Client Update
India Disbands the FIPB and Endangers BITs: One Step Forward, Two Steps Back?

LONDON
Geoffrey P. Burgess
gpburgess@debevoise.com

Lord Goldsmith QC
phgoldsm@debevoise.com

Shashwat Patel
spatel@debevoise.com

Patrick Taylor
ptaylor@debevoise.com

HONG KONG
William Y. Chua
wychua@debevoise.com

Monisha D'Souza
medsouza@debevoise.com
Not yet admitted in New York

Over the past three years, the Narendra Modi-led government in India has promoted foreign direct investment ("FDI") through the "Make in India" initiative and liberalisation of several sectors. With 90% of India's FDI flowing through the automatic route,[1] the government recently decided to disband the Foreign Investment Promotion Board (the "FIPB"), a government body which, until recently, acted as a single window clearance authority for FDI proposals under the government route. The Indian government has touted the abolition of the FIPB as a bid to further encourage FDI by promoting the principle of "maximum governance and minimum government." In a curious move, however, the government recently terminated its bilateral investment treaties ("BITs") with key trading partners, including several EU states, and indicated a desire to renegotiate terms based on its 2016 model BIT (the "Model BIT"). Although a seemingly well-intentioned action to protect India's national interests, the termination of existing BITs is causing uneasiness among foreign investors.

THE NEW FDI REGULATORY REGIME

The role of the FIPB, established in the wake of India's economic liberalisation, has been steadily diminishing over the past three years, with only 11 sectors currently falling under the government route for FDI. In anticipation of the government's decision, the FIPB stopped considering FDI proposals at the end of March this year.

Now that the FIPB has been disbanded, the responsibility for granting approvals has been entrusted to administrative ministries and departments in each sector,[2] working in conjunction with the existing Department of Industrial Policy and

[1] FDI is permitted in India under two routes—the government route, which requires the prior approval of the Indian government, and the automatic route, which does not require any government approval.

[2] An indicative list appears in the annex at the end of this update.

Promotion (the "DIPP"). The DIPP is responsible for formulating India's FDI policy, but until now has had no role in reviewing FDI proposals. By early July, the DIPP will have oversight of the FIPB's online portal and will directly take over FIPB functions that do not fall under the purview of any particular ministry (such as the approval of FDI applications relating to pre-incorporation expenses, and the import of capital goods and FDI by non-resident Indians).

The government also announced a new level of security clearance from the Ministry of Home Affairs for FDI proposals from "countries of concern", details of which have not been released.

The government is expected to issue standard operating procedures with detailed guidelines to ensure that FDI applications are processed uniformly across sectors. Ministries and departments will need to consult with the DIPP before rejecting proposals or adding conditions not prescribed under the FDI policy. Discussions are also currently underway for a quarterly review of pending proposals by a panel led by the DIPP and the Department of Economic Affairs. Significantly, standard operating procedures under consideration are expected to impose a 60-day limit for decisions on FDI proposals and a possible 10-week limit for security clearances. A strict time frame would certainly be beneficial to foreign investors, as there was significant timing uncertainty under the FIPB regulatory approval framework.

Some have welcomed the FIPB's abolition, but there is also a fair amount of skepticism and confusion about the new regulatory regime. Although the change may be seen as merely administrative from a foreign investor's perspective, as a practical matter, individual ministries and departments will suddenly be tasked with complex new obligations. Gaining familiarity with the subject matter and processes could take time. In addition, the government's proposal to provide greater timing certainty to foreign investors could add significant pressure on new decision-makers. Moreover, the practicalities involved in the additional responsibilities for the DIPP and the coordination between the DIPP and individual ministries could give rise to excessive red tape, the very defect that the FIPB's single-window clearance system was intended to prevent in the 1990s.

The absence of precedents when dealing with sector-specific regulators increases the uncertainty for foreign investors. Practical implementation may vary by sector, leading to different outcomes on the same facts. Furthermore, given that sectoral regulators would likely have a narrow sector-specific outlook when reviewing proposals, it is hoped that the government will draw on the expertise of former FIPB officials to ease the transition. Foreign investors may therefore

have to take a wait-and-see approach for new proposals under the government route.

The finalisation of standard operating procedures fleshing out the new framework and next steps for foreign investors is now keenly awaited. The efficacy of the new regime and its impact on FDI in India will need to be scrutinised over the coming months.

INDIA'S INVESTMENT TREATIES — ONCE BITTEN TWICE SHY?

Since 1994, India has signed BITs with more than 80 countries to promote trade and investment.[3] However, in the wake of the landmark decision in *White Industries* in 2011,[4] the first known investment treaty ruling against India, several foreign investors have initiated investment arbitrations against India. India was one of the most active sovereign participants in investor-state dispute proceedings globally in 2016. Through the Model BIT, India is attempting to revisit its investment protection obligations to address concerns arising from the series of claims raised against it. However, while the Model BIT was expected to modify existing terms to limit India's liability without hindering FDI, the government seems to have achieved a contrary result through a largely protectionist Model BIT.

Notable aspects of the Model BIT include the following:

- the scope of protected investors and investments has been narrowed;
- foreign investors will be obliged to exhaust all other remedies available in India before pursuing a claim under the treaty;
- the "most favoured nation" clause, largely seen as a means of fostering non-discrimination, has been deleted;
- the Model BIT does not apply to tax claims, notwithstanding the considerable uncertainty foreign investors have faced with regard to the application of India's tax laws; and
- the Model BIT provides for unilateral termination by India.

India has issued termination notices to more than 80% of its BIT counterparties. However, foreign states have been reluctant to agree to new terms based on the Model BIT, leading to the recent presumed termination of 58 BITs without any replacement terms. While the Indian government's public records on BITs have

---

[3] India has not entered into a BIT with the United States, which ranks as one of the top sources of foreign investment in India.

[4] *White Industries Australia Limited* v. *The Republic of India*.

not been updated since 2013, counterparties to terminated BITs likely include some of India's prominent trading partners, including the United Kingdom, Australia, Germany, France, Russia, the United Arab Emirates and the Netherlands, a popular jurisdiction for routing FDI to India. In 2016, the Indian government also requested that counterparties to 25 existing BITs (including China, Mexico and Turkey) revise their BITs in line with India's joint interpretive statement, which captured the key terms of what became the Model BIT. With little public information about India's BITs, the full extent of the terminations and the status of these 25 revision requests remain unclear. Existing investments may still be afforded protection under the 10-15 year "sunset" clause of the terminated BITs.

The Indian government's decision to terminate existing BITs without having new treaties in place could have a detrimental effect on FDI by increasing the risk premium and overall costs. Foreign investors will likely be more vulnerable to regulatory changes and therefore should conduct satisfactory legal, financial and tax due diligence, and negotiate adequate contractual protections, including representations, warranties and indemnities.

THE ROAD AHEAD

With the abolition of the FIPB lauded as a precursor for further liberalisation, India's latest stance on its BITs is a concerning development. However, the country's growing reputation as a preferred investment destination may work in its favour during BIT negotiations. India has recently been ranked third in the list of prospective host economies for 2017–19, after the United States and China. With current conditions well-aligned to boost FDI in India, foreign investors need to keep an eye on developments in the country over the coming months as the impact of the government's latest decisions is evaluated.

* * *

Please note that Debevoise & Plimpton LLP does not practice Indian law, and that this update is based on information in the public domain.

Please do not hesitate to contact us with any questions.

Annex

India's New Sectoral Regulators for FDI Proposals

Sector	Administrative Ministry / Department
Banking	Department of Financial Services, Ministry of Finance
Broadcasting	Ministry of Information and Broadcasting
Civil aviation	Ministry of Civil Aviation
Defence	Department of Defence Production, Ministry of Defence
Financial services (in certain circumstances)	Department of Economic Affairs, Ministry of Finance
Mining	Ministry of Mines
Pharmaceuticals	Department of Pharmaceuticals, Ministry of Chemicals and Fertilizers
Print media	Ministry of Information and Broadcasting
Private security agencies	Ministry of Home Affairs
Retail trading (single-brand and multi-brand)	DIPP, Ministry of Commerce and Industry
Satellites	Department of Space
Small arms	Ministry of Home Affairs
Telecom	Department of Telecommunications, Ministry of Communications