India: The Insidious Logic of "Bilateral Investment Protection Agreements" (BIPA)

The India UAE Agreement

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Global Research, November 05, 2014

Region: Asia, Middle East & North Africa
Theme: Global Economy

Thanks to the persistent efforts by civil society groups demanding access to the full text of India-UAE bilateral investment promotion and protection agreement (BIPA) under the Right to Information Act, the agreement was recently made public by the concerned appellate authority of Ministry of Finance.

On December 12, 2013, India signed the agreement with the United Arab Emirates despite an ongoing official review of its existing BIPAs. In early 2013, the then government initiated the review and imposed a moratorium on all ongoing BIPA negotiations in the wake of public outcry over arbitration notices served by foreign investors (including Vodafone and Sistema) demanding billions of dollars in compensation for the alleged violation of existing agreements signed by India.

The Growing Backlash

It is important to note that India is not alone in reviewing its bilateral investment protection regime. Currently, a number of developing countries are questioning the rationale of investment agreements as these are neither necessary nor sufficient to attract foreign investment. The growing number of investor claims against sovereign states challenging a wide array of public policy decisions and regulatory measures has evoked deep concerns about the potential costs associated with such treaties.

South Africa, for instance, terminated its treaties with Germany, Switzerland and Spain based on a three-year review and replaced its bilateral investment regime with a domestic legislation which aims to protect investor rights while safeguarding domestic policy space.

In March 2014, Indonesia decided to terminate its bilateral investment treaty with the Netherlands and other countries due to its growing unease with the existing treaties.

While the new model treaty text is awaited, let us examine some of the important clauses of India-UAE BIPA.

Broader Definition of Investment

Like earlier agreements, India-UAE BIPA defines investment in the broadest terms possible. It means "every kind of asset" including moveable and immoveable property, shares and other interests in companies, monetary claims and contractual rights, intellectual property rights, know-how and goodwill – without any reference to certain limitations or exceptions. Of late, many countries are opting for a narrow definition of investment in treaties by excluding certain forms of investments. In the Indian context, a narrow definition of investment excluding short-term portfolio investments (held less than one year) would have been a better option as the country receives substantial hot money flows from the UAE.

Expansive Obligations

The India-UAE BIPA includes several ambiguous and standalone clauses which could be interpreted in a very expansive manner by foreign investors and arbitral tribunals. It is indeed worrisome that binding provisions such as most favoured nation (favour one, favour all), national treatment (treating foreign and local investors equally) and fair and equitable treatment have been incorporated in the agreement without any qualifications in the agreement. Not long ago, India lost a case against White Industries when the Australian investor took advantage of relying on the most favoured nation provisions in the India-Australia BIPA.

At the global level, a cursory look at some of recently concluded treaties shows that governments are adding exceptions in treaty clauses to pursue specific public policy objectives besides obligations are being carefully worded in a more precise manner to avoid expansive interpretations by arbitral tribunals.

Surprisingly, the India-UAE BIPA prohibits the imposition of additional performance requirements (in the post-establishment phase) "unless such requirements are deemed vital for reasons of public order, public health or environmental concerns." One wonders why similar exemptions to treaty obligations were not added in other core principles of the agreement.

On the positive side, taxation issues have been excluded from the scope of this agreement to avoid Vodafone-type tax disputes in the future.

Unrestricted Transfer of Payments

The agreement allows unrestricted transfer of payments (including initial capital, returns, earnings, royalties and fees) without any exceptions. This clause is problematic on three counts. Firstly, it would weaken the ongoing efforts to curb cross-border flow of illicit money between India and the UAE. It is well-known that the illicit money derived from corruption, money laundering and other illegal means in India is sent to the UAE (and other low tax jurisdictions such as Mauritius and Singapore) via hawala (an informal system of money transfer across borders) and then sent back home in the guise of foreign investment to earn profits and tax benefits. This process (popularly known as round tripping) is carried out to conceal the identities of actual investors and for tax avoidance purposes. The Indian tax authorities have become increasingly concerned about round-tripping of funds resulting in the loss of huge tax revenues to the exchequer.

Secondly, this clause may restrict the ability of Indian authorities to deploy capital controls in the event of serious balance-of-payments and external financial shocks. It would be a grave mistake for India to surrender the ability to deploy capital controls in order to seek greater investment flows from the UAE. It is important to note that the Article 69 of the India-Japan FTA (signed in 2011) allows the imposition of restrictions on transfer of payments to safeguard the balance-of-payments. What stopped India to include this important provision in the text of India-UAE BIPA?

Thirdly, the government is considering a move to re-impose the limits on royalty payments paid by the Indian subsidiaries to their foreign parent firms. This move has been triggered due to high quantum of outflows on account of technology transfers, know-how, use of brand names and trademark fees since 2009 when the limits were withdrawn. Such outflows accounted for 16-33 percent of the FDI inflows into India between 2010 and 2013. Given India's vulnerability to external sector shocks, the move to re-impose limits on royalty payments is grounded on legitimate policy objective to curb excessive outflows and therefore cannot be viewed as discriminatory or arbitrary.

Important Changes in Dispute Settlement System

For the settlement of investor-state investment disputes, the BIPA provides an explicit choice to foreign investors to bring their claims to domestic courts or international arbitration (under the framework of UNCITRAL or ICSID). Once an investor has submitted a dispute under any particular forum, that choice "shall be final and binding on that investor."

In other words, a foreign investor cannot bring claim against host state before an international arbitration tribunal once it has brought its case to domestic courts, and vice versa. This indeed is a major departure from India's earlier BIPAs which provide recourse to both international arbitration and domestic courts.

More importantly, the India-UAE agreement allows investors to challenge only executive decisions of central and state governments within a period of 5 years. The judicial pronouncements (à la 2G telecom scam) have been kept out of the ambit of this agreement.

Besides, the agreement does not allow the use of umbrella clause – a controversial provision that requires each Contracting State to observe all investment obligations entered into with investors from the other Contracting State. Under the umbrella clause, any breach of investor-State contracts could be considered as treaty violation.

The agreement also describes dispute settlement provisions and procedures in greater detail than previous agreements signed by India.

Furthermore, there is no mention of "sunset clauses" in the BIPA which guarantee investment protection for a further period (usually 10 to 15 years) even after the termination of agreement.

The Article 18 of India-UAE BIPA states that "The agreement shall remain in force for a period of ten years. During that period, and not later than January 1, 2016, both contracting parties shall commence renegotiation of the terms of this agreement and endeavor to enter into a revised or new agreement within a reasonable period." Put simply, this agreement would be renegotiated before January 2016 once the new model text is ready.

Moving Beyond Tinkering

It is beyond doubt that the current BIPA regime needs a complete overhaul, not just tinkering around the edges. Unfortunately, neither political establishment nor powerful business groups appear to be interested in an overhaul despite the convincing evidence that the current system is susceptible to abuse. The government's intention is to remain engaged with the BIPA regime.

As second-best option, New Delhi should develop a robust BIPA policy framework with a more balanced and coherent model text, in tune with domestic policies as well as new realities of international investment landscape.

Since the successive Indian governments have shown a keen interest to sign BIPAs with US, Canada and other countries in the coming days, it is imperative that a fine balance between investor rights, regulatory space and investor responsibilities is maintained in the future treaties. The BIPAs, at the very least, should not restrict the ability of the central and state governments to pursue legitimate public policy objectives.

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