, which the Indian Supreme Court invalidated in 2012.[18] Companies that brought claims include Bycell, whose Russian and Cypriot investors relied on India's BITs with those respective countries; Russia's Sistema; Norway's Telenor, which is using CECA, as its stake in an Indian joint venture is through a Singapore-registered company; and Mauritius-based investors Capital Global and Kaif Investment, which are relying on the Mauritius–India BIT.[19] Vodafone also served a notice against India under the Netherlands–India BIT regarding a dispute worth almost US$3 billion over retroactive changes to Indian tax laws, although this arbitration is now temporarily shelved as both sides provisionally agreed to conciliation proceedings.[20] Other known disputes have arisen in the satellite[21] and mining[22] sectors. Given increasing foreign investor sophistication with and appreciation of investment treaties, the complex regulatory nature of doing business in India, and pressure to stave off the decline of India's currency, further disputes appear likely.

In the last several months, the Indian government has expressed strong dissatisfaction with the investor–state dispute resolution provisions of its BITs. In April, India's Finance Minister approved the creation of a permanent body to review and advise on the renegotiation of India's existing BITs, with a stated goal of achieving the renegotiation of all such BITs.[23] The apparent purpose of the renegotiations is to weaken or remove investor–state dispute resolution provisions from India's BITs. Despite this rhetoric, foreign investors may still take advantage of India's existing network of BITs which continue to provide access to investor–state arbitration until the BITs are renegotiated. Further, even if any BITs are terminated (which is *not* the stated intention of the Indian government), BITs usually have minimum periods for which they will be in force, with sunset clauses guaranteeing protection for a further period even after a notice of termination of the BIT.

TWO CASE STUDIES OF INDIA'S BITs

While consideration of India's entire network of investment agreements is beyond the scope of this *Commentary*, we consider two such agreements, the Netherlands–India BIT and the CECA. Both the Netherlands and Singapore are highly developed jurisdictions, well-known for their adherence to the rule of law, pro-corporation policies, and ease of doing business. In each case, a foreign investor seeking to obtain the protections of these agreements could do so by inserting a company established under the laws of that jurisdiction into the chain of ownership of its Indian investment, in accordance with the requirements of the applicable treaty. While many factors may influence an investor's decision to structure an investment in a particular manner—tax, corporate efficiency, etc., treaty-based considerations should also be relevant to that determination. Several key provisions from the two agreements, and their relevant differences, are discussed below.

Definitions of "Investments" and "Investors." Both the Netherlands–India BIT and the CECA construe "investments" broadly, defining the latter as "every kind of asset" including, without limitation, moveable and immoveable property, shares and other interests in companies, monetary claims and contractual rights, intellectual property rights, and business concessions.[24] The Netherlands–India BIT further requires that investments be "invested in accordance with the national laws and regulations of the contracting party in the territory of which the investment is made…."[25] For foreign investors, this reinforces the importance of working with both international and India-qualified counsel to fully assess the local laws and regulations that may be implicated by their contemplated investments, as states often seek to rely on nonconformity with such laws or regulations as a basis to deny substantive protections to a foreign investment under a BIT.

A potentially significant distinction exists with regard to the definition of "investors." Under the Netherlands–India BIT, there is no requirement that the investor demonstrate a certain level of business operations in the Netherlands or any conditions relating to the ownership or control of the investor. By contrast, the CECA provides that India may deny the benefits of the treaty to a corporate investor that "has no substantial business operations in the territory of [Singapore]" or if investors of India "own or control the enterprise."[26] A foreign investor availing itself of the CECA may thus need to maintain a substantially greater presence in Singapore than it would be required to maintain in the Netherlands under the Netherlands–India BIT and may not be owned or controlled by Indian investors.

Investment Protection Obligations. Material differences also exist with regard to the substantive investment protections under the two agreements. The Netherlands–India BIT provides for national treatment, MFN treatment, fair and equitable treatment, and full protection and security to the investment, as well as an umbrella clause, repatriation of capital and returns, and a prohibition on the unlawful expropriation of investments by the Indian government.[27] The CECA, on the other hand, provides for national treatment, repatriation of capital and returns, and a prohibition of unlawful expropriation but does not provide for MFN treatment, fair and equitable treatment, or protection and security.[28] The CECA also carves out substantial exceptions for measures to protect health, safety, or the environment.[29]

Investor–State Dispute Resolution. Both the Netherlands–India BIT and the CECA provide for investor–state dispute resolution through tiered dispute resolution procedures culminating in binding international arbitration, although the timing for pre-arbitral dispute resolution procedures varies.[30] Under the Netherlands–India BIT, an investor must attempt to negotiate settlement of the dispute for three months after giving notice of dispute to India, before the investor can initiate arbitration.[31] Under the CECA, an investor must attempt to resolve the dispute through consultations and negotiations for six months before initiating arbitration, and it must submit the dispute to arbitration within three years of the time at which it became aware or reasonably should have become aware of the breach.[32] Both agreements contemplate either ICSID or UNCITRAL arbitration.[33] As India is not a party to the ICSID Convention, ICSID Additional Facility (assuming the other state is a party to the ICSID Convention) or UNCITRAL arbitration are the only options.

ENFORCEMENT OF AWARDS

An award is usually enforced in jurisdictions where the respondent has assets. If an investor–state arbitration is conducted under the UNCITRAL Rules or the ICSID Additional Facility Rules, the award is usually enforceable pursuant to the New York Convention. India is a party to the New York Convention. Under that convention, the courts of most countries are obligated to enforce foreign arbitral awards, reviewing them only to the extent permitted under Article V (considering, for example, procedural irregularities and conformity with the state's public policy).

Unlike arbitration under the ICSID Convention, which is completely delocalized and eliminates the role of national courts from the arbitral process, the selection of an arbitral seat in UNCITRAL and ICSID Additional Facility arbitrations is crucial for many reasons. It plays a unique role in deciding the law governing the arbitration procedure. It determines the support or intervention that may be received from the local courts in the course of arbitration. It also has a bearing on the process and rights relating to enforcement of the arbitral award. Courts in the seat thus have authority to set aside an arbitral award on grounds enumerated in the arbitration law of the seat. Further, an award set aside at the seat may not be always enforceable internationally pursuant to the New York Convention. It is therefore crucial to choose a seat in an arbitration-friendly jurisdiction.

India traditionally has had a reputation of court interference with international arbitrations, whether they are seated in or outside India. In the landmark decision of *Bharat Aluminium Co v. Kaiser Aluminium Technical Services Inc.*, the Indian Supreme Court reversed this trend and ruled that Part I of the Indian Arbitration and Conciliation Act, which confers significant powers on Indian courts to order interim measures, appoint and replace arbitrators, and set aside awards, applies only to arbitrations seated in India.[34] The decision, however, applies prospectively, i.e., only to arbitration agreements concluded after the date of the judgment rendered on September 6, 2012.[35] In *Shri Lal Mahal Ltd. v. Progetto Grano Spa*, the Supreme Court also reversed its prior broad interpretation of the public policy exception, as it is applied to enforcement of international arbitral awards. The Court held that public policy with regard to enforcement of an international award must be given a narrow meaning and that a mere violation of the law of India was insufficient to violate India's public policy.[36] Despite these welcome trends, enforcement of an arbitral award in India may take several years. Luckily, as an award in investor–state arbitrations would be typically against the Indian State, claimants may be able to locate state assets and seek to enforce the award outside India.

CONCLUSION

In view of India's troubled currency, slow growth, and political uncertainty, all of which are likely to affect the economic climate in India over the next few years, any foreign company doing business in India must be aware of India's network of BITs that constitute an additional layer of protection for foreign investors and their investments. Investors can structure their investment in advance or restructure an existing investment with a view to gaining investment treaty protection—for example, by inserting into the chain of ownership a company incorporated in a state that has a favorable BIT with India. India's BITs also afford foreign investors access to international arbitration under the UNCITRAL Rules or the ICSID Additional Facility Rules (assuming the other state is a party to the ICSID Convention), ensuring that foreign investors are free from the biases of nationals courts and that their awards are enforced internationally more easily than foreign judgments. Although many of the investment protections across BITs may seem similar in wording, it is important to appreciate that each treaty is different and to seek specialist legal advice.

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ENDNOTES

1 *See* "Counsel to India Rails against 'Misuse' of BITs," *Global Arbitration Review*, Oct. 19, 2012.

2 *ICSID Database of Bilateral Investment Treaties*, https://icsid.worldbank.org/ICSID/FrontServlet.

3 Agreement between the Republic of India and the Kingdom of the Netherlands for the Promotion and Protection of Investments, signed on Nov. 6, 1995, entered into force on Dec. 1, 1996 ("Netherlands–India BIT").

4 Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, signed on June 29, 2005, entered into force on Aug. 1, 2005 ("CECA").

5 *See, e.g.*, *Siemens A.G. v. Argentina*, Decision on Jurisdiction dated Aug. 3, 2004, ¶¶ 135-144; *Azurix Corp. v. Argentina*, Decision on Jurisdiction, Dec. 8, 2003, ¶¶ 65-66, 74; *Enron v. Argentina*, Decision on Jurisdiction, Jan. 14, 2004, ¶ 49; *Oxus Gold v. Uzbekistan*, Decision on Jurisdiction, Aug. 9, 2012 (decision not public).

6 *Occidental v. Ecuador*, Award, July 1, 2004.

7 *Glamis Gold v. United States*, Award, June 8, 2009.

8 *Vivendi v. Argentina*, Award, Aug. 20, 2007.

9 *Wena Hotels v. Egypt*, Award, Dec. 8, 2000. *See also AMT v. Zaire*, Award, Feb. 21, 1997 (holding Zaire liable after incidents of looting by the armed forces).

10 *See*, e.g., *Azurix v. Argentina*, Award, July 14, 2006; *Siemens v. Argentina*, Award, Feb. 6, 2007.

11 *Nykomb v. Latvia*, Award, Dec. 16, 2003.

12 *CMS v. Argentina*, Decision on Annulment, Sept. 25, 2007.

13 *See* "India Is Planning to Exclude Arbitration Clauses from BITs," *Business Today*, May 8, 2012.

14 *White Industries Australia Ltd. v. Republic of India*, Award, Nov. 30, 2011.

15 *Id.* ¶¶ 4.3-4.72.

16 *Id.* ¶¶ 7.6.10, 16.1.1.

17 *See* "India Is Planning to Exclude Arbitration Clauses from BITs," *Business Today*, May 8, 2012; "India to Look at 82 BIPAs as Foreign Investors Invoke Global Arbitration," *The Economic Times*, Apr. 5, 2013.

18 *See* "Another Claim Looms over 2G Licenses in India," *Global Arbitration Review*, July 18, 2012.

19 *See id.*; "India Appoints Curtis in 2G Spectrum Case," *Global Arbitration Review*, Apr. 22, 2013.

20 "Vodafone Treaty Claim on Backburner," *Global Arbitration Review*, Aug. 23, 2013.

21 "Panel Formed in Billion-Dollar BIT Claim Against India," *Global Arbitration Review*, Apr. 24, 2013 (claims filed by three Mauritian entities arising from cancellation of a contract for launch of space satellites).

22 "Counsel to India Rails against 'Misuse' of BITs," *Global Arbitration Review*, Oct. 19, 2012 (a hedge fund with a 2% stake in state-owned Coal India brought a claim over government policies to support the domestic power sector).

23 "India to Look at 82 BIPAs as Foreign Investors Invoke Global Arbitration," *The Economic Times*, Apr. 5, 2013.

24 Netherlands–India BIT, Art. 1(a); CECA, Art. 1(a).

25 Netherlands–India BIT, Art. 3.

26 CECA, Art. 6.9.

27 Netherlands–India BIT, Arts. 4(1), 4(2), 4(5), 5, 7.

28 CECA, Arts. 6.3, 6.5, 6.6.

29 *Id.* Art. 6.11.

30 Netherlands–India BIT, Art. 9; CECA, Art. 6.21.

31 Netherlands–India BIT, Art. 9(1)-(3).

32 CECA, Art. 6.21.2-6.21.4.

33 Netherlands–India BIT, Art. 9(3); CECA, Art. 6.21.3.

34 *See* "India's Supreme Court Reverses Bhatia Decision," *Global Arbitration Review*, Sept. 6, 2012.

35 *Id.*

36 *See* "India's Supreme Court Overrules Itself on Public Policy," *Global Arbitration Review*, July 15, 2013.