

# Dispute Resolution Hotline

October 09, 2020

## VODAFONE INVESTMENT TREATY ARBITRATION AWARD - PART V

### Interplay between BITs and FDI, and what India should consider in its proposed alternative framework

#### INTRODUCTION

In continuation of our earlier articles in this series, this final article briefly examines the correlation between BITs and FDI. It also assesses the alternate effective framework proposed by India earlier this year for protection of foreign investment. To access previous articles in the series, please use the links provided in the footnote.<sup>1</sup>

Bilateral investment treaties (BITs) are agreements executed by two sovereign States to promote and protect foreign investment. The preamble of most BITs contains the promise of promoting bilateral cooperation conducive to stimulate beneficial business activity. In addition, present day BITs contain mutual promises to promote economic development of the contracting States, and re-affirm the rights of States to regulate investments in accordance with their law and policy objectives.

In light of the preamble and purpose of BITs, it would appear that BITs play a significant role in promoting FDI. However, various other factors compete in attracting a fair share of FDI. Macro-economic stability, financial health of a country, nature of investment, market size, availability of infrastructure and skill among others, influence FDI inflows. In the midst of these factors, what role do BITs play in promoting FDI?

It is essential for policy makers to understand the impact of BITs on FDI and investor confidence, before engaging in widespread termination of BITs as a narrow response to investor-State disputes.

#### CO-RELATION BETWEEN BITS AND FDI

The correlation between BITs and FDI has been the subject of numerous empirical and literal studies over the years. An examination of various studies would reveal that BITs have a positive, if not significant role, in promoting FDI. A study of OECD countries ranging from 1985 – 2014 indicates that BITs have a significant and positive impact on FDI flows from OECD countries to their partner host countries.<sup>2</sup>

Investor-State dispute settlement provisions were initially presumed to be a factor in contributing to FDI inflows. However, while dispute resolution provisions in BITs were assumed to be the primordial cause for instilling greater investor confidence, their presence has also become a primordial reason for nations to terminate BITs owing to the growing number of disputes initiated by investors against States.

Since 2001, presence of investor-State dispute settlement provisions have been noticed to have a reduced impact on FDI, in favour of other substantive provisions of BITs. An UNCTAD study specifically reveals that substantive commitments in BITs apart from investor-State dispute settlement provisions, impacts FDI.<sup>3</sup> However, a latter study suggests that even given the reduced impact of ISDS since 2001, overall investor-State dispute settlement provisions did have a positive effect on FDI promotion, and that it would have been riskier for countries to abstain from providing dispute resolution mechanisms to investors.<sup>4</sup>

With respect to sectoral impacts of BITs, it is difficult to predict the same due to uneven concentration of disputes in certain sectors. An empirical study of twelve countries in Central and Eastern Europe, and Former Soviet Union, indicated that BITs have a larger impact on FDI in the mining sector, and found that FDI in other sectors did not respond to BITs at all.<sup>5</sup> The study indicates that there is differential impact of BITs on different types of FDI, depending on the sectors involved.

Unfortunately, the survey of the extant work does not lead to any conclusive finding as to a significant impact of BITs on promoting FDI or inflows in particular sectors. However, it can be stated that a State's domestic business environment, broader economic determinants and external commitments (arguably including international agreements and treaties) play a comprehensive role in attracting FDI.

#### FDI, BITS AND INDIA

The top five countries from which India has received FDI in the last three years are Mauritius, Singapore, Netherlands, Japan and U.S.A. (in descending order).<sup>6</sup> It is note-worthy that despite termination of the India – Mauritius BIT and the India - Netherlands BIT in 2016, FDI from Mauritius and Netherlands increased from 2018 to 2019.

India does not have a BIT with USA. Yet, USA features among the top five countries for FDI inflows in India since 2000. On the other hand, economic partnership agreements with Singapore and Japan remain in force. Investment from the two countries continues to be significant. An analysis of the above demonstrates that there may be no direct correlation with BIT terminations or continuations, and FDI inflows.

However, a recent empirical study on India demonstrates that, while the presence or absence of BITs with a specific

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country does not necessarily result in investor protection, a collective institution of having a system of investment protection by the presence of economic cooperation agreements or other international investment treaties fosters FDI in India.<sup>7</sup> While acknowledging the significant positive effect of cumulative BITs entered into by India, it attributed the positive effect to a regime of overall protection to investors.

### PROPOSED ALTERNATIVE FRAMEWORK IN INDIA<sup>8</sup>

From studies and analyses, it can be aptly said that a BIT is one in the gamut of several factors that contribute to attracting FDI and fostering investor confidence. Thus, as long as India is able to demonstrate its concomitant willingness to offer investor protection and sustained business reforms, albeit domestic, it can continue to attract FDI despite termination of BITs.

Early this year, reports suggested that India is considering enactment of a domestic law for protection of foreign investments in India, with a robust dispute resolution mechanism and unequivocal investment protection guarantees.<sup>9</sup> The Finance Ministry is stated to have recommended mediation and establishment of special fast-track courts for this purpose. Alternatively, it is also stated to consider vesting jurisdiction with the National Company Law Tribunal (NCLT). This could re-instate investor trust in India.

International investment disputes are a special species of disputes. We have previously written here<sup>10</sup> that if mediation is furthered, it is critical for the mediator to hold the requisite expertise and recognition in the field of international investment law, national law and regulation. It may not be advisable to create a panel or list of mediators for parties to select from, since this could expose the list to lack of independence and conflict of interest. Party consent for appointment of mediator must therefore be mandatory. In the event of lack of consensus, the baton could be handed over to mediation centres of arbitral institutions to appoint suitable mediators. For uniformity in each case, special mediation rules modelled on internationally recognized mediation rules may be formulated and appended to the legislation.

Failing mediation, special courts dedicated solely to investor-State disputes, and not NCLTs, provide for a better solution. Expert judges with knowledge of international investment and national laws, wielding sound commercial acumen, must be appointed. Considering that these disputes may not be abundant in number, it might be more effective to engage lawyers with requisite knowledge, experience and expertise on a rotation basis or for a fixed time period to take the judicial mantle.

Most importantly, a single level of appeal to the Supreme Court with minimum grounds for appeal could go a long way in speedy disposal of cases. A brief time limit for filing and disposal of appeals, with a framework for expeditious execution, are indispensable. However, the problem with enacting a fresh legislation and introducing a new scheme would be that Courts which are ultimately tasked with enforcement of BIT Awards under the new regime would not have the benefit of decades of judicial evolution, refinement and interpretations.<sup>11</sup> A comprehensive and effective framework will need to be designed by India to tackle these challenges.

### CONCLUSION

BITs have been considered to be unique models for foreign investment protection on a public-private plane. Investor-State dispute settlement provisions in BITs offer effective remedies for investors to resolve disputes with States under international law. However, these do not necessarily promote foreign investment. Other factors such as national FDI policies, openness of an economy, fewer entry barriers, macro-economic stability, availability of labour and capital among other factors greatly influence FDI promotion.

While BITs may not play a significant role in promoting FDI, they provide effective provisions for protection of investment. They are quintessential to provide neutral and independent access to investors to international law remedies engaging State responsibility. The goal of BITs today is to strike the right balance between State regulation and investor rights. Likewise, legislative protection of foreign investment in the absence of BITs must also meet this careful balance. Robust and transparent processes must find place in the national investment protection legislation to promote and protect foreign investment. This will accentuate the economic benefits of foreign investment – namely growth, employment and sustainability.<sup>12</sup>

– Yashasvi Tripathi & Kshama Loya Modani

You can direct your queries or comments to the authors

<sup>1</sup> Part I available at: [https://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/vodafone-investment-treaty-arbitration-award-part-i.html?no\\_cache=1&cHash=8fb65ba0b511a1193bc061ee430cf1f](https://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/vodafone-investment-treaty-arbitration-award-part-i.html?no_cache=1&cHash=8fb65ba0b511a1193bc061ee430cf1f);

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<sup>2</sup> Armstrong, Shiro Patrick and Nottage, Luke R., The Impact of Investment Treaties and ISDS Provisions on Foreign Direct Investment: A Baseline Econometric Analysis (August 15, 2016). Sydney Law School Research Paper No. 16/74. Available at SSRN: <https://ssrn.com/abstract=2824090>

<sup>3</sup> The Impact of International Investment Agreements on Foreign Direct Investment: An Overview of Empirical Studies, 1998 – 2014, UNCTAD

<sup>4</sup> Prof. Luke Nottage & Prof. Jaivir Singh, Does ISDS Promote FDI? Asia Pacific Insights from and for Australia and India, Asia-Pacific Forum for International Arbitration, p. 5

<sup>5</sup> Liesbeth Colen and Andrea Guariso, What Type of FDI Is Attracted by Bilateral Investment Treaties?, LICOS Centre for Institutions and Economic Performance, KU Leuven June 2012, <https://www.etsg.org/ETSG2012/Programme/Papers/197.pdf>

<sup>6</sup> [https://dipp.gov.in/sites/default/files/FDI\\_Factsheet\\_June20\\_23Sept2020.pdf](https://dipp.gov.in/sites/default/files/FDI_Factsheet_June20_23Sept2020.pdf)

<sup>7</sup> Working Paper 391, The Impact of Bilateral Investment Treaties on FDI inflows into India: Some Empirical Results, June 2020, [https://think-asia.org/bitstream/handle/11540/12036/Working\\_Paper\\_391.pdf?sequence=1](https://think-asia.org/bitstream/handle/11540/12036/Working_Paper_391.pdf?sequence=1)

<sup>8</sup> This section is adapted from the article 'Balancing state regulation & investor rights', published by Kshama A. Loya & Moazzam Khan in The Economic Times on January 31, 2020. Available at <https://economictimes.indiatimes.com/markets/stocks/news/view-balancing-state-regulation-investor-rights/articleshow/73792172.cms>

<sup>9</sup> <https://www.livemint.com/news/india/government-plans-new-law-to-protect-foreign-investment-11579084078405.html>

<sup>10</sup> <https://economictimes.indiatimes.com/markets/stocks/news/view-balancing-state-regulation-investor-rights/articleshow/73792172.cms>

<sup>11</sup> 'BIT award enforcement at bay in India as Indian court rules out applicability of the Indian A&C Act, 1996', published by Kshama A. Loya and Moazzam Khan in the Asian Dispute Review, January 2020.

<sup>12</sup> <https://economictimes.indiatimes.com/markets/stocks/news/view-balancing-state-regulation-investor-rights/articleshow/73792172.cms>

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