Investments under the India-EFTA Agreement: Re-writing the Rules of the Game?

INTRODUCTION

On March 10, 2024, in what has been described as a historic and a watershed development, India entered into a trade and economic partnership agreement (the "**TEPA**") with the European Free Trade Association ("**EFTA**") after 16 years of negotiation. The EFTA currently has four member countries: Iceland, Liechtenstein, Norway and Switzerland (collectively, the "**EFTA States**," and together with India in respect of the TEPA, the "**Parties**").

Out of the 14 chapters which comprise the TEPA, Chapter 7 on Investment Promotion and Cooperation (the **Investment Chapter**") is of special interest. The Investment Chapter sets out certain 'objectives' of the Parties – a key part of which requires the EFTA States to aim towards (i) increasing foreign direct investment ("**FDI**"), and (ii) facilitating new jobs through such FDI in India by specified numbers and timeframes, in exchange for India enhancing market access and simplifying customs procedures.

The TEPA marks a significant step towards re-formulating India's bilateral and multilateral investment regime. Such Indian regime has already undergone a drastic change since 2016. After terminating most of its erstwhile bilateral investment treaties ("**BITs**"), India has been re-negotiating new investment agreements based on its 2015 Model BIT. In this regard, it has signed some fresh treaties (which are not yet in force), such as those with the United Arab Emirates, Brazil and Kyrgyzstan. In addition, India has recently signed a few free trade agreements ("**FTAs**"), including those with Mauritius, the UAE and Australia. Moreover, it is in the advanced stages of negotiating FTAs with certain developed nations/blocs (such as the EU and UK) to capitalize on the global supply chain shifting away from China.

However, as far as the Investment Chapter is concerned, other than the possibility of having major implications for India in the short to medium term, its aspirational provisions could provide a new global template for international investment agreements in general, deviating significantly from traditional BIT design – which

typically involves sovereign reciprocity and equality with respect to both rights and commitments. Indeed, the Investment Chapter seeks to explicitly incorporate differentiated rights and responsibilities, as well as explicit targets – including by taking into account variations in developmental, market and capital-exporting status among the Parties.

If the Investment Chapter does manage to re-write the rules of investment treaty negotiations between developed and developing countries, it could have far-reaching consequences for foreign investors and FDI inflow. In this note, we analyze some of the unique provisions of the Investment Chapter, as well as the legal concerns which arise from such provisions.

OVERVIEW OF THE INVESTMENT CHAPTER

Anomalous objectives

Article 7.1 of the TEPA sets out certain 'shared' goals of the Parties, which provide the foundation for the Parties' obligations relating to FDI under Article 7.2. At first glance, this formulation seems consistent with the design of most BITs. For instance, under paragraphs 1 and 2 of Article 7.1, the TEPA Parties collectively recognize the importance of promoting and facilitating FDI as a means of fostering growth, innovation and a 'green transition.' Further, the Parties acknowledge the role of mutual cooperation in terms of developing a skilled workforce.

Countries that host FDI may feel that, instead of strengthening local enterprises, foreign investment may end up impeding local businesses through destructive competition. While FDI may involve valuable technology transfers to a host country, its government may be concerned that such technology may result in labor displacement. To that extent, the elements of paragraphs 1 and 2 seem logical.

However, in paragraph 3, the purportedly shared objectives of the Parties (the "**Objectives**") appear to involve only such aims which are attributable to the EFTA States alone, including to:

1. increase FDI from EFTA investors (barring sovereign wealth funds) into India by USD 50 billion within 10 years from the TEPA entering into force, and an additional USD 50 billion in the next five years; and

2. facilitate the generation of one million jobs in India as a result of such FDI within 15 years of the TEPA entering into force.

Unequal obligations

While paragraph 3 of Article 7.1 lays down anomalous Objectives, Article 7.2 of the TEPA establishes certain unequal obligations – which appear contrary to the principle of reciprocity, as witnessed in the language and formulation of most BITs. For instance,

while the EFTA States are required to promote FDI from their investors to achieve the shared Objectives of the TEPA, India is merely required to "*endeavor to ensure a favorable climate*" for FDI – further subject to its evaluation of potential risks related to security and public order. Accordingly, despite the appearance of 'shared' Objectives, the burden of increasing FDI and generating new jobs lies on the EFTA States alone. In other words, India has no reciprocal obligation to facilitate either investment or jobs within such States. This represents a major deviation from investment treaties signed between most countries based on the notion of reciprocity and mutual protection, where nationals of each State are expected to invest in the territory of the other.

Government-to-government consultations

Importantly, the TEPA Parties do *not* have recourse to the general dispute settlement mechanism (as set out under Chapter 12) with respect to any matter arising under the Investment Chapter. Instead, Article 7.7 of the TEPA creates a three-tier government-to-government consultation mechanism for the resolution of differences - but only in relation to the obligations of the EFTA States, not India's.

Remedial measures

Further, the TEPA permits India to take temporary and proportionate remedial measures if no mutually satisfactory solution can be arrived at. Such remedial measures are intended to balance the concessions given to the EFTA States in the Schedule of Commitments under Chapter 2 of the TEPA (Trade in Goods).

ANALYSIS

A major departure

The Investment Chapter represents a significant departure from traditional FTAs and BITs, as well as from international investment treaties previously signed by India. For instance, India's FTAs with Australia and Mauritius do not include an investment chapter at all, while the investment chapter in its FTA with the UAE only affirms the parties' desire to promote an attractive investment climate. Similarly, while recent BITs signed with Brazil, Kyrgyzstan and Belarus incorporate several international law obligations in relation to the treatment of investors, they do *not* require such States to commit a specific investment amount.

However, the TEPA not only includes an investment chapter but also sets out a commitment from the EFTA States to (i) invest specified amounts of capital and (ii) generate a specific number of jobs resulting from such FDI in India within pre-identified deadlines. To be sure, the language of the Objectives does *not* appear to create a binding obligation on the EFTA States. For instance, paragraph 3 of Article 7.1 states

that the EFTA States "*shall aim to*" increase and facilitate FDI and job generation, respectively, in India.

Nevertheless, the overall scheme of the Investment Chapter suggests unequal rights and commitments, as evidenced through a combined reading of (i) the Objectives (paragraph 3 of Article 7.1); (ii) the obligations of the EFTA States (paragraph 1 of Article 7.2); along with (iii) India's unilateral right to take remedial measures if the Objectives are not achieved (paragraph 1 of Article 7.8). Such combined reading also suggests that the performance of treaty obligations by the EFTA States may constitute a condition precedent for such States to utilize the concessions and market access provided by India. This is also reflected in the Parties' reported understanding with respect to the binding nature of the obligations under the Investment Chapter. For instance, the Swiss State Secretary for Economic Affairs has emphasized that the Objectives have a *legally binding* aspect, including on account of the fact that if the EFTA States are unable to achieve the TEPA's Objectives, India has the power to unilaterally and proportionately reduce, or even revoke, the market access granted to such States.

At the global level, the TEPA may represent a major shift in future BIT and FTA negotiations, especially between developing and developed States – including by requiring advanced countries to invest significant amounts of capital towards the growth and development of emerging economies and their workforces in exchange for being granted favorable access to large, new markets. This potential shift appears to have been recognized by the EFTA States during the TEPA negotiations, as evidenced in the explanation provided by the Swiss State Secretary for Economic Affairs. Such statements suggest that the rationale behind incorporating the Investment Chapter within the TEPA was to reach a balanced deal since treaty negotiators appear to have acknowledged the significant mismatch in market size – for instance, while India can provide foreign investors with access to a market comprising 1.4 billion people, Switzerland can offer such market access only in terms of a population comprising nine million.

The commitments made by the EFTA States also seem to address a long-standing critique of investment treaties, which alleges the absence of a direct and/or robust correlation between BITs and FDI inflow. While a large number of empirical analyses conducted with the aim of assessing the impact of signing investment treaties on FDI flows have come to divergent conclusions, a majority of such studies have indeed indicated a positive correlation between the two. Nevertheless, given that finding a full-proof methodology to test such critiques remains difficult, the continued uncertainty about the accuracy of such claims was acknowledged by India's Department of Economic Affairs in its written submissions to a Parliamentary Committee, as described in the latter's 2022 report (the "**Parliamentary Report**").

Legal concerns

The Investment Chapter of the TEPA raises certain additional legal concerns. For instance, the three-tier government-to-government consultation mechanism is limited to the resolution of differences *only* in relation to the obligation of the EFTA States to promote investments into India. Thus, although India is required to endeavor to ensure a favorable FDI climate for EFTA investors, Indian treaty obligations are not subject to the same consultation mechanism. Moreover, the TEPA does not set out any identifiable consequences for India's failure to comply with such requirements.

Therefore, if any of the EFTA States is aggrieved with (the lack of) India's endeavors to ensure a favorable FDI climate for its investors, none of such States appear to have recourse to a clear and readily available mechanism under the TEPA for the purpose of seeking a remedy. Moreover, as discussed above, the general dispute settlement mechanism under Chapter 12 of the TEPA does not extend to its Investment Chapter – as commonly seen in FTAs that contain separate investment-related provisions – which, in turn, tend to provide for dedicated international judicial mechanisms to resolve investment-related disputes (as opposed to trade disputes).

Further, the TEPA's Investment Chapter may pose problems for individual investors from the EFTA States, especially because India does *not* have a separate BIT in force yet with any of such States. Indeed, India has faced several claims under its erstwhile BITs on account of alleged non-compliance with specified standards of treatment, where foreign investors have initiated investor-State arbitration against India, including by taking recourse to principles of fair and equitable treatment ("**FET**") and anti-expropriation.

Modern investment agreements typically provide foreign private entities with the ability to sue sovereign nations before an international arbitral panel if the former are aggrieved on account of alleged interference with their investment, including when the host State violates the treaty's standards of treatment. As the preamble to almost every BIT reflects, the bargain struck by self-interested States in exchange for ceding valuable sovereign regulatory space through the signing of international investment instruments is to both promote and protect FDI. Importantly, the obligation to *protect* foreign investment – when not honored – may give rise to liabilities under international law. This makes BITs a particularly potent tool for foreign investors. Conversely, States signing such treaties may face unanticipated policy or sovereignty costs, including on account of a 'regulatory chill' and public backlash.

However, in the TEPA's Investment Chapter, traditional BIT obligations with respect to standards of treatment, as are typically owed by one State to foreign investors of the other (such as FET, prohibition against unlawful expropriation, etc.) on a reciprocal basis, are absent. In that regard, the Parliamentary Report's concerns regarding a 'regulatory chill' appear to have been addressed in the TEPA – such that India's

sovereign right to legislate and/or regulate may not be compromised as far as internationally arbitrable disputes are concerned, including with respect to allegations from individual investors of the EFTA States in connection with India's potential non-compliance with provisions of the TEPA.

Accordingly, the TEPA does not provide investors from the EFTA States with any of the rights that are traditionally available to foreign investors against host States under most BITs - including the right to invoke investor-State arbitration against India if the latter breaches any of its treaty obligations. It is likely, therefore, that aggrieved foreign investors from the EFTA States will either (i) be constrained to approach India's domestic courts for the purpose of challenging a governmental decision or action or (ii) have to rely on diplomatic channels for redressing their grievances.

In general, in the absence of investor-State arbitration, if a host country expropriates, discriminates against or otherwise interferes with an investment made by a foreign national (including to the extent of eroding, impairing or otherwise extinguishing its value), the former is likely to consider the question of legality in respect of such seizure and the amount of compensation due (if any) to be a matter exclusively for its own national law and local courts. However, local courts may not have the expertise to apply complex principles of international law to complicated FDI transactions. Even if courts have such expertise, domestic law may limit them from adjudicating upon international commitments. Further, local courts often have a heavy backlog of cases. Coupled with inefficient procedures, such caseload itself may deny or significantly delay justice, including on account of the fact that obtaining a final judicial determination proves difficult.

Further, relying on diplomatic protection alone (where aggrieved investors may seek help from their home countries for the purpose of obtaining a satisfactory settlement) also poses various problems. For one thing, home country governments may not espouse a claim against an offending host state, no matter how egregious the latter's conduct might be. The decision to espouse an investor's claim may be highly politicized, as government officials need to consider various political and economic considerations. At best, a home country might prematurely settle or abandon a claim if it determines that a prolonged pursuit of such claim will prove detrimental to its national interest, or if extra-legal factors are involved (such as macroeconomic conditions or strategic diplomatic relations with the host State).

CONCLUSION

An investment treaty between two States, both of whose nationals expect to invest in the territory of the other and in equal measure, should be, and typically is, based on the notion of reciprocity. However, such reciprocal arrangements may lead to skewed outcomes in the context of a treaty between a traditionally capital-exporting State and a developing country – where nationals of the latter are less likely to invest abroad.

Developing countries nevertheless sign such BITs to attract FDI and advanced technology. These BITs are premised on a specific bargain: the promise to protect investment in return for more capital and better technology.

In this regard, the Investment Chapter of the TEPA offers a unique way of attracting foreign investment by linking concessions and market access with specific, time-bound targets of FDI and jobs. Such a treaty may provide a blueprint for future BIT negotiations – especially those between a developing and a developed country, respectively.

While a BIT should ideally aim to create a symmetrical relationship between two contracting States, in reality, an inevitable asymmetry often exists – since one State (an industrialized country) will typically be the source of capital, and the other (a developing country) must then become the recipient of such capital. However, the TEPA aims to provide an additional investment of US$100 billion from the EFTA States into India without requiring the latter to sign traditional BITs (as yet), where such separate and standalone investment treaties may have contained standards of treatment and/or recourse to investor-State arbitration – both of which would have involved India's obligations towards EFTA investors.

However, it remains to be seen if, and to what extent, companies from the EFTA States will increase their investments into India in the absence of a typical FDI protection regime that includes recourse to investor-State arbitration. While India has been incentivized to ensure a favorable investment climate under the TEPA, it may seek to establish this treaty as a template for future BIT negotiations – including in the context of investment chapters under those FTAs that are currently being negotiated with advanced economies. In this regard, India may even want to move away from its Model BIT.

While India's Model BIT has been criticized for sending mixed signals to investors and nations alike, it does retain investor-State arbitration – albeit in conjunction with certain additional elements, such that it (i) requires the exhaustion of local (judicial and administrative) remedies for a period of at least five years before a foreign investor can submit an international arbitral claim; (ii) accords deference to a State's legitimate regulatory measures; and (iii) excludes tax measures.

A working paper published by the U.S. International Trade Commission in November 2022 (the "**Working Paper**") specifically attempts to disentangle the effects of investor-State arbitration on FDI. To that end, using a large dataset spanning a 30-year period, the Working Paper finds evidence to conclude that BITs do stimulate FDI – but *only when* such treaties contain binding investor-State arbitration. Significantly, the Working Paper also concludes that treaty provisions that limit the scope of investor-State arbitration tend to reduce FDI.

A case in point is China. As a growing capital-exporting country, it saw the virtues of investor-State arbitration in terms of its own global ambitions. Thus, to protect their own investors, governments could seek to strengthen protections in international investment agreements, even if the same rules are used against them in some cases.

Importantly, the Parliamentary Report did acknowledge the impact of international investment agreements on FDI, including in terms of employment generation and domestic production. Further, it had noted the general demand from most countries in respect of including investor-State arbitration as a mode of dispute resolution under investment treaties. Further, while indicating that India's Model BIT required substantial improvement, the Parliamentary Report had specifically identified the provisions on investor-State arbitration as an area of concern, including in terms of the extent to which the Model BIT required the exhaustion of local remedies.

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