PROTECTING INVESTMENTS BY US COMPANIES IN INDIA IN THE ABSENCE OF INDIA-US BILATERAL INVESTMENT TREATY

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1. INTRODUCTION:-

A. Foreign Direct Investment In India

With the liberalization of the Indian markets since the 1990's, India has seen a significant increase in foreign investment. The cumulative amount of Foreign Direct Investment ("FDI") flows into India (Equity inflows + 'Re-invested earnings' & 'Other capital') from April 2000 to April 2011 is quantified at approximately US$ 1,97,billion.[3] The major countries contributing FDI inflow into India are Mauritius, Singapore, USA, UK, Netherlands, Japan, Cyprus, Germany, France, and UAE.

Table showing share of top three investing countries FDI equity inflows into India[4]

Ranks	*Country*	***2009-10*** *(April-March)*	***2010-11*** *(April-March)*	***2011-12*** *(for April 2011)*	***Cumulative Inflows*** *(April '00 - April '11)*	*%age to total Inflows (in terms of US $)*
1.	**MAURITIUS**	49,633 **(10,376)**	31,855 **(6,987)**	4,332 **(976)**	247,092 **(55,203)**	**42 %**
2.	**SINGAPORE**	11,295 **(2,379)**	7,730 **(1,705)**	5,214 **(1,175)**	58,090 **(13,070)**	**10 %**
3.	**U.S.A.**	9,230 **(1,943)**	5,353 **(1,170)**	356 **(80)**	42,898 **(9,529)**	**7 %**

If sectors are considered Service Sector has seen the maximum investment with 21% of FDI inflow comprising of FDI in Service Sector. It is followed by Infrastructure Sector comprising of 15% of the

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[3] Fact Sheet On Foreign Direct Investment (FDI) available at http://dipp.nic.in/fdi_statistics/india_FDI_April2011.pdf

[4] Fact Sheet On Foreign Direct Investment (FDI) available at http://dipp.nic.in/fdi_statistics/india_FDI_April2011.pdf

total FDI inflow. The Energies Sector covers around 7 % of the total inflow. The Pharma and Health Care Sector sums up to 3% of the total inflow. [5]

B. India and Bilateral Investment Treaties

It was in mid '90s that the Bilateral Investment Treaty (BIT) was initiated by the Government of India. The objective was to offer favorable conditions and treaty based protection to the foreign investors and investments which would eventually attract the investors from abroad to invest in the growing economy of India with enhanced securities against adverse changes, thus promoting investment inflow.

India signed its first BIT in 1994 with the United Kingdom. Since 1994, India has signed BITs with 75 States. Out of which 66 are already in force and 9 are yet to be entered into force. Negotiations with another 25 States are underway. Around 40 BITs are with developing and less developed States. Around 20 of the BITs enforced have been done in last five years. In addition to the above, Comprehensive Economic Partnership Agreement with Japan and Comprehensive Economic Co-operation Agreement with Singapore and Korea have separate chapters on investment protection. India has BITs with all major countries contributing FDI inflow into India, to the exclusion of USA and UAE.

C. India- US Bilateral Investment Treaty

Though US ranks number three in the list of major contributors of FDI into India and contributes around 7% of India's cumulative FDI inflow, unfortunately India and the US have not yet entered into any bilateral investment agreement. In 2008, the United States and India held two constructive rounds of exploratory talks on a treaty that would provide binding legal rules regarding one country's treatment and investments from another country. A press release by the Ministry of Commerce and Industry of India dated September 21, 2011 indicated that the discussion with USA on a BIT were nearly complete[6]. Hopefully, the two countries will conclude a BIT soon.

In the meantime, however, the question which needs to be addressed is how does one protect investment in the absence a bilateral investment agreement between the two nations.

2. WHY IS PROTECTION OF INVESTMENT NECESSARY?

Compared to several developing economies India is definitely considered a much safer jurisdiction to invest. Investors do not have to worry about issues like nationalization, rampant expropriation, politically motivated and forceful confiscation and redistribution of private property etc. But, still there are several crucial issues where investors in India would like or rather need to seek protection and security.

[5] Fact Sheet On Foreign Direct Investment (FDI) available at http://dipp.nic.in/fdi_statistics/india_FDI_April2011.pdf
[6] Source http://pib.nic.in/newsite/erelease.aspx?relid=76118

A. Learning from the past: The Dabhol Debacle

Dabhol was one of India largest foreign investment project to date. Indian financial institutions, overseas lenders, and export credit agencies contributed approximately $ two billion in secured loan. A consortium led by Enron[7] entered into a contractual arrangement with the Maharashtra State Electricity Board (MSEB) in India for the construction and operation of an electrical power plant, the Dabhol Power Project. Enron was the majority shareholder in the Dabhol Power Corporation (DPC), with General Electric (GE)[8] and Bechtel[9], each owning a 10% stake. The US Companies had routed their investments from Mauritius and Netherlands. Under the relevant agreements, GE was responsible for supplying the gas turbines and Bechtel would serve as the general contractor. To protect their respective investments and loans GE, Bechtel and Enron asked Overseas Private Investment Corporation (OPIC) to support the Dabhol project as, *interalia,* as an investment insurer. Accordingly, OPIC entered into political risk insurance contracts with each of the parties, to provide coverage for their equity stakes and loans against political violence, incontrovertibility and expropriation.[10]

Shortly after conclusion of the contract and commencement of construction, the Project became the object of considerable controversy. Public opinion strongly opposed the Project on the ground that the energy purchase price was allegedly considerably higher than that of other power producers. State elections had also brought about a change in the governing party; the incumbent party had consistently shown strong opposition to the Project and in 1995 it suspended the Agreement.

DPC immediately exercised its right to international arbitration and commenced an arbitration proceeding in London against the state government for breach of contractual commitments, at the point which the state government challenged the jurisdiction of the arbitral tribunal. Moreover, MSEB filed a suit in the Bombay High Court to declare the Power Purchase Agreement (PPA) void.

A renegotiated PPA was, however, concluded in 1996 under which the energy purchase price was reduced and MSEB was obliged to purchase a portion of Enron's interest in the Project.

Five years later, after a year and a half of operation, the MSEB defaulted on its payment obligations. In April 2001, DPC commenced arbitration proceedings against the MSEB, the state government, and the central government. In response, the Board asked the Maharashtra State Regulatory Commission (Commission) to enjoin DPC from pursuing international arbitration, which the Commission did, finding that it had exclusive jurisdiction over the dispute between DPC and MSEB. This was appealed to the Bombay High Court, which ruled that the Commission had authority to determine its own

[7] An American energy, commodities, and services company based in Houston, Texas

[8] An American multinational conglomerate corporation incorporated in Schenectady, New York and headquartered in Fairfield, Connecticut, United States

[9] An American engineering company headquartered in the Financial District of San Francisco.

[10] Request for Arbitration under the Incentive Agreement between the government of United States of America and the Government of India (India v US) at 9 (2004) available at https://www.opic.gov/insurance/cliams/awards/documents/GOI110804.pdf

jurisdiction. The Indian Supreme Court reversed the order of the Bombay High Court, instructing the Bombay High Court to make a finding on whether the Commission had exclusive jurisdiction. The Bombay High Court then held that the Commission had such jurisdiction, and the case again went to the Indian Supreme Court, where it remained pending when the parties resolved the disputes in 2005.

In addition, the state government obtained an injunction from the Bombay High Court against DPC pursuing international arbitration against the government under its guaranty. And the Government of India obtained an injunction from the Delhi High Court against DPC pursuing international arbitration against that government under its guaranty. The situation was further complicated in late 2001 when Enron entered into bankruptcy proceedings.

The next series of arbitrations occurred from 2003 to 2005. On the one hand, the U.S. companies sought to collect on their political risk insurance from OPIC, arguing that the Indian governments and courts had taken away the arbitration remedy provided in the relevant contracts. When OPIC did not pay the companies' claims, the companies instituted arbitration proceedings under the auspices of the American Arbitration Association against OPIC. The panel found that the MSEB the state government and the Government of India each violated the relevant agreements for political reasons and without any legal justification. The panel also found that MSEB, the Commission, and the Indian courts had enjoined and otherwise taken away the claimants' international arbitration remedies in violation of established principles of international law and in disregard of India's commitments under the New York Convention and the Indian Arbitration Act. As a result, the panel ordered OPIC to pay the companies. Ultimately in April 2004, in an agreement engineered by OPIC, Enron's 65% shareholding was purchased by its previous partners, GE and Bechtel. Thereafter, the U.S. government instituted arbitration proceedings against the government of India for claims to which OPIC was subrogated under the U.S. investment guaranty agreement with India.

At the same time, the U.S. companies, which had channeled their investments through subsidiaries in Mauritius and the Netherlands, brought separate arbitration cases directly against India under BITs India had with those two countries.

Despite non-cooperation by the Indian authorities in the arbitral process, Bechtel was successful in its claims against the State of Maharashtra and the MSEB and is reported to have been awarded US$125 million. Related claims were raised by Bechtel against the Republic of India; these claims were subsequently dropped pursuant to a settlement agreement under which the company was reported to have received US$160 million. GE also entered into a settlement agreement with the State of India under which it terminated arbitral proceedings against the government and was granted financial remuneration for losses sustained. In July 2005 GE and Bechtel sold their stakes in the

Dabhol Power Project to two Indian agencies; fiscal concessions were granted by the central government to the DPC as part of a rescue package to bring the Project back into production.[11]

The takeaway

While the ability of corporations subject to their jurisdiction to pursue international arbitration had been effectively thwarted by Indian courts and state entities, they could not prevent international arbitration brought by foreign governments or by offshore corporations under applicable BITs. Thus, while international arbitration had failed effectively to resolve any Dabhol dispute since 1995, in 2005, the commencement of arbitration by the United States under the Investment Incentive Agreement and Investment Arbitration under the Mauritius BIT seemed to have a significant impact. It was only due to the pressure created by these investment disputes that the overall settlement of the matter, and the various pending arbitrations and court proceedings were terminated

B. <u>Reasons to opt for protection</u>

Though rule of law in predominant in India, some of the central issues, surrounding the legal structure in India are the clarity of laws, rules and regulations; roles, responsibilities and jurisdictions of regulatory institutions and coordination among regulatory bodies. Besides the problems already highlighted above in the Dabhol case some issues which an Investor might face when doing business in India are as follows:-

i. <u>Regulatory uncertainty</u>

India has an opaque and sometimes volatile regulatory apparatus that makes it difficult for investors to feel secure in investing. The ever changing regulation and interpretations often leave the investors and their investments in a limbo. The regulation of listed and unlisted equity is characterized by complexity which creates problems of regulatory arbitrage and lack of transparency.

Thus, it essential for every investor in India to take protective measures to enable them to mitigate damage and loss that might be caused by an active.

ii. <u>Delay in justice</u>

Delays in the judicial process in not unheard of in India. The Indian Legal System is fraught with delays which many a time makes the investors wary of choosing India as the investment venue despite the lucrative prospects it entails for foreign investment. With statistics suggesting that the average pendency time of a case in the Indian Judiciary is fifteen years[12] the investors are apprehensive about the fate of their investments should it so happen that they face a suit in India. The delay in Indian judicial system is due to numerous reasons such as acute shortage of judges,

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[11] Ronald J Bettauer, *India and International Arbitration: The Dabhol Experience. 41 The Geo. Wash. Int'L. Rev 381 (2010)*; *see also* Preeti Kundra, *Looking Beyond the Dabhol Debacle: Examining its Causes and Understanding it Lessons*, 41 Vanderbilt Journal Of International Law 907 (2008).
[12] Source http://pib.nic.in/newsite/erelease.aspx?relid=62745

lengthy and cumbersome procedure for a suit, unnecessary adjournments sought by the parties. Thus, the undue and unreasonable delays in justice necessitate that an investor before investing in India takes all due measures to protect his investment which will prove a worthy defense against the getting entangled in the long drawn process of the Indian judiciary at some later point in time.

iii. <u>Delay in permission and clearances from non-judicial authorities.</u>

International and National reports have suggested that decrease in foreign investments in India is owing to hurdles in environmental clearances, problems in land acquisition and bureaucratic delays. Various approvals from authorities like Foreign Investment Promotion Board, Reserve Bank of India, Pollution Control Boards, Directorate General of Foreign Trade etc make foreign investment in India a long drawn and sometimes a tedious process. The post investment approval procedures also have created havoc with project implementation. The recent RBI report[13] highlighted the issue by drawing reference to much awaited projects belonging to South Korean steel giant POSCO, London-based Vedanta Resources PLC and Giant steelmaker Arcelor-Mittal. Further even the CEO Snap poll conducted by CII[14] opined that several foreign companies have been unable to start and more importantly expand their projects in India due to governmental approval related issues.

Thus bureaucratic delays, discretionary interpretation, are impediments to investments in India making it absolutely essential for foreign investors to seek protection of their investments under the international investment treaty regime.

iv. **<u>Intervention by the Courts</u>**

Courts in India are quick to assume jurisdiction over any matter brought before them, if remotely connected to India. In the famous case of White Australia Industries Ltd. V. Coal India Ltd.[15], the Indian Courts set aside the 2002 ICC arbitral award and instead seized upon the underlying coal contract's stipulation that Indian law will govern the contract. Consequently the Australian Company has taken the Indian Government to an Investment Arbitration. In many cases courts are not inclined towards accepting "foreign jurisdiction clause" [16] and exercised jurisdiction on grounds of balance of convenience. Further, it can be concluded from plethora of cases that Indian courts have assumed natural jurisdiction over contracts entered by Indians with foreign entities and haven't given regard to exclusive jurisdiction vested on a neutral court.[17] Ability to challenge awards on grounds such as of 'against public policy of India' has opened a whole new arena of litigations challenging enforcement of

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[13] Shefali Anand, *Foreign Investment in India Slows* available at http://online.wsj.com/ article/ SB1000142405274 8704698004576104011818941244.html

[14] Economic Times, *Land, environmental clearance hurdles stalling investments: CII,* available at http://articles. economictimes.indiatimes.com/2011-12-04/news/304744731_investment-plans-ceos-industry-body-cii-today,

[15] 2004 (2) Cal LJ (Cal) 197

[16] 1960 Cal 155; AIR 1962 Calcutta 601 (V 49 C 128) paras 8, 20; AIR 1973 Calcutta 526 (V 60 C 122) para 3].

[17] Modi Entertainment Network v. W.S.G. Cricket Pte. Ltd., 2003 AIR SCW 733

foreign arbitration awards. The Supreme Court[18] over the years have interpreted the term "public policy" very broadly by including subjects of fundamental policy of Indian law, interest of India, justice or morality, patently illegal and consequently altered the fundamental distinction between foreign and domestic awards. The *Venture Global*[19] case has largely rendered superfluous the statutorily envisaged mechanism for enforcement of foreign awards and substitutes it with a judge made law. A bare perusal of some Indian judgments would signify that a foreign judgment can be impeached on almost every challenge made against it in an Indian court.

v. <u>Corruption</u>

India ranks 87th in the list of corrupt nations in the world, with the least corrupt nation ranked first.[20] Corruption in India permeates nearly all branches of government and bureaucracy and has made it thoroughly impossible for any work requiring government sanctions to proceed without greasing the hands of the government officials and ministers alike. Corruption at several levels of bureaucracy is always likely to result in losses to the investors not just in terms of profits but many a time also in terms of opportunity. Hence, it is essential that foreign investors to protect their investment from being exposed to the banes of the corruption in India.

vi. <u>Government Contracts</u>

Most of the large projects attracting foreign investment particularly in Infrastructure Sector (road, rail, power, port) are implemented on PPP models and therefore government's role becomes very crucial. Knowing the uncertainties and every changing stands due to various reasons including political uncertainties makes such projects vulnerable to long delays and requires protection.

3. HOW CAN US ENTITIES SECURE INVESTMENT

As reflected above, India has several BITs and other investment agreements. Best way to protect ones investment is to use these agreements for the purpose of structuring investments into India. Indian BITs are very widely worded and can be seen as an Investor friendly treaty. Indian BITs have a broad definition of the terms investment and investment. This makes it possible to seek treaty protection easily through corporate structuring.

The model clauses for Indian BITs include nationals and companies under the definition of an "investor". Further, companies are defined to include corporations, firms and association. More importantly, Indian BITs adopt the incorporation test to determine the nationality of a corporation. This is a very beneficial provision as a holding company, which even though is merely a shell company, would not be excluded from treaty benefits.

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[18] Oil and Natural Gas Corporation vs. Saw Pipes 2003 (5) SCC 705; Fuerst Day Lawson Ltd vs. Jindal Exports Limited, 2001 (6) SCC 356

[19] Venture Global Engineering v. Satyam Computer Services Ltd, AIR 2008 SC 1061

[20] Corruption Perceptions 2010 index available at http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results

Further, the word "investment" is defined to include every kind of asset established or acquired including changes in the form of such investment, in accordance with the national laws of the Contracting Party in whose territory the investment. In specifically includes the following within the ambit of investment:-

(i) movable and immovable property as well as other rights such as mortgages, liens or pledges;

(ii) shares in and stock and debentures of a company and any other similar forms of participation in a company;

(iii) rights to money or to any performance under contract having a financial value;

(iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party;

(v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals.

The benefit of this is that even if the foreign parent or subsidiary is merely a shareholder in a locally incorporated Indian Company, they would be able to espouse claims under the treaty by the virtue of their investment in the nature of shares in India. This again aids corporate structuring and enables an investor to achieve maximum treaty benefits. Thus, if the parent company incorporated within a non-treaty jurisdiction (p), carries out operation in India through an Indian Subsidiary (S) which is held through an intermediary incorporated within a treaty jurisdiction (i), the parent company can seek protection of their investment in the subsidiary through the treaty benefits accrued to the intermediary. (*See fig 1*)

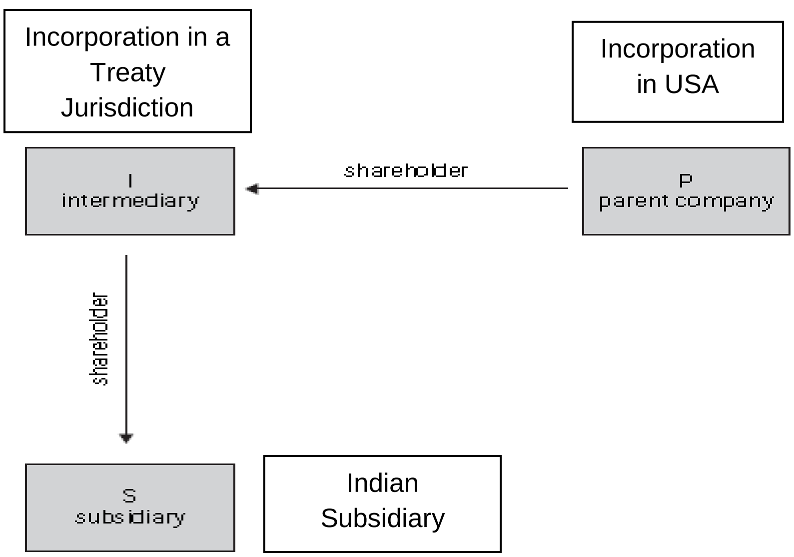

Fig 1: Operations through an India Subsidiary which is held through an intermediary in a treaty jurisdiction.

Further, it is an established principle under international law that minority shareholder rights too are protected under BITs. This gives a right to the non- controlling shareholders to espouse claims for a loss to their investments. This also enables an investor to diversify its investments through different treaty jurisdictions which will enable the investor to bring multiple claims under different proceedings to ensure full protection of one's investment. (*See fig. 2*) What exactly will be the right guaranteed to a particular structure will depend on case to case basis and can be achieved to the satisfaction of the investors by pre-analyzing treaty benefits at the time of making the investments.

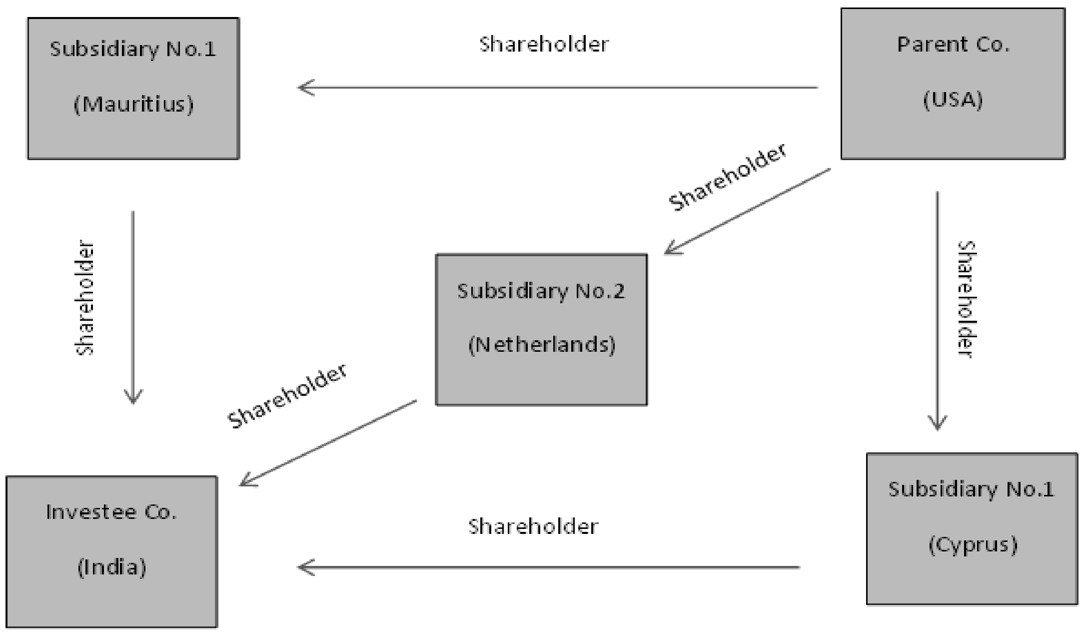

Fig 2: Investment in Indian Investee Company through multiple Subsidiaries in different treaty jurisdiction.

An important point further in favour of the foreign investor investing in India is that India has lucrative BITs with almost all tax efficient jurisdictions including Mauritius, Netherlands, Switzerland, Cyprus, Singapore etc. This enables an investor seeking corporate structuring to achieve maximum benefit from ones investment.

4. CONCLUSION

US-India BITs is a widely followed subject by corporations in both the nations. But till the time such a treaty comes into being, it is advisable to revisit India's BITs with other nations before making an investment and make use of the available window of corporate structuring to ensure full protection and security of ones investment.