

***Model Text for the Indian Bilateral Investment Treaty,
2015: A Re-Examination of the provisions defining
Investment and Expropriation***

Abstract:-

This article was written in the wake of India's termination of its BITs in 2017 with several nations, including at least 22 EU countries, as a consequence of which new investments in and from concerned nations would no longer be governed by the investment treaties assigned between the Governments. However, India released a joint interpretative statement intending that the then existing treaties with nations that were unconcluded would be aligned with the 2015 Model BIT Text. Therefore, touching on this issue, two specific provisions from the 2015 Text were examined in light of their impact on foreign inbound investments in the Indian subcontinent.

Key Words:-Trade; Investment; Law; Bilateral Treaty; India

1. INTRODUCTION

The Indian Government has recently issued notices in respect of its intention to terminate its Bilateral Investment Treaties (BITs) with several countries, including 22 EU countries. As a result, many of these BITs will reportedly cease to apply to new investments commencing in April 2017. For the remaining BITs which are yet to come to a conclusion after the completion of their initial term, India has released a new joint interpretative statement clarifying provisions so as to align its existing Bilateral Investment Treaties with the new BIT Model Text. India has further expressed its intention to align all its future BITs, free trade agreements and other multilateral trade arrangements with the Model Text. Unlike countries

30 which have previously terminated some or all of its BITs, India's action of
31 releasing a joint interpretative statement appears to be a move towards negotiation
32 with existing BIT counterparties on the substantive provisions of the Model BIT
33 Text.¹ In light of this, two specific provisions are being critically looked at, their
34 special significance arising from a reflection on the two way precipice which
35 foreign investments flowing into the Indian landscape is presently positioned on,
36 with both sides standing to lose; the provisions thus named concern the definitions
37 of 'investment' and 'expropriation' respectively, as in the original Model BIT
38 Text.

39 *1.1 RESEARCH QUESTIONS*

- 40 (a) What are the implications of adopting an 'enterprise' based definition of
41 investment as compared to the prior 'asset' based definition?
- 42 (b) Does the new Model Text allow for 'indirect expropriation' in an
43 investment context and whether if the same should be retained?

44 **2. AN ANALYSIS OF RELEVANT PROVISIONS**

45 *2.1 EVALUATING 'ASSET' BASED DEFINITION OF* 46 *INVESTMENT*

47 The new Indian BIT Model Text is an improvement from its predecessor
48 models. Unlike the model dating back to 1993, which used an "asset"
49 based definition of investment, covering potentially every kind of asset
50 (e.g., cash deposit in a bank account), the new model text of the Indian
51 Investment Treaty as released by the Government has adopted an
52 "enterprise" based definition of investment, thereby narrowing it to foreign
53 direct investment (FDI). The defining of investment in the following way:
54 "...investment does not include the following assets of an enterprise: (i)
55 portfolio investments of the enterprise or in another enterprise...(vi)
56 claims to money that arises solely from the extension of credit in
57 connection with any commercial transaction..." only goes on to show the

¹ Nicholas Peacock and Nihal Joseph, Mixed messages to investors as India quietly terminates bilateral investment treaties with 58 countries, Herberth Smith Freehills – Arbitration notes (March 16, 2017) <available at <http://hsfnnotes.com/arbitration/2017/03/16/mixed-messages-to-investors-as-india-quietly-terminates-bilateral-investment-treaties-with-58-countries/>>, as last accessed on April 3, 2017

58 purported intention of excluding entities that do not have any actual or real
59 or substantive commercial presence in the host state; the same is further
60 made clear in the joint interpretative statement as well.² Unlike the assets
61 based definition which would enable almost every kind of assets,
62 moveable and immovable, to qualify as investment and enjoy protection
63 under treaties whether or not they contributed to the development of host
64 countries, under the enterprise based definition the investor would have to
65 be an incorporated legal entity in compliance with domestic law in order to
66 be able to qualify for protection.³

67 An enterprise based definition mainly focuses on the establishment of
68 foreign investment in the host state as a new enterprise or the acquisition
69 of controlling stake in another enterprise in the territory of the host state.
70 This kind of an approach has already gained ground from the definition of
71 investment as laid down in the Canada States Free Trade Agreement (since
72 superseded by NAFTA): “a) the establishment of a new business
73 enterprise, or b) the acquisition of a business enterprise; and includes: c) as
74 carried on, the new business enterprise so established or the business
75 enterprise so acquired, and controlled by the investor who has made the
76 investment; and d) the share or other investment interest in such business
77 enterprise owned by the investor provided that such business enterprise
78 continues to be controlled by such investor”.⁴ However, there is potential
79 scope for raising the argument that the need for preserving development
80 objectives of host countries in a multilateral investment framework may be
81 accounted for by not merely narrowing the definition of investment but
82 rather by an inclusion of substantive provisions that include all countries,

² “...The Contracting Parties affirm that the Agreement aims to protect investors that have direct, real and transparent links with the economies of both Contracting Parties.” Paragraph 2.2 Consolidated Interpretative Statement, Department of Economic Affairs, Ministry of Finance, Government of India F.No. 26/07/2013 – IC;

³Kavaljit Singh, India and bilateral investment treaties – are they worth it?, Beyond Brics, Financial Times, 2015 <available at <http://blogs.ft.com/beyond-brics/2015/01/21/guest-post-india-and-bilateral-investment-treaties-are-they-worth-it/>> (as last accessed on February 17, 2017)

⁴ Key Terms and Concepts in IIAs: A Glossary, United Nations Conference on Trade and Development, United Nations Publications, 2004, at pgs. 94-96

83 and especially developing countries to pursue their respective development
84 objectives.⁵

85 As has already been noted by UNCTAD, development policy objectives
86 do not necessarily conflict with a broad definition since the coverage of an
87 investment agreement may be adapted to the respective needs and
88 obligations of the parties entering into an investment treaty thereto.⁶
89 Taking the above into consideration, the term 'FDI' has to be laterally
90 defined in order to cover within its ambit direct investment enterprises
91 including incorporated (subsidiaries or associates) or unincorporated
92 (branches) enterprises in which a direct investor owns 10% or more of
93 equity or voting power or an of its equivalents. Furthermore, in the
94 instance the director investor is found to own less than 10% of shares then
95 what must be taken into account is his possible representation in the Board
96 of Directors or his participation in perhaps policy-making decisions of the
97 company, etc.⁷

98 *2.2 EVALUATING RELEVANCE OF 'EXPROPRIATION'*
99 *CLAUSE*

100 Provisions describing expropriation being a common feature of bilateral
101 and multilateral investment treaties seek to balance the conflicting
102 interests of the investor's property rights and the host state's requirement
103 of regulatory leeway in light of 'public purposes'. Expropriation may be
104 carried out in two forms, namely, direct expropriation and indirect
105 expropriation. Direct expropriation is executed when the host State follows
106 a formal procedure of acquiring the title of the expropriated property from
107 the investor while indirect expropriation is carried out when the

⁵ Concept Paper on the Definition of Investment, Communication from the European Community and its Member States, Working Group on the Relationship between Trade and Investment, World Trade Organization, WT/WGTI/W/115, 16 April, 2012 <available at http://trade.ec.europa.eu/doclib/docs/2004/july/tradoc_111123.pdf> (as last accessed on February 17, 2017)

⁶ The Shift Towards Services, United Nations Conference on Trade and Development, United Nations Publications, 2004, at pg. 225

⁷ Refer August Reinisch, An Investment Competence of the EU after the Lisbon Reform Treaty?, Session 3: The Treaty of Lisbon and Investment Protection, European Law and Bilateral Investment Treaties: Exploring the Grey Areas, British Institute of International and Comparative Law & Lovells LLP, December 4, 2008 <available at www.biicl.org/files/3972_august_reinisch.doc> (as last accessed on February 20, 2017)

108 acquisition is made through indirect and prolonged measures which
109 ultimately divest the investor of his shareholding.⁸

110 India's Model Bilateral Investment Treaty Text too provides under Article
111 5, in the same manner as in its 2003 Model, for both direct and indirect
112 expropriation: "...Neither Party may nationalize or expropriate an
113 investment of an investor (hereinafter "expropriate") of the other Party
114 either directly or through measures having an effect equivalent to
115 expropriation, except for reasons of public purpose, in accordance with the
116 due process of law and on payment of adequate compensation..." In this
117 way, it may be said that the present Model Text as forming the subject of
118 discussion in this note provides, through the aforementioned definition as
119 well as in collation with the words "...Each Party shall not apply to
120 investor or to investments made by investors of the other Party, measures
121 that accord less favourable treatment than that it accords, in like
122 circumstances, to its own investors...", the emphasis being made here on
123 "in like circumstances", an oblique sanctioning of indirect expropriation⁹.

124 Host states have generally been provided with a right to regulate, under the
125 customary international law, without any concomitant obligation to
126 compensate, in order that it may protect or promote public interest or
127 interests in connection to the public purpose such as public health, national
128 security, human rights, etc. A foreign investment, therefore, faces the risk
129 of being adversely affected by measures taken on behalf of the host State
130 that does not directly concern the investment or which do not exterminate
131 the legal title of the investor with respect to the investment. Still, the State
132 could casually propose the argument that the disputable measure had been
133 passed in public interest and that therefore it would not be liable to
134 compensate the investors for any damages caused purportedly
135 unintentionally because of the measure is taken. The obvious implication

⁸ Prateek Bagaria and Vyapak Desai, Bilateral Investment Treaties and India, Nishith Desai Associates <available at http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Bilateral_Investment_Treaties_and_India.pdf> (as last accessed on February 20, 2017)

⁹ See Expropriation: UNCTAD Series on Issues in International Investment Agreements II, United Nations Conference on Trade and Development, United Nations, 2012, at p. 8 <available at http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf> (as last accessed on February 20, 2017)

136 arising here is that indirect expropriation, however it is termed or defined,
137 would in its broadest sense cover potentially any measure taken by the
138 host State causing an adverse impact on the foreign investment without
139 any added consideration being taken into account.¹⁰

140 Furthermore, Article 5.3(a)(ii) in the Model Text provides for a method of
141 determining indirect expropriation wherein the determination is made by
142 way of an appropriation of the investment by the host State. This would,
143 therefore, require a transfer of complete or near complete value of the
144 investment to the host State, implying thus that even if the investment was
145 entirely divested in both a legal and economic sense no indirect
146 expropriation would be seen to result unless the value of the investment
147 was transferred to the host State.¹¹ However, if we take Article 300A of
148 the Indian Constitution to be the strict authority for the purpose of any
149 reading on this point, it clearly establishes the legality of expropriation by
150 means of direct measures and the containment of an ‘indirect
151 expropriation’ clause in the Indian BIT Model Text today would have to
152 be strongly reproached since there is no coverage for indirect
153 expropriation under Article 300A.¹²

154 Thus, instead of the mechanism as has been laid out in the Indian Model
155 text, the ideal recourse would be to incorporate the ‘Sole effects’ doctrine
156 as a test for determination of expropriation. The said doctrine posits that
157 the only determining factor in respect of whether an indirect expropriation
158 has resulted would be to test the effect of the governmental measure on the
159 investment. If the purported interference exceeded a certain level, there
160 would be expropriation irrespective of the purpose behind the attempted
161 measure. The *Metalclad*¹³ example may be referred to in order to
162 substantiate this line of reasoning. In *Metalclad*, the claimant had received

¹⁰ Suzy H. Nikiema, Best Practices Indirect Expropriation, Best Practices Series, International Institute for Sustainable Development, March 2012 <available at http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf> (as last accessed on February 20, 2017)

¹¹ Analysis of the 2015 Draft Model Indian Bilateral Investment Treaty, Law Commission of India, Report No. 260, Article 3.2.3, August 2015, at p. 18 <available at <http://lawcommissionofindia.nic.in/reports/Report260.pdf>> (as last accessed on February 20, 2017)

¹² Constitution of India, 1950, Art. 300A

¹³ *Metalclad v. Mexico* ICSID Case No. ARB(AF)/97/1

the assurance of the Federal Government of Mexico that a project of its meant for a hazardous landfill facility was in proper compliance with the relevant domestic environmental and planning regulations. Despite the assurance provided, the requisite construction permit was denied by the local municipal authorities and the regional government further declared the land in question to be a national area for the purpose of protecting a rare plant species. The tribunal, however, took account of only the effects and not the motives of the measure. The question that was determined was whether the investor had been deprived of his economic benefit in the investment and it was ultimately answered in the affirmative.¹⁴ In *Vivendi II*¹⁵, it was stated that ‘if public purpose automatically immunizes the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose’.

3. CONCLUSION

From the discussion that has been carried out on the provisions as contained in the new Indian BIT Model Text, namely, definitions of investment and expropriation, the said two definitions having been picked for emphasis as opposed to the rest of the definitions contained in the Text because of its relevance from international/foreign inbound investments, what seems to form as the overarching conclusion is the need for adopting such uniform rules, tests and measures that reflect the nation’s susceptibility to and stability for attracting inbound investments from abroad. However, it is also to be necessarily seen and verified that such concerns are balanced against the domestic financial position so as to not cause any disadvantage ultimately to the country’s own internal financial controls, regulations, and dynamics through the risk of undue exploitation of potential loopholes in the governing Text.

¹⁴ Ursula Kriebaum, Regulatory Takings: Balancing the Interests of the Investor and the State, The Journal of World Investment & Trade, at p. 724 <available at http://www.univie.ac.at/intlaw/kriebaum/pub_uk_12.pdf> (as last accessed on February 20, 2017)

¹⁵ *Vivendi v. Argentina* ICSID Case No. ARB/97/3