



# The Indian Journal for Research in Law and Management

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Editor-in-Chief – Dr. Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

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## INDIA'S SHIFT FROM INVESTOR PROTECTION TO STATE SOVEREIGNTY: ANALYSING THE 2016 MODEL BIT

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### INTRODUCTION

Bilateral Investment Treaties (BITs) are bilateral legal agreements between two states with the purpose of safeguarding investments by investors from one signatory state within the other state's territory. Originally conceived to encourage and protect foreign direct investment (FDI), these treaties commonly provide enforceable guarantees against expropriation, ensure fair and equitable treatment, allow free transfer of capital, and provide access to international arbitration through Investor-State Dispute Settlement (ISDS) procedures. For several decades, BITs were regarded as key to promoting cross-border capital flow by minimizing political and legal risks. Yet the past two decades have been marked by increasing discomfort with the asymmetries in these treaties, particularly from the point of view of developing nations such as India. This led to India's fundamental transformation of its BIT policy with the release of a new Model BIT in 2016. This article critically examines the development, implications, and future direction of India's BIT regime.

Bilateral Investment Treaties (BITs) are such that they offer a secure and predictable legal environment for foreign investors in a host country. Protection against expropriation is one of the key attributes of BITs, whereby a foreign investor's property cannot be nationalized or taken by the host country without proper compensation. The purpose of such a provision is to insulate investments from politically driven takings and assure the investor that its property rights will be upheld under international law.

The other pillar of BITs is the Equal and Fair Treatment (FET) clause, which requires that foreign investors be accorded treatment in a transparent and non-discriminatory way. The

standard does not allow for arbitrary, capricious, or abusive treatment by the host state and is frequently used by investors in claims that regulatory actions have disproportionately affected their activities. As a matter of fact, free repatriation of profits is an essential guarantee extended by most BITs, which allows investors to bring back returns, dividends, and capital to their home country without excessive delay or hindrance, thus motivating them with a feeling of monetary security and liquidity.

A significant provision that appears in many BITs, is the MFN, which entitles an investor to the same treatment as a comparable foreign investor from a third state. The MFN clause provides a level of assurance to investors on an equal basis, and permits the investors to benefit from more favourable provisions in treaties of the host state. The most powerful and controversial provisions, is the Investor-State Dispute Settlement (ISDS). This clause permits foreign investors who believe the host state has breached a treaty, to disregard local courts and bring proceedings for arbitration directly to international tribunals. With these protections derived from BITs, BITs have come under scrutiny and have acted as flashpoints for controversy practitioner in developing countries, evidenced in India. One of the prominent criticisms is that BITs interfered with national sovereignty. BITs limit the power of states to legislate or regulate in significant areas such as health, environmental protections and taxation, due to the jurisdiction of potential lawsuits made by foreign investors. India's recent high-profile disputes with Vodafone and Cairn Energy, deriving from newly imposed retrospective taxation measures provides an example of how investors can seek to use BITs, to challenge sovereign decisions in an international arbitration context.

A number of objections are based on the ISDS mechanism itself, viewed as a vehicle for corporate power rather than public policy. ISDS has been criticized for empowering unelected arbitral tribunals – often opaque and indeterminate – to overturn national lawmaking. This has consequences for government decision-making, evidenced by "regulatory chill" wherein governments become hesitant to put forward the same types of strong regulation that would be in the public interest, but are sensitive to investors. We see this with national laws banning toxic chemicals, lax regulations on individuals' access to justice, and overly sensitive policies for environmental protection. Power imbalances lead the rights of foreign investors to differ from domestic investors, and in some cases, domestic companies have little or no access to the same protections or international remedies. The full burden of investor lawsuits falls disproportionately on developing countries, with arguably the most problematic lawsuits are

unpredictable potential liabilities to governments. An investor's lawsuit sometimes produces more than just financial liabilities to the government; governments sometimes are ordered to pay damages of hundreds of millions which restricts using those funds for social development and public benefit.

## **INDIA'S EXPERIENCE WITH BITS AND THE ARBITRATION BACKLASH**

India began its BIT journey in the 1990s with a liberalisation strategy, but by the early 2010s, a series of high-profile arbitration claims exemplified the dangers posed by excessive treaty obligations. The case of *White Industries Australia Ltd v. Republic of India* (2011)<sup>1</sup> proved pivotal. White Industries had contracted with Coal India to develop a coal mine, and, ultimately, a commercial dispute went to international arbitration. The dispute flowed from an issue of contracting in the private sphere, however, White Industries invoked the ISDS clause in the India-Australia BIT. Moreover, using the MFN clause, it imported provisions from India's BIT with Kuwait - provisions that were more generous to investors, which included a guarantee for effective legal remedies. The tribunal penalised India for the delays in its judicial process, which is the first time India lost a BIT arbitration case.

This decision unleashed a deluge. India soon found itself mired in other similarly complex and politically sensitive disputes with *Vodafone*<sup>2</sup> and *Cairn Energy*<sup>3</sup> surrounding, again, retrospective taxation. In *Vodafone's* case, the tax demand was in connection with an offshore acquisition of Hutchison Essar by Vodafone International Holdings; even though the Indian Supreme Court ruled in *Vodafone's* favor in 2012, Parliament amended the Income Tax Act retrospectively to supersede this ruling. After this, *Vodafone* commenced arbitration under the India-Netherlands BIT. In 2020, the tribunal at the Permanent Court of Arbitration held that India had breached the FET clause, by adopting retrospective tax measures, and ordered it to cease any enforcement of the retrospective tax measures and to pay out compensation to *Vodafone*.

The *Cairn Energy* case took a somewhat similar path. In 2014, the Government of India raised a retrospective tax demand for 1.4 billion dollars against *Cairn*, asserting capital gains arising

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<sup>1</sup> *White Indus. Austl. Ltd. v. Republic of India*, UNCITRAL, Final Award (Nov. 30, 2011)

<sup>2</sup> *Vodafone Int'l Holdings B.V. v. Republic of India*, PCA Case No. 2016-35, Award (Perm. Ct. Arb. Sept. 25, 2020)

<sup>3</sup> *Cairn Energy PLC & Cairn UK Holdings Ltd. v. Republic of India*, PCA Case No. 2016-7, Award (Perm. Ct. Arb. Dec. 21, 2020)

from an internal restructuring by Cairn in 2006. The Government of India proceeded to restrain Cairn's assets in India, causing Cairn to commence an arbitration proceeding under the India-UK BIT. The tribunal ruled in Cairn's favor in December 2020, awarding Cairn more than 1.2 billion dollars. At the time the award was issued, it was the largest award ever against India, under any BIT. Both tribunals determined that legal certainty, that retroactivity is not to be applied, and that investors' legitimate expectations are important considerations. The White Industries case represented a watershed moment in India's investment treaty context, demonstrating the frailty of a prior Bilateral Investment Promotion and Protection Agreement (BIPAs). The dispute occurred between White Industries Australia Ltd, a private mining corporation, and the Republic of India, as represented by Coal India, a public sector enterprise. White Industries executed a contract with Coal India for the delivery of mining equipment and services at the Piparwar coal mine. The dispute originated when Coal India purportedly refused to pay amounts for performance-based bonuses, subsequently causing White Industries to seek some remedy.

What began as a commercial contract dispute before the Indian judiciary escalated in complexity and intensity after the Claimant, White Industries, invoked the Investor-State Dispute Settlement (ISDS) regime under the India–Australia Bilateral Investment Promotion Agreement (BIPA). In challenging the jurisdiction of the tribunal, India argued that White Industries was essentially engaged in a simple business contract—even if it could be classified as “investing” in India—and that it did not qualify as an “investor” under the treaty. In rejecting India’s defence, the tribunal determined that White Industries’ financial claims arising from the contract—especially its right to receive payments—fell within an “investment” under the very broad definition in the BIPA. The tribunal's finding was arguably compounded by White Industries' reliance on the Most-Favoured-Nation (MFN) clause. By relying on the MFN clause, White Industries imported a more favourable standard that addressed “effective means of asserting claims, and enforcing rights”, from India's BIPA with Kuwait. White Industries’ position was that the delayed resolution of its claims by the Indian judicial system, more than nine years, had breached the MFN standard. The tribunal found for White Industries, determining that India breached its international legal obligations by failing to provide an effective remedy in a reasonable time

This case established a significant precedent with broadly impactful ramifications. First, India lost an international arbitration despite the underlying dispute being purely contractual, showing how treaty definitions can expand a private commercial dispute into a state liability

under international law. Second, the case also demonstrated the risks inherent in BIT drafting that lacks clarity, in terms of what constitutes an "investment." Third, it illustrated the dangers of unqualified MFN clauses, which investors can deploy as a way of cherry-picking the most favorable treaty protections available to them. Most significantly, the case raised red flags regarding India's legal sovereignty, as foreign investors were able to bypass Indian courts by suing the Indian state directly at an international forum.

In the wake of these findings, the White Industries case effectively compelled India to engage in a complete overhaul, and likely renegotiation, of its investment treaty architecture. It was one of the central disturbances to an international investment framework and, on a larger level, served as the first impetus for the 2016 Model BIT, which redefined "investment," excluded MFN clauses, emphasized state regulatory space, and included a provision requiring overseas investors to exhaust local remedies prior to commencing international arbitration. The case Morgan Stanley continues to be referenced as a warning sign of the dangers of an investor-oriented treaty framework and has substantially shaped India's evolving investment Treaty approach.

The wave of litigation spurred India into a wide-ranging review of its investment treaty framework. From 2016 to 2019, the government terminated, unilaterally, 58 BITs, most of which were with European and Asian countries, with commitment with strategic partners. The UK, the Netherlands, and Germany were among the states with which India unilaterally terminated BITs. This termination was not a dismissal of treaty obligations but a new step to pull back from the treaty base in order to negotiate new treaties on the frame of the 2016 Model BIT.

The 2016 Model BIT represented a paradigmatic change, moving away from the previous investor-centric model, and towards a model more upholding of state sovereignty and regulatory space in the investor-state context. Notable reforms included, the definition of "investment" being narrowly construed so as to exclude indirect and speculative claims; a more restrictive criteria for determining who qualifies as an "investor" - which requires a demonstrated credible and substantial business activity in the home country; and mandatory exhaustion of local remedies. In particular, after the Model BIT, foreign investors must exhaust Indian courts for five years before commencing international arbitration; a process that is highly unusual and strict given any overseas response to an investor grievance. The Model BIT removes MFN clauses, and limited recourse to ISDS on defined grounds only. It explicitly

excludes any of those measures having to do with taxes from arbitration, to prohibit investment disputes like the Vodafone or Cairn cases in the future. Additionally, the preamble and operative provisions emphasized the host state's right to regulate in the public interest concerning health, environment, financial stability, and labor standards.

### **CRITICAL APPRAISAL OF THE 2016 MODEL BIT**

The 2016 Model BIT has received some praise for its recognition that investors are not infallible sponsors and for reclaiming certain regulatory autonomy and avoiding expensive litigation. The criticism stems mostly from the perception that the Model BIT is overly defensive. The unfavorable conditions for arbitration and investor-state dispute settlement (ISDS) entailed will likely deter legitimate investors from investing in India, especially those seeking a legal guarantee from the State and an efficient method of dispute resolution. The 5-year exhaustion period arbitrarily adds heavy burden on foreign investors given the delays within the inefficient judicial system. Another source of critique relates to the removal of clauses such as MFN and the dilution of the FET standard, which on the whole some critics argue impinges the valuable balance in favor of the state as the sponsor - clauses which served as limitations on arbitrary state action and were significant in upholding investor confidence and goodwill. The Model BIT's omission of an umbrella clause, which was used to enforce host state commitments beyond the treaty, also dilutes foreign investors' recourse.

This restrictive model is not only contrary to a development occurring across the world, with many countries developing more balanced BITs, but it is also relatively unusual in the sense that there are few examples of BITs that require such strict preconditions for ISDS (or have removed MFNs entirely). Through the Association of Southeast Asian Nations, for example, or within European Union treaties and agreements under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), ISDS is maintained, albeit with exceptions for public interest, procedural safeguards, or considerations that promote social responsibility. India, by comparison, could be seen as investing inward, potentially further isolating itself from the international investment climate.

The basis of India's policy transition has revolved around reasserting the primacy of state sovereignty. The government has consistently stated its aim to ensure foreign investors have no ability to interfere with domestic law-making, particularly in sensitive areas like taxation or with respect to natural resources. The 2016 Model BIT captures this motif not only through the

language utilized, but with the re-organization of obligations, principally to clarify the obligations on the investor. For example, the Model BIT states that host states retain the right to regulate within the interest of the public and requires the investor to respect domestic law, environmental provisions, and anti-corruption provisions. The obligations imposed on investors were non-justiciable obligations of "responsible business conduct."; while the duties imposed on the investor would be inherently ignored in an international arbitration context, this nonetheless makes obligations more clear.

India is not alone in emphasizing sovereignty. A number of developing countries are reassessing how to align investor protection with considerations for public good. However, India's approach - characterized by unilateral treaty termination and extremely narrow ISDS provisions - is an example of one of the most aggressive models in the world today. By protecting regulatory space, a drawback is that to the extent that investors value legal certainty and an enforceable right, it provides an odd signal. India's termination of many of its BITs has resulted in strategic conflict with several of its major trading partners. A number of countries have either protested the treaty terminations or filed new claims under survival clauses - these are clauses in the old treaty that preserve investor rights for a period of time post-termination of 10-15 years. These cases have also contributed to reputational issues regarding India's reliability as a treaty partner. Simultaneously, India's ambition of becoming a global hub for manufacturing and new generation Free Trade Agreements (FTAs) with investment chapters will likely necessitate an ability to negotiate away from the non-negotiable 2016 Model BIT. For negotiators and policymakers, aligning India's BIT policy globally within a legitimate regulatory framework is one of the biggest challenges.

India's pivot from a liberal, investor-led BIT regime to a sovereignty-led Model BIT marks a more complex shift in the international governance of investment. The series of high-profile arbitration claims prompted India to act in the interest of re-establishing government's right to regulate for the public good, free from the cloud of litigation. The Model BIT, as India adopted it in 2016, provides some insulation from the issues that arise from opportunistic or speculative claims, but raises concerns over India being an attractive destination for long-term investment.

As India contemplates how to balance these competing demands, it may have to approach investment treaties differently in the future. The treaties could incorporate more balanced FET clauses, allow for conditional access to ISDS, or add hybrid approaches like investor-state

mediation. The modalities of MFN clauses could be reinvoled in a modified manner, and with expressed exceptions, with fairness to investors in a way that does not compromise state autonomy.

Ultimately, BITs are more than just legal agreements, they serve as an effective tool of economic diplomacy. A nuanced, properly calibrated investment treaty framework can sustain confidence in investors while upholding sovereign control. India's challenge will be how it can find this balance such that it can continue advancing its own developmental agenda, while remaining a credible partner in an evolving international investment framework.

The overriding theme of India's 2016 Model Bilateral Investment Treaty (BIT) is its unequivocal emphasis on state sovereignty and regulatory space. This was not merely a superficial change, but rather a change in philosophy and approach to treaties in India, particularly in respect to BITs. India's experience in arbitration with taxpayers' money, with multiple BITs, led to a realisation by the Indian government about the extent to which investor protections were limiting its ability to govern in the public interest. The case of White Industries is a great example of how amorphous language in treaties, particularly if coupled with Most-Favoured-Nation (MFN) clauses, can be used as a sword against a state and its judicial system. India's reaction to that, as reflected in its 2016 Model BIT, is to put squarely at the forefront the right of a state to act and regulate in areas of public welfare, especially in relation to things that are generally agreed to be sovereign functions like taxation, environmental protections, and judicial system

The preamble of the 2016 Model BIT is not merely a ceremonial gesture; it establishes the ideological foundation for the substantive provisions of the treaty. It clearly affirms the host state's inviolable right to regulate in the public interest and emphasizes that BITs are not instruments of investor dominance but are collaborations for mutual benefit. This is further reinforced throughout the operative text which categorically removes from the scope of an investor's claims, any measures taken by the host state for the purposes of protecting public health, the environment, labour standards or national security. These carve-outs are significant because they allow for the fulfilment of the state's obligations under both constitutional law and international law without the threat of investor-state arbitration hanging over their heads. This reassertion of public law over private claims is arguably the most critical departure from India's earlier, more liberal BIT system.

Another central feature of the new BIT model is the substantial reduction of investor rights. Earlier treaty provisions gave investors considerable latitude to present claims under broadly defined standards, including "fair and equitable" and "legitimate expectations." The 2016 Model BIT changes that completely. First, it does not include Fair and Equitable Treatment (FET) as a default standard. If there is a FET obligation, it has to be negotiated and included in the text. If it is included, the parameters of the FET obligation are much narrower than in the earlier generation of treaties. Similarly, the elimination of umbrella clauses, which previously allowed investors to elevate breaches of contract or of administrative obligations into treaty breaches, preserves the regulatory autonomy of the state. Investors now face heightened thresholds and procedural thresholds before their international law-based claim can be accepted as admissible

The requirement to exhaust local remedies may be the most contentious procedural safeguard. This requirement also requires an investor to pursue its claims in the Indian judiciary for a minimum of time (often five years) before they will be permitted access to international arbitration. The intention is to perform two functions. First, it legitimizes domestic legal systems while reinforcing the notion that host-state courts are the primary method of redress. Second, it creates a difficult procedural hurdle for investors, many of whom regard delay and inconsistency in the judicial process as a risk. Although the intention is to mitigate opportunistic litigation, the requirement also raised issues regarding legal uncertainty and enforceability, particularly among institutional investors used to fast-track arbitration.

The Model BIT also creates non-justiciable obligations for investors. These provisions mark an important change in India's treaty practice. Investors are now expected—not legally bound—to adhere to standards of corporate social responsibility (CSR); to follow anti-corruption principles; to conform to labour laws; and to comply with environmental regulations and obligations. While the mechanisms for enforcement of these clauses cannot follow the same approach that can be taken for obligations placed upon the host state indicators, these obligations imply a shift toward an investment relationship that includes mutual responsibility. This can be regarded as part of a larger shift in treaty drafting both globally and by host countries that aspire to have investment regimes that may not only be protective of capital, but promote sustainable development as well.

Of course, the treaty includes positive assertions of autonomy to regulate. For instance, a number of clauses state that nothing in the treaty shall be interpreted in a manner that prevents

a state not to enact, amend or enforce laws and agreements that it considers necessary as part of the protection of their national interests. These provisions reflect international legal standards set out in - for example - the United Nations Conference on Trade and Development (UNCTAD), Investment Policy Framework for Sustainable Development. These rights and their being codified seek to rebalance the relationship between the rights of investors and the exercise of government sovereignty, which many critiques indicated had been heavily imbalanced in favourable of investors, and in particular reflected in the respective BITs.

From a doctrinal frame, this rebalancing raises several legal and policy questions. While the sovereignty focus is appropriate, some scholars have argued that India's position may be viewed as too defensive; which may jeopardize the national credibility of its international commitments. A treaty regime where expectations of enforceable rights are minimised and the demands of compliance are maximized may not be a bilateral balance with which most successful international "legal" agreement include. The absence of binding investor obligations or even enforceable CSR provisions is portrayed as merely symbolic and indicate if the treaty does promotes responsibility in investment, or merely codifies the discretion of governments.

Moreover, this sovereignty-first approach has diplomatic ramifications. India's decision to unilaterally pull out from numerous BITs while pushing the 2016 Model BIT to be the exclusive template for any re-engagement has created irritation among important trade and investment partners. Various countries have balked at renewing new treaties based on the rejected BIT model. In other cases, countries have continued with arbitration claims based on old BIT sunset clauses, working to further erode trust. This diplomatic hesitancy comes at a real economic price. India's FDI goals, to attract stakes in long-term investments and gradually be integrated into GVC through FTAs, will not benefit from a rigid investment platform that may inhibit Indian markets. In sum, the 2016 Model BIT demonstrates a conscious effort made by India to recapture sovereign regulation of its people in the wake of expanding international investor rights under law. While the alteration follows well-established global lines of dialogue concerning sustainability and balanced investment regimes, the Indian model is lying on one extreme of the spectrum. It is a significant corrective to historic vulnerabilities but one that must ultimately be reined back based on most effectively managing investor expectations, legal certainty, and compatibility with international treaty obligations. As India continues to renegotiate BITs and participate in multilateral trade dialogues, a more flexible and nuanced

approach may be necessary to balance sovereignty with international cooperation and economic competitiveness

### **COMPARATIVE PERSPECTIVE: U.S MODEL BIT**

Previously, before 2004, the U.S. Model BIT defined investment in a very expansive way. The U.S. Model BIT utilized an asset-based approach and defined investment broadly as "investment means every kind of investment owned or controlled..." This included an extensive list of qualifying investments, including equity (stocks), debt (bonds), service contracts, property rights, shares of a company, claims to money, intellectual property rights (i.e. patents, copyrights), and more. The impetus for this was to provide maximum protection for foreign investors by casting a wide net as to what could be considered a protected investment. In contrast, in later versions of the U.S. Model BIT that were issued after 2004 and 2012, the U.S. Model BIT provided a more specific and structured definition of investment. These later treaties defined investment as "investment means every asset...that has the characteristics of an investment, including the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk." The list of examples remained similar the newer treaties mentioned enterprises, shares, stocks, bonds, derivatives, rights of IP, licenses, and both tangible and intangible property, but the later U.S. Model BIT offered one more requirement. As a result, an asset would only qualify if it satisfied the characteristic of the "typical characteristics" of a genuine investment.

This change in definition had legal implications. The new definition links investment to elements of risk, commitment and expectation of profit, and therefore aimed to limit the volume of claims that could be brought under BITs. It made it more difficult to bring frivolous or speculative claims, and more successfully safeguarded the host state's regulatory space. The legal effect of the post-2004 model was to better delineate what is eligible for protection under international law.

This change in treaty language is particularly relevant to India. The arbitration case of White Industries laid bare the threats to India as a host country of vague, overbroad investment definitions together with Most-Favoured-Nation (MFN) clauses in its BITs. The complete shift in the U.S. to narrower investment definitions served as a model for India's efforts to reform, including the 2016 Model BIT, by undertaking a similar narrowing of definitions and by reclaiming regulatory space.

## **CONCLUSION**

India's 2016 Model BIT represents a consequential re-imagination of investment treaty practice, one influenced by Hindility to find a 'space for policy' while aiming to reduce litigation risk. The India-BIT arguably offered a step towards winding the dial back on investor privilege, and also appearing to make gains towards a more state-centric treaty perspective, but such changes also raise concerns around India's investment climate and international credibility. Moving forward, at this point, India needs to find a balance that strikes a more sensible compromise between 'protecting' its sovereign interests, and 'providing' legal certainty and fair treatment for investors. Making touching base with treaty partners, while also inking the best available global practices, could help produce a more stable investment regime that aligns with goals for development and economic contentment.