WHITE & CASE

Risky Business: Protecting Indian Investments Abroad

January 2013

GMR's ouster from the US$511 million airport modernization project in Maldives has refocused the spotlight on political risks facing foreign investments. As the GMR-Maldives story unfolds, this is a good time for Indian investors to think about how to manage political and regulatory risks in transnational investment projects.

For Indian investors, adept at navigating bureaucratic hurdles, interaction with foreign investors and governments is generally smooth. Recently, however, roadblocks in Essar's US$750 million investment in Zimbabwe and Jindal's US$2.1 billion project in Bolivia have highlighted the challenges of investing abroad.

Indian investors, much like investors from other countries, face greater risk when entering into agreements with foreign governments or entities as opposed to domestic transactions. Apart from direct government expropriation of assets, a change in regime makes government contracts susceptible to breach, annulment or renegotiation of the terms of such contracts.

So how can Indian investors legally protect their assets while investing in economically viable projects in politically volatile countries?

For starters, Indian investors may obtain political risk insurance (PRI) from private insurers or government agencies. While premiums for PRI can be expensive, this provides coverage against risks such as expropriation, adverse regulatory changes, political violence, civil disturbance, license cancellation, government frustration or repudiation of contracts, and currency inconvertibility. According to the World Bank Group's MIGA (Multilateral Investment Guarantee Agency) 2012 Report on "World Investment and Political Risk", demand for PRI has increased sharply since 2005. Driven by the unexpected events in the Middle East and North Africa as well as expropriations in Latin America, growth in PRI has been the strongest in 2011 since the onset of the financial crisis.

Checklist for Indian Investors

- Consider if the host country has a Bilateral Investment Treaty (BIT) with India. If not, structure the investment through a third country to obtain investment treaty protection
- Consider obtaining political risk insurance (PRI).
- Consider involving multilateral or bilateral funding agencies.
- Engage with local communities, NGOs and government in the host country.
- Include an arbitration clause with a clear choice of governing law, designating a neutral place as the "seat" of arbitration.

Nandan Nelivigi

White & Case

Aditya Singh

White & Case

This article was published in a slightly different form in *The Economic Times*, 14 January 2013

Additional protection may also be available under Bilateral Investment Treaties (BITs) or Bilateral Investment Promotion and Protection Agreements (BIPAs). These are agreements between two states in which each agrees to provide certain protections to investments originating from the other. India has signed these agreements with 82 countries and the UPA government is currently negotiating BITs with the United States and Canada.

These agreements are valuable for investors as they include substantive protections such as most-favored nation treatment, compensation for expropriation, and fair and equitable treatment. Earlier, BITs provided for state-to-state dispute resolution before the International Court of Justice. But today, these agreements allow investors to directly submit disputes regarding treaty violations to independent and neutral international arbitration tribunals. This allows foreign investors to enforce their rights without relying on courts in the host country. These tribunals have regularly held states to standards of contract implementation similar to those applicable in private commercial transactions. When Liberia revoked a 20-year agreement it had signed with a French company, a tribunal ordered Liberia to pay damages for breach of contract. When the Qaddafi regime nationalized its foreign oil concessions, arbitral tribunals held Libya liable for substantial damages. Similarly, Indonesia's suspension of a power plant project involving a foreign investor led to a tribunal holding it liable for damages. Recently, a tribunal in Stockholm held Russia liable to minority Spanish shareholders in a case involving expropriation of shareholding in the now-bankrupt Yukos oil company.

India, too, has had its share of investment arbitration threats from foreign companies, including Vodafone in the tax dispute (India-Netherlands BIT), Sistema, Capital Global & Kaif Investment in the telecom licence cancellation dispute (India-Russia BIT/ India-Mauritius BIT) and a successful claim by White Industries where India was held liable under the India-Australia BIT.

On the other hand, Indian investors have rarely relied on investment arbitration. The only publicly known case involves a London-based lawyer of Indian nationality who brought the UK to arbitration under the India-UK BIT. India, however, has BITs with most major destinations for Indian investors including Mauritius, Singapore, the Netherlands, the UK and Switzerland. When investing in a country that does not have a BIT with India, parties can structure the investment through a third country that has a BIT with the host country. This strategy enables foreign investors to incorporate their business in countries other than their principal place of business, and to take advantage of treaties negotiated by other countries.

However, for the few countries that do not have BITs with any other country (e.g., Maldives), PRI coverage and other protections are critical. For instance, involvement of multilateral lenders (like International Finance Corporation and Asian Development Bank) and bilateral lenders (such as the government-sponsored banks and agencies of the United States, Germany and Japan among others) as debt providers to the relevant project creates additional protection against political interference. This allows investors to leverage the political relations of the relevant lenders and agencies with the host country.

Investors can also act on the basis of any direct contractual relationship. Unlike investment treaty protections, these contractual rights depend on the bargaining power of each party as they are negotiated and established directly between the investor and the foreign party/state. It is important to negotiate an arbitration clause that sets out the roadmap for a neutral and effective mechanism for resolving international disputes.

All in all, aborted projects should not disincentivize Indian companies from investing in foreign countries. However, as the Indian companies venture into unfamiliar territories, they must explore the most effective international legal protections.

Nandan Nelivigi is a partner and head of the India practice and Aditya Singh is an associate in the International Arbitration group at White & Case, an international law firm.