

**Names:**

Biplove Choudhary Ph.D.  
Parashar Kulkarni

**Institutional affiliation:**

Centre Coordinator, Centre for Trade and Development (Centad)

**Full postal address:**

405, Bhikaiji Cama Bhavan, Bhikaiji Cama Place, New Delhi-110066

**Phone/fax numbers:** +91-11-41459226 Fax: +91-11-41459227

**Emails:** [biplove.choudhary@centad.org](mailto:biplove.choudhary@centad.org); [parashar.kulkarni@centad.org](mailto:parashar.kulkarni@centad.org)

# **Bilateral Investment Treaties: Understanding New Threats to Development in a Comparative Regional Perspective<sup>1</sup>**

## **Section I. Overview**

### **Definition**

UNCTAD defines Bilateral Investment Treaties (BITs) as agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each others territories by companies based in either country. BITs constitute to date the most important instrument for the international protection of foreign investment.<sup>2</sup>

While the specific elements of the treaties and the manner of their application differs across countries, typically the coverage of BITs extends to scope and definition of investment, its admission and establishment, national treatment, most favoured nation treatment, fair and equitable treatment, compensation in the event of expropriation, war and civil unrest or other damage to the investment, guarantees of free transfers of funds and recuperation of capital gains and dispute settlement mechanisms both state-state and investor-state.

### **Objectives**

The proponents of BITs have sought to justify them in terms of the overall benefits in attracting Foreign Direct Investment (FDI) Cross border investments have been seen as an important source of bridging the savings-investment gap and boosting economic growth in developing countries. They are thought to be important mechanisms for effecting technology transfer, employment generation and relaxing constraints on Balance of Payments. Profit remittances on account of foreign equity are related to the performance of investment projects unlike the inflexible repayment obligations of foreign debt. These supposed benefits from FDI have generated an intense competition amongst developing countries.

### **BITS and FDI**

It has often been claimed that BITs are an important mechanism to increase FDI flows. However, although the evidence seems to the presumed linkage between BITs and inflow of FDI is of a contested nature. Thus based on an analysis of twenty years of data of bilateral FDI flows from the OECD to the developing countries, Driemeier argued that there is little evidence of BITS stimulating additional investment in host countries. Rather, BITs act 'more of a complement than a substitute for domestic institutions' leading to the conclusion that those that are benefiting from them are least in need of a BIT for demonstrating the quality of their property rights.<sup>3</sup> There is little discussion of the 'adverse' incentives to potential foreign investors or provision of insurance

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<sup>1</sup> Biplove Choudhary, Centre Coordinator, Centre for Trade and Development (Centad) and Parashar Kulkarni, Research Officer, Centad. The authors are thankful to K.M Gopakumar for providing valuable inputs in the writing of this paper.

<sup>2</sup> Bilateral Investment Treaties, 1959-2000, UNCTAD, United Nations, New York and Geneva, 2000

<sup>3</sup> Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite, World Bank, DECRG, June 2003

much beyond what the domestic investors enjoy with enormous impact on the policy choices available to host governments.<sup>4</sup>

Despite this, in recent years, countries are responding to increased global competition for FDI by becoming more proactive in their investment promotion efforts. For instance, the number of countries implementing investment-related policies, and the range of measures they used, have both grown 2004.<sup>5</sup> Amongst the leading instruments of investment promotion, are investment agreements. While they do not contribute directly to increasing incentives to invest the way tax allowances, asset subsidies etc do, they provide protection to foreign investment from risks such as expropriation and remittance control, which exist in developing countries. International investment agreements come in various forms, primarily BITs and Double tax avoidance treaties (DTTs). In addition, investment chapters in FTAs and comprehensive investment cooperation agreements form other types of international investment agreements. Table 1 (Annexure I) details investment agreements based on the type and region of signatories and type of agreements.

Overall, International investment agreements (IIAs) have proliferated at the bilateral, regional and interregional levels over the past decade. In 2005 alone, 162 international investment agreements (IIAs) were concluded, bringing the total number of IIAs to almost 5,500. BITs accounted for almost half of these agreements as seen in Figure 1 (Annexure I).<sup>6</sup>

Developing countries have also been active players in signing investment treaties and as outlined in Chart 1 (Annexure I), 30 percent of BITs signed until July 2004 were South-South BITs. In total, 113 developing countries have entered into BITs with another developing country. China, Egypt and Malaysia have each signed more than 40 such agreements, and have also signed more agreements with other developing countries than with developed countries.

Double Tax Avoidance Treaties also saw a rise as seen in Figure 2 (Annexure 1). The number of DTTs signed by 2005 has reached a total of 2700. The growth rate of South-South DTTs is particularly high. From 1990 to 2005, the number of South-South DTTs has increased from 96 to 312. India, China and Malaysia accounted for the largest number of such treaties.<sup>7</sup>

The remaining agreements were typically in the form of international trade and investment agreements. Since the last five years, such comprehensive treaties have seen a spurt. While the total number of PTIAs is still small compared to the number of BITs (less than 10 percent), they almost doubled during the past five years (Figure 3, Annexure 1). In addition, as of 1 July 2006, at least 67 agreements were under negotiation involving 106 countries.<sup>8</sup>

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<sup>4</sup> Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite, World Bank, DECRG, June 2003

<sup>5</sup> Developments in international investment agreements in 2005 (2006) IIA Monitor No. 2, United Nations, New York and Geneva, 2006

<sup>6</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>7</sup> Developments in international investment agreements in 2005 (2006) IIA Monitor No. 2, United Nations, New York and Geneva, 2006

<sup>8</sup> Developments in international investment agreements in 2005 (2006) IIA Monitor No. 2, United Nations, New York and Geneva, 2006

This is also the case in terms of advanced agreements such as comprehensive trade and investment treaties. For instance until July 2004, as outlined Figure 3 (Annexure 1) only 7 percent of global trade and investment treaties did not involve developing countries. By 2004, the total number of PTIAs among developing countries had risen to 49, and 31% of all current PTIAs have been concluded between or among developing countries. This is a natural trajectory as developing countries increase their share in global inward FDI, and recently in outward FDI too. For instance in 2005, 57 transnational corporations listed in the Fortune 500 were from developing and transition economies, compared with 19 in 1990.

India has also signed a number of investment promotion agreements. As on December 2005, India had signed 56 bilateral investment treaties. Eight amongst India's top ten investors have signed an investment agreement with India (Table 2, Annexure 1). India has signed BITs with both developing and developed countries. These include 2 LDCs, 33 developing countries and 21 developed countries.

While the number of investment treaties is increasing, the number of investor state disputes on account of violation of these agreements has also increased. These trends have been examined later in the paper. In 2005, at least 50 new investor-State dispute settlement (ISDS) cases were filed, bringing the total number of treaty-based arbitration to a new peak of at least 226 by the end of 2005 (figure 4). These cases involve 62 countries. This is the highest annual increase ever recorded. 136 out of the total of 226 cases were filed with International Centre for Settlement of Investment Disputes (ICSID). (Figure 5, Annexure 1) At least 61 Governments – 37 of them in the developing world, 14 in developed countries and 10 in South-East Europe and the Commonwealth of Independent States – have faced investment treaty arbitration.<sup>9</sup> Though difficult to quantify precisely, it is estimated that the financial implications of such cases are exceedingly high.

This paper would attempt to understand the development concerns with reference to standard BIT provisions with special reference to the explosion in investment arbitration and dispute settlement systems in recent years. Subsequently, the manner in which BITs provisions have been sought to be applied by foreign investors in developing country settings would be analyzed in a comparative regional perspective with the help of two case studies: the case of Dabhol Power Corporation in India and the case of the Cochabamba water privatization in Bolivia. Both these cases attracted a lot of attention and raised a number of development concerns both in their respective countries and also globally highlighting a number of unanticipated consequences for the host country in signing on to BITs without adequate safeguards. In the sections to follow the International Institute for Sustainable Development's Model International Agreement on Investment for Sustainable Development is compared with the India-Netherlands BITs. In the concluding section, some policy issues have been flagged.

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<sup>9</sup> Developments in international investment agreements in 2005, IIA Monitor No. 2, UNCTAD, United Nations, New York and Geneva, 2006

## Section II. Understanding Development Concerns in Bilateral Investment Treaties with Special Reference to Dispute Settlement Systems

The core function of a BIT is to create an enabling environment for the inflow of foreign investment by providing certain basic guarantees through a series of rights and obligations between the investor and the state enshrined in the text of the agreement. Whether or not, the investment agreements afford flexibility and policy space for undertaking developmental goals is determined by the *nature* and *scope* of the obligations undertaken in terms of the core substantive provisions of what is or is not permissible under the agreement.<sup>10</sup>

An issue of central importance relates to the very definition of investment as contained in BITs. UNCTAD notes that the recent trend in International Investment Agreements (IIAs) (an overwhelming proportion of which are BITs) is to have a broad open ended definition of what constitutes investment which may or may not be subject to limitations.<sup>11</sup> Thus, for example, Bilateral Investment Treaty between the Republic of India and the Kingdom of Netherlands for the promotion and protection of investments lays down the definition of what constitutes 'investment' in Article 1 in an open ended manner.<sup>12</sup> Treaty coverage of all assets included in the definition may not be consistent with the development policy of states at every period in the life of an agreement.<sup>13</sup>

Although, the scope of provisions contained in the various BITS are fairly diverse, the following rights have been seen to arise out of a typical modern BIT:<sup>14</sup>

1. Absolute standards of treatment such as fair and equitable treatment
2. Freedom from discriminatory measures by providing relative standard of treatment such as National Treatment (NT) or Most Favoured Nation (MFN)
3. Protection against expropriation or nationalization through compensation
4. Dispute settlement provisions including both state to state and investor to state

While these treaty provisions cover most sectors unless expressly carved out from application and mostly apply in the post establishment phase, recent trends in US and Japanese BITs have extended these provisions to the pre establishment phase as well.<sup>15</sup>

It is important to take stock of these trends and examine the development concerns arising out of the provisions of BITs especially since the historical nature of BITs is undergoing a change and they are fast becoming a preferred mode of pushing in aggressive investment protection measures by the developed countries. The substantive guarantees laid down in BITs are leading to a new system of international rights and obligations for the signatories and becoming the fundamental

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<sup>10</sup> Preserving Flexibility in IIAs: The Use of Reservations, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2006

<sup>11</sup> International Investment Agreements: Flexibility for Development, UNCTAD Series on Issues in International Investment Agreements, United Nations, New York and Geneva, 2000

<sup>12</sup> Article 1 in the Text of the Agreement of the Bilateral Investment Treaty between the Republic of India and the Kingdom of Netherlands for the promotion and protection of investments

<sup>13</sup> International Investment Agreements: Flexibility for Development, UNCTAD Series on Issues in International Investment Agreements, United Nations, New York and Geneva, 2000

<sup>14</sup> Luke Eric Peterson, Bilateral Investment Treaties and Development Policy Making, International Institute for Sustainable Development, Canada, 2004

<sup>15</sup> Luke Eric Peterson, Bilateral Investment Treaties and Development Policy Making, International Institute for Sustainable Development, Canada, 2004

source of international law in the area of foreign investment while displacing customary international law and in some cases even relevant domestic law.<sup>16</sup>

It is sometimes stated that the objective of investment treaties is to foster development. Peterson's examination of over 150 treaties entered into by Western governments such as US, Canada and UK reveals that references to development are 'exceedingly rare' either in the preamble to the treaty or in the treaty's substantive provisions.<sup>17</sup> Even when references are made to economic development there is a linkage assumed between the flow of private capital and economic development. The provisions are tuned to the interests of the foreign investor and do not have clauses towards recognition of government regulation as an element of successful development policy. This 'widespread failure to identify development as an important objective of investment treaties' has important policy implications.<sup>18</sup> Similarly, other provisions relating to existence of Special and differential treatment (S&DT) by way of relatively less onerous commitments relating to national treatment, carve out clauses for sensitive industries, social sectors, imposition of performance requirements and other developmental obligations are also rare in treaty practice of developed countries such as UK. Peterson observes that overall 'BITs tend to be *highly* reciprocal, narrowly focused on investment protection (rather than development or other policy goals) and garnished with few exceptions. (Emphasis in original)<sup>19</sup>

Peter Chowla's analysis of the major substantive provisions within BITs has focused attention on areas which may inhibit or promote developmental goals in the host country.<sup>20</sup> Chowla's analysis also helps explain the changing nature of BITS over time. Clauses relating to National Treatment (NT), pre-establishment rights, domestic tax exemption, public health exemption, capital movement safeguards and ban on local content requirements have been examined in the study. As far as NT and pre establishment rights are concerned, 50 per cent of the BITs signed before 1990 did not include NT clauses while more recent treaties are likely to include them. While 40 per cent of the treaties signed by Asian countries had NT clauses, African countries had no treaties without NT clauses. Pre-establishment clauses are still not common and countries such as US, Canada and Japan are likely to have them.<sup>21</sup> All BITS include exemptions to MFN treatment for benefits derived from economic unions or free trade areas.<sup>22</sup> Since patents are covered under the definition of investments, it is important to know whether BITs have public health exemptions.

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<sup>16</sup> Susan D. Franck, The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future, U.C. Davis Journal of International Law and Policy, Fall 2005

<sup>17</sup> Luke Eric Peterson, Bilateral Investment Treaties and Development Policy Making, International Institute for Sustainable Development, Canada, 2004

<sup>18</sup> Luke Eric Peterson, Bilateral Investment Treaties and Development Policy Making, International Institute for Sustainable Development, Canada, 2004

<sup>19</sup> Luke Eric Peterson, Bilateral Investment Treaties and Development Policy Making, International Institute for Sustainable Development, Canada, 2004

<sup>20</sup> Peter Chowla, Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties, Development Studies Institute, London School of Economics and Political Science, London, 2005

<sup>21</sup> Peter Chowla, Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties, Development Studies Institute, London School of Economics and Political Science, London, 2005

<sup>22</sup> Peter Chowla, Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties, Development Studies Institute, London School of Economics and Political Science, London, 2005

Chowla's examination shows that more recent BITs are more likely to include such protections.<sup>23</sup> As far as capital movement safeguards are concerned certain host countries end up with more safeguards than others indicating the fact that negotiating strength of the respective countries any BIT is important for building in safeguards. Similar is the case with performance requirements with poor countries and small economies being unable to sign treaties that enforce performance requirements.<sup>24</sup> Finally, the analysis shows that dispute resolution clause in BITs is almost a universal feature with only five agreements in the sample, and that too before 1981, not including clauses on investor-state arbitration.<sup>25</sup>

A detailed examination of the debates around all the major substantive provisions of BITs is beyond the scope of the paper. In the remaining part of this section, provisions relating to dispute settlement procedures and investment arbitration and some critical issues of development concerns shall be dealt with at some length.

The provisions relating to dispute settlement have been an area of increasing policy concern primarily due to the rise in such cases in the recent years and the substantial financial liability implicit in such clauses. In most BITs, the investor is granted the right to sue the state if governmental actions under the pretext of expropriation of the business of the firm. This by itself constitutes an expansion of investor rights as in most cases governments can claim sovereign immunity virtually closing down the legal recourse. Expropriation has been permitted in cases where it is undertaken for a public purpose, carried out in a non-discriminatory manner following the due process of law and after payment of compensation.<sup>26</sup> The ambit of expropriation has been expanded to include cases of 'indirect expropriation', 'creeping expropriation' or regulatory takings as including measures 'tantamount' or equivalent to expropriation or actions that would substantially impair the value of investments. These terms have been defined in a vague manner leaving the policy makers and the courts with no definitive indication of an assessment of the potential impact of this provision. The arbitration proceedings are not bound by precedents and with limited avenues for appeals. This aspect of BITs has seen the overall caseload expand rather dramatically in recent years. There is an increasing worry that these provisions are prone to misuse as even normal risks of running businesses can be subsumed under the expropriation clause. These provisions have been seen as anti-democratic, as a 'Trojan horse' of investment treaties with the 'secret tribunals being dubbed as a 'private court of capital'.

Arbitration has emerged as emerged as the preeminent method for resolving complex international disputes and the preferred method over options such as the use of force or other informal solutions such as closed door diplomatic negotiations.<sup>27</sup> Historically, arbitration of investment disputes was not available to individual investors as they had no standing and no direct cause of action against a Sovereign for a violation of international law affecting their

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<sup>23</sup> Peter Chowla, *Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties*, Development Studies Institute, London School of Economics and Political Science, London, 2005

<sup>24</sup> Peter Chowla, *Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties*, Development Studies Institute, London School of Economics and Political Science, London, 2005

<sup>25</sup> Peter Chowla, *Comparing Naughty BITS: Assessing the Developmental Impact of Variation in Bilateral Investment Treaties*, Development Studies Institute, London School of Economics and Political Science, London, 2005

<sup>26</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite*, World Bank, DECRG, June 2003

<sup>27</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

investments.<sup>28</sup> The only choice available to investors was to route claims through their home country which filed cases on their behalf at the International Court of Justice. Under this system, it was not easy for claims to be translated into compensation and the only enforcement tool was the enactment of a Security Council Resolution which is not commercially useful in such cases. Alternatively, pursuit of claims in the country of the sovereign against the sovereign was not seen as attractive for the investors.<sup>29</sup>

In order to remedy the situation, investment treaties provided investors with a direct cause of action against a Sovereign for damages and a choice of neutral setting for resolution of their grievances. These shifts were a 'major innovation' and have led to the creation of a private cause of action against Sovereigns and placed the enforcement of public international law rights in the hands of private individuals and corporations.<sup>30</sup> However, though these options have been available since 1960s it is only since the last decade or so that there has been a phenomenal increase in the number of claims brought under diverse investment treaty arbitrations. This trend is seen to be likely to persist in the future.<sup>31</sup>

Investment treaties usually specify the institutions to be used in case of a dispute and the institutions have evolved their own set of rules governing the arbitration process. Thus in the Bilateral Investment Treaty between the Republic of India and the Kingdom of Netherlands for the promotion and protection of investments lays down the provisions relating to disputes between the contracting parties in Article 10 of the treaty.<sup>32</sup> As per different clauses of the Article, if negotiations cannot settle the dispute after six months, either Contracting Party can submit the dispute to arbitration. The arbitration tribunal is to consist of three arbitrators. The arbitrators are to be appointed by each Contracting Party within two months of the receipt of request for arbitration and within two months from them a third arbitrator is to be appointed as the Chairman of the tribunal. If within the periods specified as noted earlier, the necessary appointments have not been made the President of the International Court of Justice is to be invited to make such appointments. The arbitral tribunal shall reach its decision by a majority of votes and such decision shall be final and binding on both Contracting Parties.<sup>33</sup>

The arbitration process is marked by complete lack of transparency in most cases with no public accountability even in cases involving legitimate public interest having significant public impact.<sup>34</sup> Though the rights enshrined in the BITs are reciprocal in nature, it is weighed heavily against the developing countries. Thus for example, an examination of the arbitration cases filed

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<sup>28</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

<sup>29</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

<sup>30</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

<sup>31</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

<sup>32</sup> Text of the Agreement between the Republic of India and the Kingdom of Netherlands for the promotion and protection of investments

<sup>33</sup> Article 10 (different clauses) of the Text of the Agreement between the Republic of India and the Kingdom of Netherlands for the promotion and protection of investments

<sup>34</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite*, World Bank, DECRG, June 2003

before the ICSID showed that out of 120 cases there were only 2 cases where the plaintiff is a developing country and the defendant a developed country.<sup>35</sup>

The entire procedure including records of meetings, replies, interim relief, evidence gathering, awards, annulment or set aside are governed by strict rules of confidentiality and the process is not transparent.<sup>36</sup> Although, there have been recent movements in favour of incorporating transparency obligations into recent trade agreements and model investment treaties,<sup>37</sup> the overall situation is still shrouded in secrecy. For instance, UNCTAD notes that issue of transparency still subsists (despite some movements towards transparency in some cases) in broader BITS context.<sup>38</sup> It also refers to the fact that increased transparency could be achieved if it was possible to introduce 'relevant modifications to the international arbitral rules that are relied upon by reference in these BITS (first of all UNCITRAL and ICSID rules).' The UNCTAD review further makes mention of the proposed reforms of the ICSID procedure wherein the tribunals would have the authority to accept and consider submissions from third parties and to allow third parties to attend hearings, or even to open them to the public without obtaining the consent of both parties as is currently the case.<sup>39</sup>

Commenting on the nature of the outcomes of investment disputes, Franck notes that while there has been remarkable consistency in some areas such as jurisdictional determinations, there is marked inconsistency as well. Questions have also been raised about the 'legitimacy and reliability of the investment treaty dispute resolution process'.<sup>40</sup> Considering the fact that the dispute resolution process is yet in its infancy, it is perhaps an opportune time to examine the question about what the future holds for investment treaties intertwined as it is with the future of the investment treaty arbitration.<sup>41</sup>

UNCTAD notes instances where it has been seen that the same facts and circumstances can be litigated by different investors in different tribunals even when different results emerge.<sup>42</sup> This has led to situations investors having shares in the same investment are in a position to initiate multiple arbitrations in the name of an affiliate company under different BITS.<sup>43</sup>

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<sup>35</sup> Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite, World Bank, DECRG, June 2003

<sup>36</sup> Susan D. Franck, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions, Fordham Law Review, Vol. 73, 2005

<sup>37</sup> Susan D. Franck, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions, Fordham Law Review, Vol. 73, 2005

<sup>38</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>39</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>40</sup> Susan D. Franck, The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future, U.C. Davis Journal of International Law and Policy, Fall 2005

<sup>41</sup> Susan D. Franck, The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future, U.C. Davis Journal of International Law and Policy, Fall 2005

<sup>42</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>43</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

Following Franck, it is seen that inconsistency can arise under three different scenarios:<sup>44</sup>

1. Different tribunals coming to different conclusions about the same standard in the same treaty
2. Different tribunals organised under different treaties coming to different conclusions about disputes involving the same set of facts, related parties and similar investment rights
3. Different tribunals organised under different investment treaties considering disputes involving a similar commercial situation and similar investment rights but coming to opposite conclusions.

Since treaty awards have a significant impact on the future conduct of states in terms of economic development, foreign relations and in general for the exercise of legislative and regulatory powers.<sup>45</sup> At the same time they increase the uncertainty for investors.<sup>46</sup>

Franck has argued for a new framework towards removing the inconsistency of the arbitration process and enhancing the legitimacy of the current investment arbitration approach.<sup>47</sup> She has argued for introducing enhanced textual clarity about the meaning of substantive rights and providing detailed definitions for guidance of arbitrators. Franck also suggests improvements by way of revision of procedural rights in investment treaties and introducing structural safeguards into the text of the treaty's dispute resolution process.<sup>48</sup> Suggestions have also been made by ICSID for creation of an investment arbitration appellate body which could review awards, correct errors and establish a reliable body of law and for consolidation of similar claims based on the same treaty or same conduct.<sup>49</sup>

Howard Mann et al in their proposal for a Model international agreement on investment for sustainable development make a number of interesting suggestions towards improvement (henceforth IISD Model Agreement). On the issue of investor/investment-state disputes an important recommendation relates to a dispute between an investor or investment and a host state commencing after domestic remedies are exhausted in relation to the underlying issues pleaded in relation to a breach of the agreement.<sup>50</sup> The IISD Model Agreement also makes a number of other important recommendations relating to issues such as improvement of transparency, building in developmental safeguards and defining the rights and obligations of investors and the host state in

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<sup>44</sup> Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, *Fordham Law Review*, Vol. 73, 2005

<sup>45</sup> Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, *U.C. Davis Journal of International Law and Policy*, Fall 2005

<sup>46</sup> See for instance the celebrated *Lauder* cases, cited in *Investor-State Disputes Arising from Investment Treaties: A Review*, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>47</sup> Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, *U.C. Davis Journal of International Law and Policy*, Fall 2005

<sup>48</sup> Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, *U.C. Davis Journal of International Law and Policy*, Fall 2005

<sup>49</sup> Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, *U.C. Davis Journal of International Law and Policy*, Fall 2005

<sup>50</sup> Howard Mann, Konrad von Moltke, Luke Eric Peterson, Aason Cosbey, *IISD Model International Agreement on Investment for Sustainable Development*, International Institute for Sustainable Development, Canada, 2005

a manner conducive to sustainable development. Some of these recommendations have been considered later in the paper.

Another issue of concern relates to the conflict of jurisdictions wherein international dispute settlement processes are initiated despite the existence of a 'domestic forum clause' in the investment contract between the investor and the host country.<sup>51</sup> The ICSID tribunals have held that the 'domestic forum clause' does not restrict invocation of the use of the investor state dispute settlement mechanism of an international investment agreement even though the 'alleged breach of contract on the part of the respondent host country is central to the establishment of a breach of the investment protection obligations in the treaty.'<sup>52</sup> The rationale behind the approach is that while domestic forum clauses relate to the breaches of contract only the investor state claim relates to breaches of the treaty itself as a separate international law obligation.<sup>53</sup> This is a potentially a disadvantage to the host country as purely contractual disputes need to be resolved in the appropriate domestic forum and is an area of increasing concern. Such an instance occurred in the Dabhol Power Corporation case in India (referred to later in the paper) where the arbitration proceedings were launched in London during the pendency of the case in the Supreme Court in India. Hearing an appeal in the matter, the Delhi High Court held that the proceedings were oppressive for the reason that despite the fact that the matter was pending before the Supreme Court, the arbitrators were proceeding further without realizing that the decision of the Supreme Court would go into the root of the matter pending before them. The Delhi High Court further held that the defendant be restrained from proceeding further with the arbitral proceedings pending before the arbitral tribunal in London until the pronouncement of the judgement with regard to the jurisdiction of Maharashtra Electricity Regulatory Commission by the Supreme Court.<sup>54</sup>

Finally, the issue of treaty shopping constitutes another area of concern. Foreign investors typically invoke BITs of home countries of convenience that have treaties with host countries where investments have been made.<sup>55</sup> Some of the international investment agreements have a denial of benefits clause which prevent investors who do not have 'substantial business activities' from taking advantage of the agreement. Accordingly, the term 'substantial business activities' can be defined adopting a liberal or strict approach and such misuse prevented. However, the fact that many of the BITs do not have this clause suggests that the use of this mechanism was not foreseen clearly by host countries which do not have such clauses.

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<sup>51</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>52</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>53</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>54</sup> Zia Mody and Sushil Jacob, India Interim Injunction, Union of India v. Dabhol Power Co Ltd, Case Comment, International Arbitration Law Review, 2004

<sup>55</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

### **Section III. Study of BITS in a Comparative Regional Perspective: Case Studies of the Dabhol Power Project in India and Cochabamba Water Privatisation in Bolivia**

#### **Case Study 1: The Dabhol Power Project, India**

Launched in 1991, the Enron power project in India has emerged as a classic example of how provisions in Bilateral Investment Treaties can be interpreted in unanticipated ways that raise a number of interrelated policy issues and concerns. The Enron case study therefore is instructive in several ways. Let us consider in this section facts of the case relating to its origin and launch, its salient features which are important from the point of view of understanding the litigation around it, criticism of the project and its operationalisation and finally the legal issues of 'coercive arbitration' under which several arbitration claims were filed under BITS.

#### **Origin and Launch of the Power Project**

Under the Electricity (Supply) Act of 1948, ownership and regulation of electricity generation was a concurrent responsibility of both the centre and the state. The State Electricity Boards (SEBs) were established in states as per the provisions of the Act as vertically integrated power companies.<sup>56</sup> Despite an extensive network of SEBs by 1990 the country was faced with a severe power shortfall with one of the lowest per capita power generation capacity in the world. There was a thinking that without adequate supply of power virtually no sector of the economy whether agriculture, industry or services could be transformed and put on a high growth path. Following the wide ranging policies of economic reforms and liberalization since July 1991, the decks were cleared for the participation of private players in the power sector in India.

It must be remembered that the lending policies of World Bank had an important role to play in influencing the new thinking relating to the power sector. With India's economic crises the Bank reevaluated its lending policies and decided to stop grant of loans to SEBs that had failed to improve their performance and meet their financial commitments in 1992. Over the next three years, the Bank cancelled over \$2 billion in non performing loans and refocused its lending strategy to issues relating to the institutional, financial and environmental sustainability of SEBs. The new policy emphasized that lending would be done only to states which agreed to 'unbundle their electricity boards, privatize distribution and facilitate the involvement of private sector in power generation'.<sup>57</sup> Under the power sector reforms programme initiated, eight 'fast track' power projects were proposed to be taken up as negotiated deals through the Memorandum of Understanding route and not through a process of competitive bidding. Thus although the idea of private sector participation was proposed, its operationalisation by way of arriving at detailed guidelines was not through. Though it is well known that the usual practice is for governments to issue requests for proposals under which competing bids can be invited by several developers, the government chose to close the deal via the MOU route wherein the bids have to be accepted or rejected without any comparative basis. Under the former stream, the developer with the lowest cost bid as per the laid down government specifications of the contract wins the deal. As shall be seen later the deal also attracted fierce criticisms on several other compelling grounds. Under the

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<sup>56</sup> Details of the Act available at [http://www.msebindia.com/m1/m1\\_index.shtml](http://www.msebindia.com/m1/m1_index.shtml) Accessed on September 10, 2006

<sup>57</sup> Reforming India's Energy Sector (1978-1999) Precis, World Bank Operations Evaluation Department, Spring 2001, Number 206 available at [www.worldbank.org/html/oe](http://www.worldbank.org/html/oe) Accessed on September 12, 2006

negotiated process, the developers and government arrive at an in principle understanding and after requisite clearances a Power Purchase agreement (PPA) is signed.

This was the overall setting in which the Enron project took off. With a proposed capacity of 2015 megawatts (MW) and around \$3 billion of investments, this constituted largest foreign investment in the country. The Project constituting of two phases envisaged establishment of a total capacity of 2,015 MW at Dabhol on a Build Own and Operate basis (BOO).<sup>58</sup> Under the proposal, the state governments were required to provide guarantees to foreign investors so that in case the cash strapped State Electricity Boards (SEBs) failed to pay all outstanding dues. Accordingly, a Memorandum of Understanding (MOU) was signed with the Government of Maharashtra (GOM) on June 20 1992 for setting up of a thermal power plan generating 2000 megawatts (MW) of power forming nearly 20 per cent of the installed capacity in the state. The PPA was signed for a duration of 20 years with the MSEB having an option of a further extension of 5 or 10 years. The state of Maharashtra, the second most populous state in the country is an industrial powerhouse with high levels of industrialization and contributes to nearly one fourth of the gross value added by the industrial sector in India.<sup>59</sup>

Subsequently, in April 1993, Bechtel Enterprises and General Electric Company (GE) came together to form Dabhol Power Company (DPC) and registered it as an Indian Company under the Indian Companies Act, 1956. (Shareholding pattern of the different constituents were 80%, 10% and 10% respectively) Additionally, the GOI agreed to sign on a counter guarantee to the power project restricted to Phase I of the project.<sup>60</sup> Although the PPA was governed by Indian Laws, the parties agreed to settle any disputes arising under the agreement by arbitration in London under UNCITRAL Arbitration Rules.

### **Salient Features of the Power Purchase Agreement**

The PPA signed between the MSEB and the DPC has been noted by experts to be the ‘most controversial document in the history of power sector in India’. It was kept away from the public domain and was a closely guarded secret until political compulsions and widespread criticisms of the deal forced DPC to make it public.<sup>61</sup>

Analysis of the PPA document by some leading power experts in the country revealed the following.<sup>62</sup>

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<sup>58</sup> The Enron Story: Controversial Issues and Peoples’ Struggles, Subodh Wagle, Prayas, Pune, India, 1997 available at [www.prayaspune.org](http://www.prayaspune.org) Accessed on September 12, 2006

<sup>59</sup> White Paper on Maharashtra’s Power Sector Reforms, Industries, Energy and Labour Department, Mumbai, 2002, available at <http://www.maharashtra.gov.in/white%20paper%20final%20aug%2027.htm> Accessed on September 15, 2006

<sup>60</sup> The Enron Story: Controversial Issues and Peoples’ Struggles, Subodh Wagle, Prayas, Pune, India, 1997 available at [www.prayaspune.org](http://www.prayaspune.org) Accessed on September 12, 2006

<sup>61</sup> The Enron Controversy: Techno-Economic Analysis and Policy Implications by Girish Sant, Shantanu Dixit and Subodh Wagle, Prayas, September, 1995 available at [www.prayaspune.org](http://www.prayaspune.org) Accessed on September 12, 2006

<sup>62</sup> The Enron Controversy: Techno-Economic Analysis and Policy Implications by Girish Sant, Shantanu Dixit and Subodh Wagle, Prayas, September, 1995 available at [www.prayaspune.org](http://www.prayaspune.org) Accessed on September 12, 2006

1. Even though the DPC was believed to be liable for heavy penalties in instances of non performing parameters such as time over-run, capacity short fall and the like, most of these are passed on to the contractors.
2. Internal rate of return (IRR: profitability indicator) is to the tune of 28 per cent (post tax real) equivalent to over 40 per cent flat rate of return in dollar terms. As recommended Vanguard Capital, a GOI appointed consultant an IRR of 17% to 21 % (posttax, real) is considered attractive enough for inflow of foreign investment even in high risk contexts.
3. The high capital costs together with the excessive promised rate of return were to result in excess payments of about \$ 350-425 million to Enron as a one time payment in 1996 currency.
4. The tariff structure agreed to is very complex being backloaded (with an inbuilt rise of four per cent) and dollar denominated as also the Plant Load Factor (PLF) The tariff structure stipulated in the PPA is very complex. Accordingly, the cost of power is in reality quite high

Experts noted that the fact that the overall cost of the project was excessively high and was considerably padded by Enron in order to generate very high rates of return. Thus for instance, it was brought out that the total cost of the project which was to the tune of \$3 billion was five times higher than the cost of the main plant equipment. It has been seen that in indigenously built power projects the cost of the main plant equipment is roughly 60 per cent of the total cost of the project.<sup>63</sup>

Highlighting the one sided nature of the PPA, it has been argued that under the terms of the agreement, the GoM and GoI are underwriting all risks of the project while providing an average rate of return of 40 per cent and guaranteeing a 90 per cent off take of power by shutting down cheaper generation and providing other concessions under threat of penalties. Enron for its part was bringing only 10 per cent of the costs with very little liability in comparison. In return, the MSEB would need to shell out Rs. 1200 crore in the very first year of its operation with costs rising every year by four percent on account of capital servicing, foreign exchange rate variation and increased fuel costs.<sup>64</sup> The cost of power as per the terms of the PPA was so high that it was widely considered to be a recipe for financial ruin of MSEB and the GoM who served as guarantors to the project.<sup>65</sup>

In March 1995, when the State Assembly elections were held, BJP-Shiv Sena alliance won the elections thereby replacing the Congress Party government which had led the negotiations to the project. In May 1995, the new government appointed a Cabinet sub-committee chaired by deputy Chief Minister, Mr. Gopinath Munde to investigate the project. In its report, the sub-committee recommended that Phase I of the project be repudiated and Phase II cancelled interalia on ground of lack of transparency in the entire negotiation process, lack of adoption of the competitive bidding process, high costs and high tariffs of the project and the capacity payment agreement under which the MSEB was to pay for the electricity irrespective of whether it was actually being used or not, objections raised by the World Bank<sup>66</sup> towards the project and on environmental

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<sup>63</sup> Prabir Purkayastha, The Enron Power Purchase Agreement, Delhi Science Forum, April 2006 available at [www.delhiscienceforum.org](http://www.delhiscienceforum.org) accessed on September 15 2006

<sup>64</sup> Prabir Purkayastha, The Enron Power Purchase Agreement, Delhi Science Forum, April 2006 available at [www.delhiscienceforum.org](http://www.delhiscienceforum.org) accessed on September 15 2006

<sup>65</sup> Madhav Godbole, EAS Sarma, Aftershocks of Dabhol Power Project, Economic and Political Weekly, August 26, 2006

<sup>66</sup> An evaluation of the Enron project by World Bank carried brought out in April 1993 led to the assessment that the project was unviable, did not satisfy the test of least cost power and is not justified by the power demands of Maharashtra quoted in The Munde Committee, Report of the Cabinet Sub-

considerations.<sup>67</sup> The PPA has subsequently cancelled by the state government with the Chief Minister, Mr. Manohar Joshi stating that the 'deal is against the interests of Maharashtra. Accepting the deal would indicate an absolute lack of self respect and would amount to betraying the trust of the people'.<sup>68</sup>

In response, the Dabhol Power Company and the project sponsors instituted arbitration claims of damages in excess of \$ 300 million in London against the MSEB and the Maharashtra state government.<sup>69</sup> The state of Maharashtra brought in a suit in the Bombay High Court to invalidate the arbitration clause and the guarantee of the MSEB to pay on the ground that both had been secured by illegal means.<sup>70</sup> The US government issued a statement critical of the contract repudiation and cautioned that these developments would have negative consequences for foreign investment in India.<sup>71</sup>

A process of review and renegotiation was then initiated by the state of Maharashtra with the Panel undertaking the exercise and proposing a mutually acceptable renegotiated terms of the Dabhol Project in November 1995.<sup>72</sup> Under the renegotiated terms, a special purpose entity, Maharashtra Power Development Corporation Limited (MPDCL) was created with a 30 percent shareholding transferred from that of Enron thereby reducing the share of Enron to 50 percent. The PPA was amended and the project put on track by July 1995. Yet again, the controversy refused to die and as opinion of experts continued to mount the Dabhol project was again shut down in 2001.

The cancellation of the project led to multiple arbitration proceedings at multiple forums. A total of 10 arbitration were initiated by stakeholders of the project in London and New York.<sup>73</sup> A total of 16 cases were reportedly filed by the DPC and Indian government each other in and outside India.<sup>74</sup> The arbitration was initiated under clause 8.1 of the shareholders agreement under which disputes between shareholders can be settled under ICC rules in New York State alone, under the exclusive jurisdiction of the New York law.<sup>75</sup> The Mumbai High Court however had restrained both GE and Bechtel for pursuing the arbitration claims. Earlier, an international court had ordered the Union Government to pay Overseas Private Insurance Company (OPIC), a US agency, a total claim of \$57 million as per an insurance agreement with GE and Bechtel.<sup>76</sup> MSEB also issued a contempt of court notice to the DPC in the Mumbai High Court against the Rs

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Committee to Review the Dabhol Power Project, 1995, reproduced in Human Rights Watch Report available on [www.hrw.org/reports/1999/enron/enron-b.htm](http://www.hrw.org/reports/1999/enron/enron-b.htm) accessed on September 18, 2006

<sup>67</sup> The Munde Committee, Report of the Cabinet Sub-Committee to Review the Dabhol Power Project, 1995, reproduced in Human Rights Watch Report available on [www.hrw.org/reports/1999/enron/enron-b.htm](http://www.hrw.org/reports/1999/enron/enron-b.htm) accessed on September 18, 2006

<sup>68</sup> Jeswald W. Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life against Form*, International Lawyer, Winter, 2001

<sup>69</sup> Jeswald W. Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life against Form*, International Lawyer, Winter, 2001

<sup>70</sup> Jeswald W. Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life against Form*, International Lawyer, Winter, 2001

<sup>71</sup> Jeswald W. Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life against Form*, International Lawyer, Winter, 2001

<sup>72</sup> Jeswald W. Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life against Form*, International Lawyer, Winter, 2001

<sup>73</sup> <http://www.thehindubusinessline.com/2003/09/27/stories/2003092702590100.htm>

<sup>74</sup> [http://www.financialexpress.com/fe\\_full\\_story.php?content\\_id=90995](http://www.financialexpress.com/fe_full_story.php?content_id=90995)

<sup>75</sup> <http://www.thehindubusinessline.com/2003/09/27/stories/2003092702590100.htm>

<sup>76</sup> <http://www.thehindubusinessline.com/2003/09/27/stories/2003092702590100.htm>

26,000-crore arbitration filed by DPC in a London Court stating that the DPC has violated the Supreme Court's injunction against starting any arbitration proceedings.<sup>77</sup>

In the arbitration case, a suit was filed before Delhi High Court that it should issue an interim injunction to stay the arbitration proceedings before the London arbitral tribunal. Earlier, the Supreme Court had passed an interim order stating that pending the its final decision, the arbitral proceedings commenced in London could not proceed. However, despite the fact that the matter was pending before the Supreme Court, the arbitral tribunal continued with the proceedings. The Delhi High Court held that the proceedings were oppressive for the reason that despite the fact that the matter was pending before the Supreme Court, the arbitrators were proceeding further without realizing that the decision of the Supreme Court would go into the root of the matter pending before them. The Delhi High Court further held that the defendant be restrained from proceeding further with the arbitral proceedings pending before the arbitral tribunal in London until the pronouncement of the judgement with regard to the jurisdiction of Maharashtra Electricity Regulatory Commission by the Supreme Court.<sup>78</sup>

Taking advantage of the BIT between the Government of the Republic of Mauritius and the Government of the Republic of India for the promotion and protection of Investment, GE filed a claim under the treaty. GE and Enron filed the claim through their affiliates Capital India Power Mauritius I and Enron Mauritius Company against MPDCL, MSEB and the state of Maharashtra leading to an award in excess of ninety six million seven hundred thousand dollars pronounced by the International Court of Arbitration of the International Chamber of Commerce.<sup>79</sup> Besides, Offshore Power Production (OPP), a limited liability partnership organised under the laws of Netherlands that owns -- through its subsidiary company Enron Mauritius Company (EMC) with a 65% interest in DPC, has filed a notice of claim under the Indo-Netherlands Investment Promotion Treaty.<sup>80</sup>

In December 2005, both Dabhol Power Company and Maharashtra State Electricity Board on Wednesday settled their long-standing disputes on the PPA, with 'consent terms' filed in the Supreme Court ending all legal proceedings in India and abroad in an out of court settlement reached between them.<sup>81</sup> The terms of the agreement are not yet known but the road has been cleared for a revival of the project by a new Joint Venture company, Ratnagiri Gas and Power Private Ltd promoted by the Indian Public Sector Undertakings such as National Thermal Power Corporation and Gas Authority of India Limited.<sup>82</sup> The project has been revived in order to save the reputation of the power elite of the country with a slew of tax concessions and waivers being provided to the joint venture company.<sup>83</sup> It has been estimated by some experts that the burden of subsidy to be borne by what was a defunct project is to the tune of around Rs. 10,000 crores in what has been termed privatization of profits and nationalization of losses.<sup>84</sup>

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<sup>77</sup> <http://www.thehindubusinessline.com/2004/07/03/stories/2004070302700600.htm>

<sup>78</sup> Zia Mody and Sushil Jacob, India Interim Injunction, Union of India v. Dabhol Power Co Ltd, Case Comment, International Arbitration Law Review, 2004

<sup>79</sup> International Court of Arbitration of the International Chamber of Commerce, Case No. 12913/MS, Final Award available with the authors

<sup>80</sup> [http://www.financialexpress.com/fe\\_full\\_story.php?content\\_id=90995](http://www.financialexpress.com/fe_full_story.php?content_id=90995)

<sup>81</sup> <http://www.rediff.com/money/2005/dec/07dpc.htm>

<sup>82</sup> <http://www.rediff.com/money/2005/dec/07dpc.htm>

<sup>83</sup> Madhav Godbole, EAS Sarma, Aftershocks of Dabhol Power Project, Economic and Political Weekly, August 26, 2006

<sup>84</sup> Madhav Godbole, EAS Sarma, Aftershocks of Dabhol Power Project, Economic and Political Weekly, August 26, 2006

## Case Study 2: Cochabamba Water Privatisation Case, Bolivia

The Cochabamba water privatization case raises the familiar question of the conflict between contractual obligations of the state towards foreign capital and the its regulatory functions of upholding the larger public interest in provision of essential services such as water.

International institutions such as the World Bank (WB) and International Monetary Fund (IMF) have been seeking to define water as a 'private good' to be 'extracted and traded freely' rather than as a common property to be held by all.<sup>85</sup> Accordingly, prescriptions of privatization of management of water supplies have been aggressively advocated in order to optimize its use. The World Bank has estimated that the potential water market is in the region of US \$1 trillion.<sup>86</sup> Transnational corporations such as Vivendi Universal and Suez together control over 70 percent of the world's water market.<sup>87</sup>

Water has been called the last frontier of privatization around the world.<sup>88</sup> Over 90 percent of the world's water is still supplied by public bodies with 90 percent of the world's investment in water and sewage systems.<sup>89</sup> It has been noted that by the end of 2000, municipalities in at least ninety three countries underwent partial privatization of water or wastewater services including in countries such as China and Cuba.<sup>90</sup>

La Guerra del Agua (Water war) was the name given to the six month long conflict over water that took place in Cochabamba in Bolivia in late 1999 led by the people of Cochabamba post the efforts of the Bolivian government to privatize the city's water system.<sup>91</sup> With seventy percent of its citizens living below the poverty line, hyperinflation of 2500 percent, Bolivia is the poorest nation in South America. In order to stimulate the economy and arrest the economic crises, a series of economic reforms were undertaken by the country in the 1980s which further pushed the economy into recession.<sup>92</sup> A series of privatization efforts were launched under the active encouragement of the WB, IMF leading to the privatization of the municipal water systems of three of its largest cities, La Paz, Santa Cruz and Cochabamba. The WB loans to facilitate the

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<sup>85</sup> Timothy O' Neill, Water and Freedom: The Privatisation of Water and Its Implications for Democracy and Human Rights in the Developing World, Colorado Journal of International Environmental Law and Policy, Spring 2006

<sup>86</sup> Timothy O' Neill, Water and Freedom: The Privatisation of Water and Its Implications for Democracy and Human Rights in the Developing World, Colorado Journal of International Environmental Law and Policy, Spring 2006

<sup>87</sup> Timothy O' Neill, Water and Freedom: The Privatisation of Water and Its Implications for Democracy and Human Rights in the Developing World, Colorado Journal of International Environmental Law and Policy, Spring 2006

<sup>88</sup> Violeta Petrova, At the Frontiers of the Rush for Blue Gold: Water Privatization and the Human Right to Water, Brooklyn Journal of International Law, 2006

<sup>89</sup> Violeta Petrova, At the Frontiers of the Rush for Blue Gold: Water Privatization and the Human Right to Water, Brooklyn Journal of International Law, 2006

<sup>90</sup> Violeta Petrova, At the Frontiers of the Rush for Blue Gold: Water Privatization and the Human Right to Water, Brooklyn Journal of International Law, 2006

<sup>91</sup> Timothy O' Neill, Water and Freedom: The Privatisation of Water and Its Implications for Democracy and Human Rights in the Developing World, Colorado Journal of International Environmental Law and Policy, Spring 2006

<sup>92</sup> The basic facts of the case as described in this part of the write up have been derived from the article of Timothy O' Neill, Water and Freedom: The Privatisation of Water and Its Implications for Democracy and Human Rights in the Developing World, Colorado Journal of International Environmental Law and Policy, Spring 2006

process were conditional to the reforms of the water sector in the cities of La Paz and Cochabamba. In the latter, water and wastewater systems were run by the municipal water company called Servicio Municipal de Agua Potable y Acantrillado (SEMAPA). Reportedly, newly half of the cities residents were not connected to any water system and the quality of water was not up to the mark. In order to augment the water supplies and improve the supplies, construction of a dam, reservoir, tunnel and hydroelectric plants were proposed at costs of more US \$390 million. The cash strapped SEMAPA was struggling to meet the needs of water for its citizens as it was operating at a loss of more than \$ 2.25 million annually. The Bolivian government accordingly issued a call for tender which attracted only one bid from Agua del Tunari (AdT), a newly formed consortium consisting of International Waters as the primary owner founded by the American firm Bechtel in 1996, Bengoa of Spain and four or five Bolivian companies.

An agreement was signed on September 3 1999 between the special commission and AdT which was shrouded in secrecy and did not have any inputs from community leaders or affected groups of people. As the bid did not attract anyone except AdT, the negotiations were lop sided and the government pushed into a bad bargain wherein the city's water system was leased to AdT for a term of forty years with the company being guaranteed an annual profit of 15-17 percent. The water rates were dollarized and tied to the US Consumer Price Index and water meters were to be set up to monitor the water consumption of both users under the existing SEMAPA system and those who used their own wells. Water laws which permitted use of public waters for irrigation to individuals or groups in place since 1906 were updated to avoid conflict with domestic laws. Law 2029 was passed on Potable Water Services and Sanitary Sewage soon after the contract with AdT was signed, which provided for the state's granting of "exclusive use" rights to the third parties.

AdT started its operations in Cochabamba since November 1, 1999 and post the new water rates taking effect, the price of water shot by as much as 400 percent. This led to a wave of popular protests with people refusing to pay their water bills. After a show of protracted and organised resistance by the people, water rates were rolled back to pre-contract levels. The contract with AdT was rescinded and SEMAPA resumed control of the city's water systems and the controversial water law 2029 was also repealed.

In November 2000, AdT filed for arbitration at the ICSID seeking \$25 million from Bolivia as compensation for its lost investment including in the claim expected profits from the deal in addition to its investment. The ICSID claimed that it had jurisdiction in the matter based on a BIT between Netherlands and Bolivia which was signed in March 1992. AdT was originally registered in the Cayman islands. However, it took advantage of the fact that International Waters, AdT's majority shareholder was registered in the Netherlands. The Bolivian government objected to this interpretation and submitted that the domicile altered in anticipation of potential arbitration but the ICSID tribunal rejected its arguments and proceeded with the arbitration process. The Cochabamba residents filed a petition with ICSID arguing in the main that all submissions in the case should be made public as the outcome would have an immediate and profound impact on them. The request was denied by ICSID since such a request required the express consent of both parties.

In January 2006, the Government of Bolivia and AdT settled their dispute. As per the reports, the claims against Bolivia currently before the ICSID stood withdrawn with no compensation being

paid by the Government of Bolivia or AdT for the termination of the concession and the withdrawal of the claim.<sup>93</sup>

#### **Section IV Comparison of the Netherlands-India BIT with the IISD's Model International Investment Agreement on Investment for Sustainable Development**

For purposes of guiding BITs, India has developed a Model BITs text. However, this may or not conform to the actual agreements entered into by India with different countries. Hence in this section a comparison is attempted between the Netherlands-India BITs (henceforth NIBITs) and International Investment for Sustainable Development's (IISD) Model International Agreement.

India's Model Text of Bilateral Investment Promotion Agreement consists of 15 Articles and covers areas such as definition of investments, creation of favourable conditions and of fair and equitable treatment, according NT and MFN status, conditions for expropriation, compensation for losses, repatriation of investment and returns, subrogation clause, clauses relating to disputes between an investor and a Contracting Party, disputes between Contracting Parties, movement of personnel, application of other rules and details relating to duration and termination of the agreement.<sup>94</sup>

Before we turn to the comparison it would be necessary to understand the context in which the IISD's model international agreement text has evolved. IISD argues that the model for current IIAs have been developed over 50 years ago and no longer meet the needs and requirements of the global economy in the twenty first century.<sup>95</sup> It argues that despite the failure of earlier attempts to negotiate binding multilateral rules for international investment such as the Multilateral Agreement on Investment (MAI) earlier, it believes that attempts to forge a new approach that responds to rapid globalization and to the need to promote sustainable development must be made.<sup>96</sup> Accordingly, IISD has undertaken a critical analysis of the existing weaknesses of the existing agreements and attempted to integrate the concerns of the developing countries in its model text. It seeks to ensure that investor rights and public goods are protected in a legitimate, transparent and accountable manner.

While it is beyond the scope of this paper to get into the details of the model text, select provisions, which are critical from the point of view of putting development at the centre of BITs, would be highlighted. While highlighting the sustainable development functions of investment agreements, the definition of investment has been fairly detailed and seeks to avoid the pitfalls encountered in a raft of arbitration disputes over what constitutes investment and who is an investor. Thus for instance, it has been stated in Article 2 of the model text that certain types of investment would not qualify as 'significant physical presence'. These have been specified as sales offices without operational facilities, post office box based businesses or internet based business. Also, portfolio investments have not been covered under the agreement. Further, it has enshrined an article specifying the conditions of denial of benefits to those who do not have substantial business activities in the territory of the other party.

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<sup>93</sup> <http://www.bechtel.com/newsarticles/487.asp> accessed on October 12, 2006

<sup>94</sup> Text of the Model Bilateral Investment Promotion Agreement is on file with the authors

<sup>95</sup> IISD Model International Agreement on Investment for Sustainable Development, available at [www.iisd.org](http://www.iisd.org)

<sup>96</sup> IISD Model International Agreement on Investment for Sustainable Development, available at [www.iisd.org](http://www.iisd.org)

This approach stands in sharp contrast to the definition of investments in the NIBITs wherein investments have been defined in a broad and open ended manner without any reference to preclude certain types of investments such as those which do not qualify as 'significant'. There is no denial of benefits clause in the NIBITs.

Under the IISD Model Text, the concept of 'like circumstances' in NT has been made context specific and to be determined on a case by case basis wherein circumstances of an investment to be considered include its impact on the local community, environment and regulatory process applied in relation to a measure of concern. Under NIBITs no such amplification of safeguards have been built into the NT clauses. Similarly, the Model text unlike NIBITs proposes a number of obligations and duties of investors and investments such as those of pre-establishment impact assessment, anti corruption clauses, post establishment obligations, observance of corporate governance practices which meets internationally acceptable standards of corporate governance for the sector involved and corporate social responsibility provisions in accordance with the developmental plans and priorities of the host state as also international goals such as the Millennium Development Goals.

Again, unlike NIBITs, the Model text lists out a number of performance requirements relating to fixing of thresholds for export and achievement of domestic content and sourcing of goods from domestic companies as also leaves the text open ended to include other similar measures.

The Model Text has attempted to go beyond the standard provisions found in typical bits including NIBITs. Under Article 40 of the Model text, a setting of a dispute settlement body (DSB) has been proposed to manage the dispute settlement processes under this agreement. The DSB has been proposed to be composed of a Council of the Parties open to all Parties, a panel division and an appellate division. A legal assistance centre, which would function independently of the Secretariat, to assist the developing and least developed countries, has also been proposed. Under Article 45 the investor/investment-state disputes have been proposed not to commence unless domestic remedies are exhausted in relation to the underlying issues pleaded in relation to a breach of the Agreement.

One significant concern relating to the investment arbitration and dispute settlement process relates to the transparency of proceedings. Under Article 46, it has been proposed that all documents relating to a notice of intention to arbitrate, the settlement of any dispute, the initiation of a panel or appeal or the pleadings, evidence or decisions in them shall be made available to the public through an internet site. Further, it lays down that the procedural and substantive oral hearings shall be open to the public. Finally, it provides for the receipt of *amicus curiae* (friends of the court) submissions.

It can be seen that the IISD model text is indeed a bold proposal worthy of dialogue and consultation amongst all the stakeholders and takes care of several development concerns which have arisen out of the enforcement of provisions in typical BITs. Based as they are on templates created by developed countries almost half a century back, it is time they are revisited and amended while keeping in view the surfeit of investment arbitrations and their origin in specific provisions of BITs. It seeks to strike an overall balance of the rights of the investor and the host country and is not as is current practice skewed in favour of the investor.

## Conclusion

The need for policy space and flexibility has been seen to be integral to the policy matrix of developing countries since they face greater social and economic needs than their developed country counterparts and more so because they are still in the process of identifying the best mix of policy tools suited to their particular context and levels of development.<sup>97</sup>

Driemeier's caution that given the lack of any meaningful correlation between FDI and BITs, policymakers must pay close attention to the terms of the treaties they sign on. In the words of a Canadian trade lawyer's assessment of the investment provisions contained in Chapter 11 of NAFTA, 'they (the companies) could be putting liquid plutonium in children's food. If you ban it and the company making it is an American company, you have to pay compensation.'<sup>98</sup> Another lawyer perceptively commenting on recent trends in arbitration cases involving investment treaties says that what we are seeing now is essentially 'a shift of the use of investment agreements as a shield to use them as a sword against government activity.'<sup>99</sup> These concerns surfaced in a telling manner in both the Dabhol Power Corporation case as well as in the Cochabamba water privatization case.

UNCTAD notes that it is important that international investment agreements do not end up constraining the policy flexibility for pursuit of development goals or other national policy objectives. The importance of retaining the national policy space in the investment context was recently re-emphasized in the Sao Paulo Consensus adopted at the UNCTAD XI conference.<sup>100</sup> National policy space has been seen to be compromised in the provisions of BITs. Thus, for instance, the protection of contractual rights in BITs is easily the most influential aspect of the BITs. This provision has cleared the way for 'virtually any dispute between host and investor – at least any dispute arising out of a negotiated agreement between the two is a matter of international law.'<sup>101</sup>

The brunt of the challenges arising out of the current system of dispute settlement process lies disproportionately on the shoulders of the developing countries especially the least developed ones which lack both the human resources and the financial capability to 'navigate' within this

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<sup>97</sup> Preserving Flexibility in IIAs: The Use of Reservations, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2006

<sup>98</sup> Bill Moyers, in Trading Democracy, PBS, February 5, 2002 quoted in Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite, World Bank, DECRG, June 2003

<sup>99</sup> Howard Mann, in an interview with Bill Moyers in Trading Democracy, PBS, February 5, 2002 quoted in Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite, World Bank, DECRG, June 2003

<sup>100</sup> Preserving Flexibility in IIAs: The Use of Reservations, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2006 As per paragraph 8 of the São Paulo Consensus, it has been stated: "The increasing interdependence of national economies in a globalizing world and the emergence of rules-based regimes for international economic relations have meant that the space for national economic policy, i.e. the scope for domestic policies, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. It is particularly important for developing countries, bearing in mind development goals and objectives, that all countries take into account the need for appropriate balance between national policy space and international disciplines and commitments"

<sup>101</sup> Andrew T. Guzman, Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties, Virginia Journal of International Law, Summer 1998

system.<sup>102</sup> Thus, any effort to prevent and manage investor-state dispute settlement process must focus on capacity building and provision of technical assistance in these areas.<sup>103</sup> Following Franck and the model investment text considered earlier, issues of building in relevant safeguards and clearly stating the rights and obligations of the investor/investment and avoiding vague, open ended preambular language in the BITs text must be emphasized. The importance of revisiting the text of the existing BITs and considering actively to strengthen its provisions from the point of view of development goals and needs cannot perhaps be overemphasized.

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<sup>102</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

<sup>103</sup> Investor-State Disputes Arising from Investment Treaties: A Review, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, 2005

## Annexure I

**Table 1. International Investment Agreement concluded by regions in 2005, and cumulative**

| Region                      | BITs      |            | DTTs      |            | Other IIAs |                  |
|-----------------------------|-----------|------------|-----------|------------|------------|------------------|
|                             | Year 2005 | Cumulative | Year 2005 | Cumulative | Year 2005  | Cumulative       |
| Asia and Oceania            | 31        | 1,003      | 36        | 968        | 12         | 89               |
| Latin America and Caribbean | 13        | 464        | 9         | 322        | 5          | 62               |
| Africa                      | 21        | 660        | 17        | 436        | 2          | 34               |
| SEE&CIS                     | 15        | 671        | 27        | 576        | 0          | 34               |
| <b>Memorandum</b>           |           |            |           |            |            |                  |
| Developed countries         | 45        | 1,511      | 38        | 2,111      | 7          | 127              |
| Developing countries        | 60        | 1,878      | 53        | 1,604      | 14         | 185              |
| South-South                 | 20        | 644        | 25        | 399        | 7          | 86               |
| Least developed countries   | 16        | 399        | 5         | 184        | 2          | 35 <sup>a/</sup> |

*Note:* The above figures reflect multiple counting (e.g. BITs concluded between countries from Asia and Africa are included in the list of both regions). The net total of each category of IIAs is therefore lower than the sum of the above figures.

a/ This number includes agreements concluded by regional groups that have one or more LDC members.

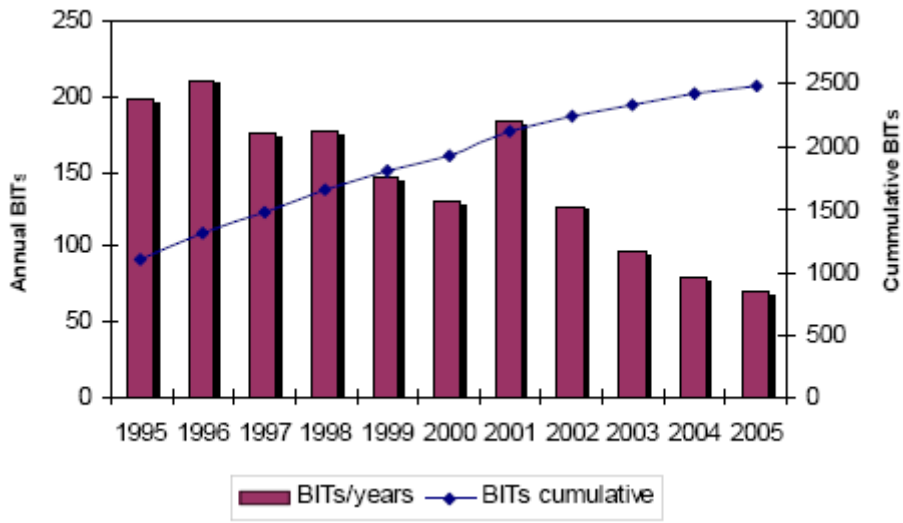
*Source:* UNCTAD.

**Table 2. Top 10 FDI Sources for India and BITs**

| Rank (based on cumulative flows from August 1991 to July 2006) | Amount in US\$ million | Country     | Does India have a BIT |
|--|------------------------|-------------|-----------------------|
| 1  | 12290                  | Mauritius   | Yes                   |
| 2  | 5302                   | US          | No                    |
| 3  | 2153                   | Japan       | No                    |
| 4  | 2071                   | Netherlands | Yes                   |
| 5  | 2058                   | UK          | Yes                   |
| 6  | 1610                   | Germany     | Yes                   |
| 7  | 1483                   | Singapore   | Yes                   |
| 8  | 815                    | France      | Yes                   |
| 9  | 771                    | South Korea | Yes                   |
| 10   | 654                    | Switzerland | Yes                   |

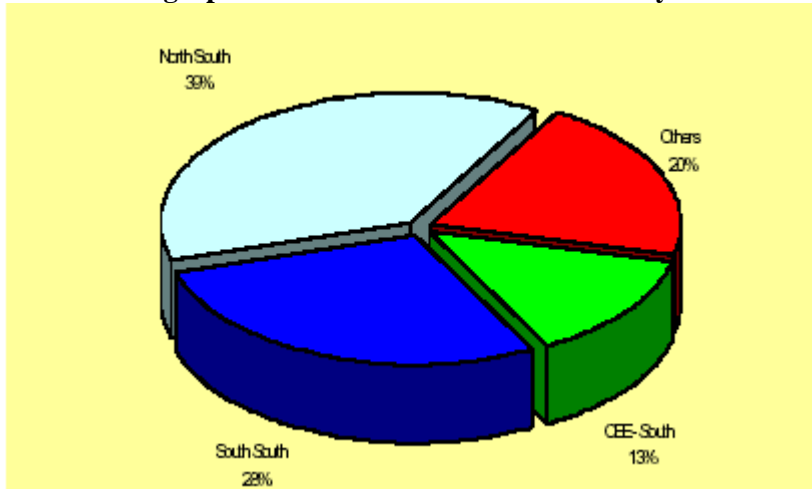
*Source:* Based on data from Department of Industrial Policy & Promotion, Government of India

**Figure 1 Number of BITs concluded (1995-05), year by year and cumulative**



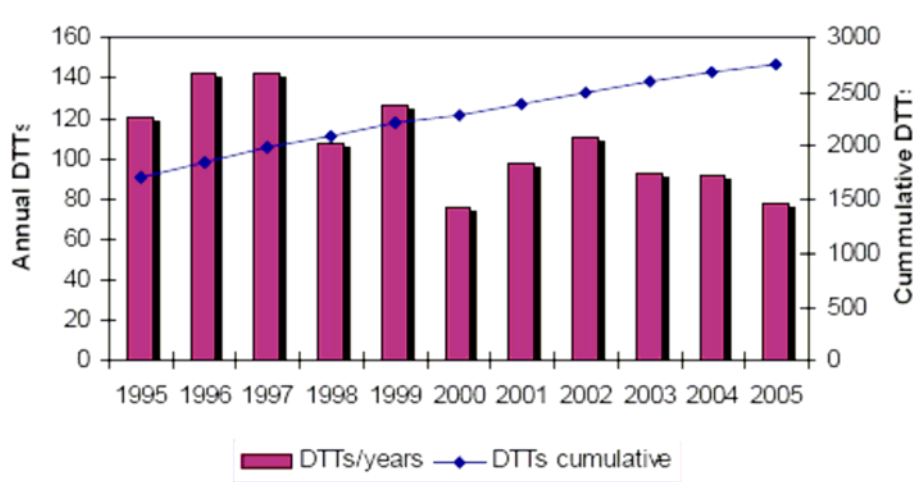
*Source:* UNCTAD 2006

**Chart 1: Geographical Distribution of BITs as of July 2004**



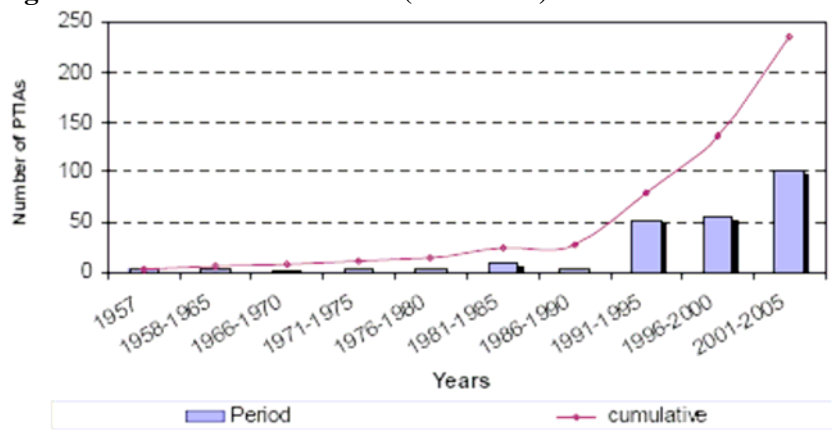
*Source:* UNCTAD 2006

**Figure 2: Number of DTTs concluded, (1995-05) year by year and cumulative**



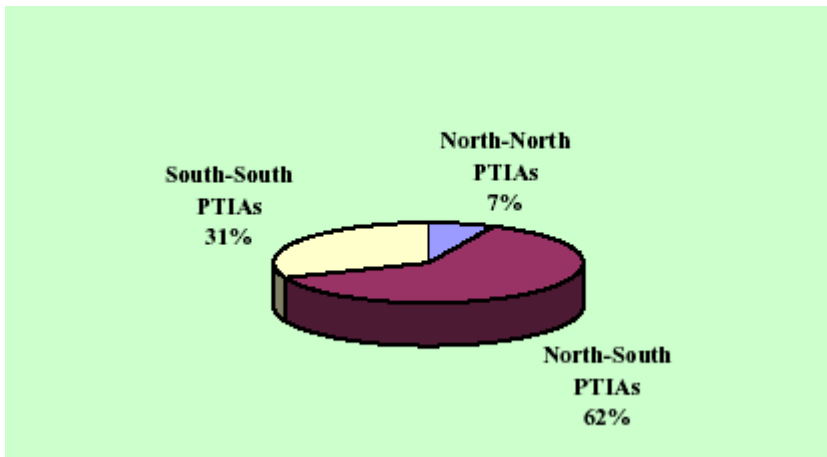
Source: UNCTAD (2006)

**Figure 3: The Growth of PTIAs (1957-2005)**



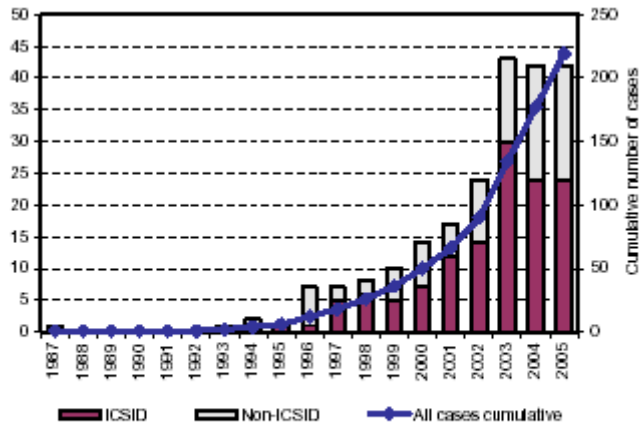
Source: UNCTAD, 2006

**Chart 2: Distribution of PTIAs as of July 2004 (excluding BITs and DTTs)**



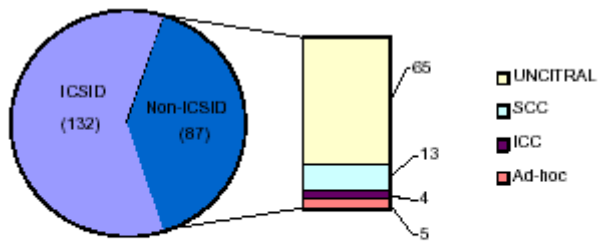
Source: UNCTAD, 2006

Figure 4. Known investment treaty arbitrations (cumulative and newly instituted cases, by year)<sup>a</sup>



Source: UNCTAD.  
<sup>a</sup> As of November 2005.

Figure 5. Disputes by rules of Arbitration



Source: UNCTAD.  
<sup>a</sup> As of November 2005.  
 SCC = Stockholm Chamber of Commerce; ICC = International Chamber of Commerce.