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What can India learn from its investment treaty with the UAE?

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In December 2013, despite an ongoing official review of its existing agreements, the Indian government signed a bilateral investment treaty (BIT) with the United Arab Emirates. Information on the deal was recently made public by the Ministry of Finance after persistent efforts by civil society groups. Earlier in 2013, the then government imposed a moratorium on all ongoing BIT negotiations following 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 treaties signed by India.

India is not alone in reviewing its bilateral investment protection regime. Other developing countries are questioning the rationale of investment agreements that 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 terminated its treaties with Germany, Switzerland and Spain based on a three-year review and replaced its bilateral investment regime with domestic legislation that aims to protect investor rights while safeguarding domestic policy space. In March 2014, Indonesia terminated [1] its bilateral investment treaty with the Netherlands and other countries due to its growing unease with the existing treaties.

The India–UAE BIT defines investment in the broadest terms possible. This means ‘every kind of asset’ — from moveable and immoveable property, shares and other interests in companies to monetary claims, contractual rights, intellectual property rights, know-how and goodwill — is included without any reference to certain limitations or exceptions. Many countries are now

opting for a narrow definition of investment in treaties. A narrow definition of investment, excluding short-term portfolio investments, would have been a better option considering India receives substantial hot money flows from the UAE.

The India–UAE BIT includes several ambiguous and standalone clauses which could be interpreted in a very expansive manner by foreign investors and arbitrators. It is worrisome that binding provisions such as most favoured nation, national treatment and fair and equitable treatment have been incorporated in the treaty without any qualifications. India recently lost a case against White Industries when the Australian investor took advantage of the most favoured nation provisions in the India–Australia BIT.

Other governments are adding exceptions in treaty clauses to pursue specific public policy objectives. Obligations are being carefully and precisely worded to avoid expansive interpretations by arbitral tribunals.

The agreement allows unrestricted transfer of payments without exceptions. This is problematic on three counts.

It would weaken ongoing efforts to curb the flow of illicit money between India and the UAE. Money derived from corruption, money laundering and the like is often sent to the UAE before returning under the guise of foreign investment. This process is carried out to conceal the identities of actual investors and for tax avoidance. India’s tax authorities are increasingly concerned by the associated loss of huge tax revenues.

This clause may also 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. Article 69 of the India–Japan FTA allows the imposition of restrictions on transfer of payments to safeguard the balance of payments. What stopped India from including this provision in the India–UAE BIT?

The government is also considering re-imposing limits on royalty payments paid by Indian subsidiaries to their foreign parent firms. This comes after high outflows on account of technology transfers, know-how, use of brand names and trademark fees since limits were removed in 2009. Given India’s vulnerability to external sector shocks, the move to re-impose limits on royalty payments is legitimate. It cannot be viewed as discriminatory or arbitrary.

For investor–state disputes settlements, the BIT provides an explicit choice to foreign investors to use domestic courts or international arbitration. Once an investor has submitted a dispute, the settlement ‘shall be final and binding on that investor’. A foreign investor cannot bring a claim against a host state to an international arbitrator if it has already brought it to domestic courts. This is a major departure from earlier BITs [2] which provide recourse to both international arbitration and domestic courts.

More importantly, the treaty allows investors to challenge only executive decisions of central and state governments within five years. Judicial pronouncements have been kept out of the

ambit of this treaty. There is also no mention of umbrella or sunset clauses.

India's current BIT regime needs a complete overhaul. But neither the political establishment nor powerful business groups are interested despite the current system being susceptible to abuse. As second-best, New Delhi should develop a robust BIT policy framework with a more balanced model text, in tune with domestic policies and the new realities of international investment.

Since successive Indian governments have shown interest in signing BITs with the US, Canada and others, it is imperative that a fine balance between investor rights, regulatory space and investor responsibilities is maintained in future treaties. BITs should not restrict the ability of the central and state governments to pursue legitimate public policy objectives.

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