



Inside India's IP Market: a Guide

2024

**A Shift in Approach to Investor-State
Dispute Settlements Prompts a
Re-evaluation of Foreign Investments**

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The first edition of Inside India's IP Market provides invaluable on-the-ground intelligence and analysis on a range of trademark and patent topics, covering every stage of the IP lifecycle and the unique challenges and opportunities facing rights holders in India.

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A Shift in Approach to Investor-State Dispute Settlements Prompts a Re-evaluation of Foreign Investments

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INTRODUCTION

Investor-state dispute settlement (ISDS) has become a critical aspect of international investment law, providing a mechanism for resolving disputes between foreign investors and host states. ISDS is a mechanism that allows investors to bring claims directly against a host state for alleged treaty violations. It is commonly included in bilateral investment treaties (BITs) and other international investment agreements. BITs are reciprocal agreements between two countries to promote and protect foreign private investments in each other's territories. BITs protect investments by imposing conditions on the regulatory behaviour of the host state and, thus, prevent undue interference with the rights of the foreign investor.

In the Indian context, ISDS has gained prominence with the surge in foreign investments. Historically, India has embraced ISDS mechanisms through numerous BITs, seeking to attract foreign investment. However, recent years have witnessed a shift in India's approach, prompting a re-evaluation of the existing agreements and the introduction of a new model BIT. This article delves into India's approach to ISDS, recent developments in investment arbitration and the implications of ISDS in India for foreign investors.

INDIA'S APPROACH TO ISDS

HISTORICAL PERSPECTIVE

India's engagement with ISDS can be traced back to the economic liberalisation in the early 1990s when the country opened its doors to foreign direct investment (FDI). As a part of this process, India entered into numerous BITs and multilateral agreements, establishing the foundation for ISDS. India's early engagement with ISDS reflected a pro-investor stance, aiming to create a favourable climate for foreign capital. India signed its first BIT with the United Kingdom in 1994. Post-1991 economic reforms and up to 2015, India signed BITs with 83 countries, out of which 74 were enforced. These BITs were largely negotiated based on the Indian model BIT text of 1993.¹ There have been extensive socio-economic changes since the first approval of the model BIT text in 1993, including the evolution of the nature of regulations governing foreign investment. The 1993 model BIT text contained provisions that were susceptible to broad and ambiguous interpretations by arbitral tribunals.² During the past few years, significant changes have occurred globally regarding BITs in general, and investor-state dispute resolution mechanism in particular.³

BIT FRAMEWORK

India's BIT framework has evolved over the years, with the country signing agreements with various nations. India's BIT framework has evolved in response to changing economic priorities and a desire to strike a balance between protecting investors and safeguarding regulatory autonomy. India's BITs typically include provisions for the protection of investments, guarantees against expropriation and mechanisms for dispute resolution, predominantly through arbitration. Some of the key provisions of India's BITs include:

- protection of investments;
- guarantees against expropriation;
- fair and equitable treatment;
- national treatment;

- repatriation of profits and capital; and
- dispute resolution mechanisms.

Be that as it may, a look at various BITs to which India is a party will make it clear that each BIT is quite different from the other in its own way, although there are many common characters present. These common characters are in form of specific rights. The basic premise is that the government will not risk investors and their investments unreasonably or inappropriately.⁴

MODEL BIT 2016 AND INDIA'S POLICY SHIFTS IN INTERNATIONAL INVESTMENT

In an attempt to address concerns about investor protection and balance sovereign interests, signalling a departure from the traditional ISDS framework, India introduced the Model Bilateral Investment Treaty by way of Office Memorandum F No. 26/5/2013/IC dated 28 December 2015, which was adopted on 14 January 2016 (the Model BIT 2016). It was shortly thereafter that India decided to terminate 58 out of its 83 BITs.

The Model BIT 2016 incorporated provisions for dispute resolution, emphasising transparency and the exhaustion of local remedies before resorting to arbitration. Unlike the 2003 version, the Model BIT 2016 was very detailed, containing 38 articles divided into seven chapters.

Below are the key features of the Model BIT 2016:

- Customary international law: article 3.1 set out that investments would not be subject to measures in violation of customary international law. The previous Model BIT 2016 contained a provision requiring the host state to grant fair and equitable treatment (FET) to an investor. Tribunals applying this standard have held that FET involves reasonableness, consistency, non-discrimination, transparency and due process. The removal of a FET provision and inclusion instead of a customary international law provision may be seen as something of a watering down of substantive protections, although still offering investors a base level of protection.⁵
- Full security and protection: article 3.2 set out that investors and investments are granted full protection and security, which created an obligation on the host state physically to protect investors and their investments.⁶
- National treatment: article 4.1 set out that investors would be treated no less favourably than nationals of the host state. This created an obligation on the host state not to act in a discriminatory manner against foreign nationals, therefore providing an important fundamental protection to attract FDI.⁷
- Expropriation: article 5.1 provided that an investment may not be nationalised or expropriated, except in accordance with the law of the host state and upon payment of adequate compensation. In common with most BITs, this does not prevent the host state from nationalising an investment; rather, it ensures that any nationalisation must be carried out with due process and that investors will be adequately compensated. Adequate compensation is set out to be at least the fair market value of the investment on the day before the expropriation takes place and must be paid in freely convertible currency. Article 5.3 clarifies that this provision covers both direct and indirect expropriation. Direct expropriation covers situations where the host state takes actual ownership of the investment. Indirect expropriation covers situations

where the state interferes with an investment, to the extent of depriving the investor of the use or benefit of it, as though it had been nationalised.⁸

- Consent to arbitration: article 17.1 contains a standing offer by the host state to arbitrate any dispute under the Model BIT 2016. Article 15 sets out that to submit a dispute to arbitration, bar certain exceptions, an investor must first exhaust all local remedies for five years.⁹

Certain common investor protections have been left out of the Model BIT 2016, which are the key policy shifts reflected in Model BIT 2016:

- FET: as explained above, the previous Indian model BIT contained a FET clause. This is a common and valuable provision in BITs and is often the subject of claims before arbitral tribunals. Although investors should note its absence, the United Nations Conference on Trade and Development has suggested that this provision could be made redundant by the inclusion of a customary international law clause, which the Model BIT 2016 contained. While a customary international law clause may not go quite as far as a FET clause, investors should be reassured it provides a similar form of protection.
- Most favoured nation: the previous Indian model BIT also contained a provision requiring the host state to treat investors no less favourably than investors from other countries. A most favoured nation (MFN) clause is generally included to level the playing field between foreign investors. Although the Model BIT 2016 no longer contained a MFN clause, the national treatment clause set out therein provided that treatment will be at least no less favourable than that to nationals of the host state, so there is a minimum standard.
- Umbrella clause: another provision not included in the Model BIT 2016 was a clause that required both parties to observe contractual obligations. This is known as an umbrella clause, as it effectively brings contractual obligations under the umbrella of BIT protection.
- Exclusion of regulatory measures: article 2.4 of the Model BIT 2016 specifically excluded from its scope certain regulatory measures, including any measures by local governments, taxation measures, compulsory licences, government procurement, grants and subsidies provided by the government and services supplied in exercise of government authority by body or organ of the host state.

ISDS AND TERMINATION OF 58 BITS WITH OTHER STATES

BITs are meant to protect the rights of both the investors and the host state, which are usually concluded between developed and developing countries based on the assumption that they promote investment from investor countries to investment-receiving countries. Most importantly, it allows individual investors to bring cases against host states if the latter's sovereign regulatory measures are not consistent with the BIT, for monetary compensation. This is known as ISDS.

Chapter IV of the Model BIT 2016 deals with settlement of disputes between an investor and a party. With respect to dispute settlement, procedural and substantive conditions have been introduced to check investor access to investor–state arbitration. Certain key conditions include:

- the Model BIT 2016 requires exhaustion of local judicial or administrative remedies for at least five years prior to commencing investor–state arbitration under Chapter IV, unless the investor can demonstrate that no domestic remedy would be capable of providing relief (article 15);
- exclusion of purely contractual disputes is another provision seeking to constrain access to investor–state arbitration and the discretion of investor–state tribunals (article 13.3);
- limitations on submission of claims where investments have been made through inter alia corruption (article 13.4);
- limitations on the jurisdiction of investor–state tribunals to review the merits of decisions made by judicial authorities (article 13.5);
- provisions regarding selection of arbitrators and conflicts of interest (article 18);
- provisions recognizing the potential establishment of an appellate body to review determinations of investor-state tribunals (article 19); and
- dismissal of frivolous claims (article 21).

In recent years, India has taken steps to recalibrate its stance on ISDS through a series of policy reforms and treaty terminations. The Indian government has expressed concerns over the ambiguity in the interpretation of certain treaty provisions, as well as the potential for disputes to impede the implementation of public policies. As part of its strategy, India has sought to renegotiate and terminate certain BITs to align them with its evolving policy objectives. The Model BIT 2016 was aimed to move away from an overly investor-friendly approach to a somewhat protectionist approach concerning foreign investments. Since its adoption, India has terminated approximately 58 BITs. The developments regarding the termination of the old stock of Indian BITs are a welcome development, signalling the country's readiness to tackle the issue of old-generation BITs. The old-generation BITs, signed mostly in the 1990s and early 2000s, are among the main obstacles to effectively reforming the international investment regime.¹⁰

IMPLICATIONS OF INDIA'S INVESTMENT TREATIES AND ONGOING DISPUTES

SAFEGUARDING REGULATORY AUTONOMY

The renegotiation of BITs and the adoption of the Model BIT 2016 reflect India's commitment to safeguarding regulatory autonomy. India's current stance on ISDS reflects an ongoing effort to strike a balance between safeguarding its sovereignty and providing a conducive environment for foreign investors. Further, the emphasis on exhausting local remedies before resorting to arbitration demonstrates a willingness to address disputes within the domestic legal framework. The emphasis on renegotiating and terminating older treaties is seen as a proactive step to modernise and align these agreements with contemporary international investment norms.

IMPACT ON INVESTOR CONFIDENCE

The ongoing disputes and policy shifts in India's approach to ISDS may impact investor confidence. Investors seek stability and predictability, and uncertainties arising from policy changes or disputes may influence investment decisions. Therefore, at the heart of India's investment treaties are provisions aimed at fostering an environment conducive to foreign direct investment. These agreements serve as assurances to international investors that

their investments will be protected, and they will be treated fairly and equitably by the host country.¹¹ By establishing a legal framework that safeguards investor rights, India endeavours to attract the capital needed for overall growth and development.

NAVIGATING ONGOING DISPUTES

Timely and effective management of ISDS cases is essential to minimise potential harm to the reputation of both the investor and the host state. Ongoing ISDS disputes can have far-reaching consequences on the reputations of both investors and host states. Transparency, open communication and adherence to international best practices can mitigate reputational risks. Engaging in good-faith negotiations and demonstrating a commitment to resolving disputes amicably can positively influence public perceptions and investor confidence.

India is currently embroiled in several ISDS cases, involving diverse sectors such as telecommunications, energy and taxation. The outcomes of these disputes will shape future policies and determine the effectiveness of India's approach to ISDS.

- Vodafone case: the high-profile Vodafone tax dispute highlighted India's stance on retrospective taxation and its potential impact on foreign investments. While not a traditional ISDS case, it underscores the complex relationship between taxation policies and investor–state relations, under the India–Netherlands BIT.¹²
- Cairn Energy case: the Cairn Energy case is another significant dispute under the India–United Kingdom BIT, where an international tribunal ruled against India in a tax-related matter. The award directed India to pay damages to Cairn Energy, bringing attention to issues of taxation and regulatory measures affecting foreign investors.

CONCLUSION

India's approach towards ISDS reflects a nuanced evolution that seeks to strike a balance between investor protection and regulatory autonomy. The termination of certain BITs, the introduction of the Model BIT 2016 and the promotion of alternative dispute resolution mechanisms signal India's proactive response to the challenges posed by ISDS. As international investment law continues to evolve, India's approach is likely to adapt, reflecting its commitment to creating an investment environment that aligns with its developmental goals and regulatory imperatives. As the country continues to navigate the complexities of international investment law, the outcomes of ongoing disputes and the success of policy reforms will play a pivotal role in shaping India's future as a destination for foreign investment.

Endnotes



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