INTERNATIONAL LAW AND DOMESTIC REGULATION OF FDI ENTRY IN INDIA: EXISTING FRAMEWORK AND IMPACT

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DECLARATION

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Dedicated to my beloved parents, S. Jaspal Singh Maanipur and Mrs. Gurmeet Kaur

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ABBREVIATIONS

AD	Authorised Dealer
ADR	American Depository Receipt
ASEAN	Association of South East Asian Nations
BITs	Bilateral Investment Treaties
BoP	Balance of Payment
CCEA	Cabinet Committee on Economic Affairs
CCI	Competition Commission of India
CII	Confederation of Indian Industries
DC	Development Commissioner
DIPP	Department of Industrial Policy and Promotion
DTA	Domestic Tariff Area
DTATs	Double Tax Avoidance Treaties
EAU	Entrepreneurial Assistance Unit
EHTP	Electronic Hardware Technology Park
EOU	Export Oriented Units
EPA	Economic Partnership Agreements
EPRs	Export Performance Requirements
EU	European Union
FCCB	Foreign Currency Convertible Bond
FDI	Foreign Direct Investment

FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FIIA	Foreign Investment Implementation Authority
FIPB	Foreign Investment Promotion Board
FIPC	Foreign Investment Promotion Council
FPI	Foreign Portfolio Investment
FTA	Free Trade Agreement
FTP	Foreign Trade Policy
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDR	Global Depository Receipt
GoI	Government of India
IBRD	International Bank for Reconstruction and Development
ICSID	International Centre for Settlement of International Disputes
IDA	International Development Association
IDRA	Industries(Development and Regulation) Act, 1951
IFC	International Financial Corporation
IIAs	International Investment Agreements
IMF	International Monetary Fund
IPRs	Intellectual Property Rights

IRDA	Insurance Regulatory and Development Authority
ITA	Income Tax Act, 1961
JV	Joint Venture
LDC	Least Developed Country
LOI	Letter of Intent
M&A	Mergers and Acquisitions
MCTI	Ministry of Communications and Information technology
MFN	Most Favoured Nation
MIGA	Multilateral Investment Guarantee Agency
MRTP	Monopolies and Restrictive Trade Practices Act, 1969
MSE	Medium and Small Enterprises
NAFTA	North American Free Trade Agreement
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
p.	page no.
pp.	pages (from and to)
Policy 2010	The Consolidated FDI Policy Document, April 1, 2010
PR	Performance Requirement
PSU	Public Sector Undertaking
PTIA	Preferential Trade and Investment Agreements

RBI	Reserve Bank of India
RoC	Registrar of Companies
RTAs	Regional Trade Agreement/Arrangements
SEBI	Stock Exchange Board of India
SEZ	Special Economic Zone
SIA	Secretariat for Industrial Assistance
SSI	Small Scale Industry
STPI	Software Technology Park of India
TNCs	Transnational Corporations
TRIMS	Agreement on Trade Related Investment Measures
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
VCF	Venture Capital Fund
WOS	Wholly Owned Subsidiary
WTO	World Trade Organisation

CHAPTER ONE

INTRODUCTION: DEFINITION AND CONCEPTS

1. FOREIGN DIRECT INVESTMENT: INTRODUCTION

In the post colonial period, the developing countries were weary of the liberal economic model which postulated that economic decisions were the prerogative of the market. There was widespread belief that national governments were responsible for economic development. Consequently, these economies in particular were reliant on state for their economic activites such as planning, and regulation[1]. State enterprises were the dominant economic actors[2] and any form of international economic transaction was looked at with suspicion,[3] especially foreign investment.This was the time when countries like India were following the self reliance or import substitution model of industrial development characterised by protection of domestic industries from foreign competition[4].

By the mid-1980s, however, this approach to development began to lose its hold which was reflected in the actions of policy makers, aid agencies, and international financial institutions. Developing countries started on the path of liberalisation, state enterprises were divested and privatised and the economies were opened up. It was hoped that this process of liberalisation coupled with de-regulation would generate financial flows into the stagnating economies.[5] In general, financial flows across national borders have different trajectories being sourced from either public or private actors. The public actors are International Bank for Reconstructions and Development (IBRD) founded in 1944,

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[1] M.B. Baker, (2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p. 408.

[2] P.Durand-Barthez, and T. Khindria (1988). "Investment and Transfer of Technology in India," *International Business Law Journal*, No. 2, p. 183.

[3] P.J. Donovan, (2004), "Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market", *Gonz. Journal of International Law*, Vol. 1, p. 3

[4] S. Chakravarthy, (2004), "India's New Competition Act 2002: A Work still in Progress," *Business Law International*, Vol. 5, No. 2, p. 70

[5] J. W. Salacuse, and N. P. Sullivan (2005), "Do BITs really work ?: An evaluation of Bilateral Treaty Regime and their Grand Bargain," *Harvard International Law Journal*, Vol. 46, No. 1, p. 90.

the International Development Association(IDA) founded in 1960 and regional development banks in Latin America, Africa, Asia and in Europe who provide aid and financing in the form of developmental loans in lieu of certain structural adjustments.[6] Private International actors are driven by the profit motive and hence require assurance of profit to channelize flows. This form of international financing can be divided into three categories: debt finance like bonds and loans, portfolio (equity) investment and foreign direct investment. For the purposes of this study, private international financing specifically the route of Foreign Direct Investment (hereinafter referred to as FDI) for developing countries is the primary concern.

The benefits of FDI are manifold for the developing countries. It brings capital, new infrastructure and possibly new industries, which are instrumental in the expansion and diversification of the economic profile and base of the host country. FDI brings in long term financial commitments, increase in the knowledge base of the host country, new technologies and skill, employment growth, and an increase in the entrepreneurial capabilities of the host country besides improving management and marketing efficiencies. Moreover, by opening up the competition to complacent domestic industries[7], sectoral efficiencies may increase with the weeding out of weak players[8]. Therefore, a more nuanced understanding of the process of FDI is essential and elucidated hereafter.

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[6] A.L. Masser, (2009), "The nexus of Public and Private in Foreign Direct Investment: An Analysis of IFC, MIGA and OPIC," *Fordham International Law Journal*, Vol. 32, No. 5, p. 1707

[7] R. Nagaraj, (2003), "Foreign Direct Investment in India in the 1990s: Trends and Issues," *Economic and Political Weekly*, Vol. 38, No. 17, p. 1709

[8] D.H. Brooks, *et al* (2003), *Foreign Direct Investment in Developing Asia: Trends, Effects, and Likely Issues for the Forthcoming WTO Negotiations*, Economics and Research Department Working Paper, Series No. 38, Asian Development Bank, Manila, p. 4 ; *supra* at 1, p. 415

2. CONCEPT OF FDI

2.1 Definitions

There is no universally agreed upon definition of FDI. The various legal instruments both in international law and its related domestic frameworks define FDI differently.[9] Each of these contains a definition of FDI with distinctive and overlapping characteristics. It is important to familiarize with this variety to understand the debate which surrounds the definition of FDI and appreciate divergent positions as regards the flow of FDI.

A glimpse of the variety of the definitions of FDI available internationally, is hereby provided. According to the IMF,

> "foreign direct investment can be defined as an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective choice in the management of that enterprise."[10]

According to the WTO secretariat:

> "FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments"[11].

According to the draft text for a Multilateral Investment Agreement as negotiated under the auspices of the OECD,

> "(foreign direct) investment means:
>
> Every kind of asset owned or controlled, directly or indirectly, by an investor, including:
>
> (i) An enterprise (being a legal person or any other entity constituted or organised under the applicable law of the contracting party, whether or not for profit, and whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, branch, joint venture, association or organisation);

[9] D.D. Bradlow, and A. Escher (1999), *Legal Aspects of Foreign Direct Investment*, Kluwer Law International, London; p. 22

[10] IMF , Balance of Payments Manual, 1980 , para 408 in *ibid*, p. 20

[11] *ibid;* p. 3

(ii) Shares, stocks or other forms of equity participation in an enterprise and rights derived therefrom;
(iii)Bonds, debentures, loans and other forms of debt, and rights derived therefrom;
(iv)Rights under contracts, including turnkey, construction, management, production or revenue-sharing contracts;
(v) Claims to money and claims to performance;
(vi)Intellectual property rights;
(vii) Rights conferred pursuant to law or contract such as concessions, licenses, authorizations and permits;
(viii) And other tangible and intangible, movable and immovable property, and any related property rights, such as leases, mortgages, liens and pledges."[12]

The United States Model Agreement (2004) in relation to the Bilateral Investment Treaties (BITs) defines investment as:

"Every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

(i) an enterprise;
(ii) shares, stock, and other forms of equity participation in an enterprise;
(iii) bonds, debentures, other debt instruments and loans;
(iv) futures, options, and other derivatives;
(v) turnkey, construction management, production concession, revenue-sharing and other similar contracts;
(vi) intellectual property rights;
(vii) licenses, authorization permits and similar rights conferred pursuant to applicable domestic law; and
(viii) other tangible or intangible, movable or immovable property ; and related property rights such as leases, mortgages, liens and pledges."[13]

Article 1 of the Indian Model BIT of 2003 defines investment as

"investment" means every kind of asset established or acquired including changes in the form of such investment, in accordance with the national laws of the Contracting Party in whose territory the investment is made and in particular, though not exclusively, includes:

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[12] *supra* at 9 ; p. 22

[13] Treaty Between the Government of The United States of America and the Government of [County] Concerning the Encouragement and Reciprocal Protection of Investment (2004), p. 3

(i) movable and immovable property as well as other rights such as mortgages, liens or pledges;
(ii) shares in and stock and debentures of a company and any other similar forms of participation in a company;
(iii) rights to money or to any performance under contract having a financial value;
(iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party;
(v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals;[14]

From the above definitions, the essentials of the meaning of FDI can be determined as understood internationally. Firstly, FDI refers to an investment in which the investor from a capital exporting country obtains a lasting interest in the host country. Secondly, the element of managerial control in the hands of the investor is of essence. Thirdly, in defining FDI the principal concerns are protection of rights and property. The primary protection is sought for the physical property whether movable or immovable. The protection is further extended to rights: intangible and administrative[15]. Intangible rights such as Intellectual Property Rights (IPRs) are rights which are themselves treated as property and the administrative rights are rights granted by the state which are essential for the operation of the investment[16].

2.2 Forms of FDI

FDI in visible terms takes the form of buying or constructing a factory or adding improvements to such a facility, in the form of property, plant or equipment. In calculating FDI however states tend to include all kinds of capital contributions such as the purchase of stocks and equity, reinvested earnings(consists of investor's share of earnings not distributed as dividends by subsidiaries or associates and earnings of

[14] Agreement Between The Government of The Republic Of India and The Government of [Country] For The Promotion and Protection of Investments, (2003)

[15] M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.10

[16] *ibid*, p. 14

branches not remitted to the investor) and lending of funds to a foreign subsidiary or branch. [17]

FDI maybe further classified into 'Greenfield Investments' and 'Mergers and Acquisitions' depending on whether a lasting interest is established on acquired. Greenfield investments involve the flow of FDI for either building up of new production capacities or for expansion of existent production facilities of the host. From the point of view of capital importing countries, Greenfield investments are better as they bring in investment is sectors where local entrepreneurs lack expertise and capacity, assure infrastructure development, generate employment as a new venture requires local expertise and ensure transfer of skills and technology to local population. However, FDI frequently takes the form of a Merger and Acquisition (M&A) activity on the part of the major transnational corporations (TNCs). Such activity has many purposes and is designed to gain a foothold in the new geographic market. It ensures global visibility in terms of brand building; increases competitiveness by lowering costs involved in research and development; and fills gaps in production lines.[18]

Definition and forms of FDI can sometimes be obscure, especially in regard to investment in stocks where FDI can be difficult to discern from another form of private international financing, portfolio investment.

3. PORTFOLIO INVESTMENT

Portfolio investment or Foreign Portfolio Investment (FPI) represents buying of shares or stocks by a resident investor of one country in a company, based or functioning in another country. The movement of the money aims to seek capital gains[19] and does not necessarily envision a significant and lasting interest in the enterprise. FPI includes investments in bonds, notes, money market instruments and financial derivatives other

[17] UNCTAD (1999), *Comprehensive Study of the Interrelationship between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI).*" UN. New York and Geneva, p. 4

[18] Hunter Jr., *et al.* (2002), "Legal Considerations in Foreign Direct Investment," *Oklahoma City University Law Review*, Vol. 28, p. 855.

[19] *supra* at 15, p. 7

than those included under direct investment, or in other words, investments which are both below the ten per cent rule[20] and do not involve affiliated enterprises. In addition to securities issued by enterprises, foreigners can also purchase sovereign bonds issued by governments.[21]

According to the IMF's 1996 *Coordinated Portfolio Investment Survey Guide* the essential characteristic of instruments classified as portfolio instruments is that they are traded or tradable.

> "Equity securities have been defined in the *Survey* as instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual values of incorporated enterprises (shares, stocks, participation, American deposit receipts (ADRs), mutual funds, and investment trusts).Debt securities include bonds and notes, money market securities (instruments such as treasury bills, commercial and finance paper, negotiable certificates of deposit with maturities of one year or less), and financial derivatives or secondary instruments, such as options."[22]

Investors who primarily manage portfolio investment are known as Foreign Institutional Investors (FIIs) and operate through capital markets (Stock exchanges). The money is spread over in many companies to diversify risk. This ensures that their individual stake in any particular company is not to an extent to affect changes in a company's shareholding pattern upon their entry or exit. Thus, FIIs switch investments depending upon their market strategy to maximize profits, in the process earning the label of fair weather friends. They invest in particular sector or country, if there is positive trend in the industry, and exit as soon as there is a whiff of loss on their investment by remaining invested. Such strategies, at times, create volatility in the capital markets and withdrawal of investments from the stock market has a cascading effect on the stock prices of companies.

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[20] The definition of FDI utilized in the IMF 1993 (fifth edition) *Balance of Payments Manual* states that a direct investment is established when a resident in one economy owns 10 percent or more of the ordinary shares or voting power, for an incorporated enterprise, or the equivalent, for an unincorporated enterprise. This is known as the ten percent rule. cited in *supra* at 17 p. 4

[21] *supra* at 17, p. 4

[22] *supra* at 17, p. 5

3.1 FDI and Portfolio Investment Distinguished

FDI and portfolio investment are two ways of investment by foreign investors which may be distinguished on the basis of their objectives. Portfolio investors are generally perceived as specialized financial intermediaries not interested in management or effective control of the enterprise. They manage savings of investors (especially small investors) collectively on their behalf towards specific objectives in terms of risks, returns and maturity of securities. FDI and Portfolio Investment address different financing needs: the first one is foreign-owned, while the latter one is more used by domestic companies/entities. FDI is firm- and sector-specific, while FPI is more fungible.

FPI produces greater macroeconomic impact through changes in asset prices and liquidity in the financial sector, while FDI tends to significantly influence microeconomic factors by shaping the productive capacities of the host country.[23] Unlike FDI, FIIs do not have managerial responsibilities in their investment and more often than not are not even physically present in host countries. The decision by TNCs to undertake FDI in a country is influenced mainly by the host country's determinants such as legal systems, political stability, market size, etc.[24] while FPI may be affected by external factors, such as financial policies in capital exporting countries, the state of liquidity on international capital markets, and changes relevant for diversification of international portfolios.[25]

FDI scores over FPI in terms of its stability. The direct investors have long term objectives of establishing a business base in overseas markets, brand building[26] and ultimately running a profitable venture. The reversibility[27] of investment is more difficult in FDI where the physical property of the investors may also be at stake, than in case of portfolio investment, which can easily be sold off on financial markets. In the context of

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[23] *supra* at 17, p. 25

[24] A.Perry-Kessaris,(2003), "Finding and Facing Facts about Legal Systems and Foreign Direct Investment in South Asia," *Legal Studies*, Vol. 23, p. 650

[25] *supra* at 17, p. 34

[26] *supra* at 7, p. 1710

[27] *supra* at 23

these differences FDI is viewed as more desirable from a developing countries' perspective.

4. FDI: ECONOMIC IMPORTANCE AND ITS REGULATORY CHALLENGES

Prima facie, the contribution of FDI to development seems direct. TNCs establish subsidiaries and affiliates which directly increases the level of investment in host countries augmenting their productive capacities and employment levels. The probability of transfer of technology, management expertise and marketing skills in a FDI venture is quite high. Due to their role as channels for the distribution of goods from one country to other markets TNCs can increase access to export markets[28]. Risks, both commercial and non-commercial are assumed voluntarily by TNCs though insurance may be sought to mitigate them. In principle earnings are repatriated if the affiliates are profitable, thus investment will be repaid by profits[29].

However, FDI has an often neglected downside that entails a loss of control on domestic production and development options. The development of particular sectors of production is left to foreigners' choice due to the firm and sector specific nature of FDI. Deliberate domestic policy considerations and options may often be ignored by the foreign investor who does not have a connect with the host state. Furthermore, FDI can crowd out domestic enterprises through unfair competition and through raising important sums of local savings. FDI can negatively impact the balance of payments situation of a country, if production by affiliates requires important volumes of imports. The effect is accentuated if production is geared towards host country's domestic markets and not towards export markets. The cost of FDI in the long run increases exponentially, as repatriated earnings and royalties tend to increase with the maturity of affiliates.[30]

The see-saw battle is taking place between attracting more investment and controlling it at the same time. A state seeks to balance these competing functions under the umbrella

[28]D.H. Brooks, and L.R. Sumulong (2003), *Foreign Direct Investment: The Role of Policy*, Economics and Research Department Policy Brief, Series No. 23, Asian Development Bank, Manila.,p.4

[29] *supra* at 17 p. 23

[30] *ibid*, p. 24

of investment laws. The strategy of the host (especially developing countries) is to ensure the localization of the foreign investment process by ensuring that the form that is chosen to implement the foreign investment is amenable to local pressure, such as in the form of joint ventures. They seek to defeat the possibility of the internationalisation of the foreign investment by increasing the contact of the investment with the state. The foreign investor, on the other hand, favors incorporation of maximum international elements to ensure the security of his investment and its removal from the scope of the local control devices[31]. The regulation of FDI to extract benefits requires a balancing of interests[32] of both the investors and the host states. Therefore, a clear definition of FDI and the regulatory framework at the entry stage of FDI encompassing pre-entry, point of entry and approval are important for this balancing of interests

5. DEBATE ON THE DEFINITION OF FDI

The primary research question of the present study pertains to an appropriate definition of FDI and therefore it is pertinent to examine the debate surrounding it. The debate surrounds the inclusion of portfolio investment in the definition of FDI. On the one hand is the view espoused by the developed countries[33] that distinctions between portfolio investments and FDI concerning protection accorded under international law should be abolished. It is based on the assumption that both types of investors undertake similar risks voluntarily[34]. Bilateral Investment Treaties entered by such states cover Foreign Portfolio Investment, though it may not be mentioned explicitly. Implied coverage is provided by the defining investment as "every kind of asset" and including shares[35] in the definition of foreign investment. The reasons provided for such enhanced coverage include inter-alia, complete protection to direct investors having assets in the form of portfolio investment against losses arising from expropriation, avoiding confusion

[31] *supra* at 15, p.104

[32] *supra* at 28, p. 8

[33] *supra* at 9; p. 23

[34] *supra* at 15, p.8

[35] *ibid*, p.10

between FPI and FDI, by categorizing them as one and attracting investment flows through further liberalization of investment regimes. It is argued that due to the complementary nature of FPI and FDI, promoting FPI would help to attract FDI. Therefore, a broader definition of FDI is advocated.[36]

On the other hand is the view of most of the developing countries,[37] who desire to restrict the definition on FDI in light of the fact that the protection of foreign investment accorded under customary international law extends only to FDI. The reasons offered in support of the view focus on the fact that a direct investor enters the host with the express consent of the host making it is easier to ascertain direct linkages between him and the investment. Portfolio Investments are made on stock exchanges virtually anywhere in the world and the host state cannot determine linkages which may be detrimental or undesirable to it.[38] Therefore exclusion of portfolio investment allows host country government flexibility in the liberalization and regulation of capital accounts and control over the volatility of FPI. Weak domestic financial markets can hence be sheltered from destabilizing inflows and outflows of FPI.[39] Also, as the regards the inclusion of shares in the definition of FDI in various treaties, it is argued that 'the shares' refers to the shares of a joint venture company in which the direct investor is a stakeholder. It is not meant to include shares held by a non-resident and purchased entirely outside the host state[40]. The developing country position prefers protection to only long term investments. This may be found consistent with the Doha mandate, which speaks of 'long term cross- border investment, particularly FDI that will contribute to the expansion of the trade.'

Foreign investment is an essentially intrusive process occurring within the jurisdiction of the host. The definition of foreign investment should be understood in the specific context attributable to it by state practice and in terms of the precise words used in the

[36] *supra* at 17, p.36

[37] *supra* at 9; p. 23

[38] *supra* at 15, p. 8

[39] *supra* at 17, p. 36

[40] *supra* at 15, p. 9

treaties if it has to justify the balancing of competing interests of investors and the host states.

5.1 Indian Position on The Definition Of FDI

Recently, the Department of Industrial Policy and Promotion (DIPP) under India's Ministry of Commerce and Industry released the Consolidated FDI Policy document, 2010 consolidating all prior regulations on FDI into one document. It reflects the current 'regulatory framework' on FDI in India. While the Draft Note[41] confirmed that:

> "The motivation of the direct investor is a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise", it went on clarify that "in India the 'lasting interest' is not evinced by any minimum holding of percentage of equity capital/shares/voting rights in the investment enterprise".

Clearly, India was going astray from the international best practice evinced by the IMF which requires a critical minimum qualifying share of 10% in equity capital of a domestic entity by a non-national investor for it to be included as FDI. The attempt was to broaden the definition of FDI to ensure the categorization of other varieties of investment flows as FDI. This inflation of resultant FDI inflow statistics was aimed at cheering up 'free market' advocates who quote greater comparative flows to China[42] in order to push for greater policy liberalization.[43]

The final Consolidated FDI Policy (Policy 2010) that came into effect on April 1, 2010 removed this clarification and the same has been retained in the revised version which came into effect from April 1, 2011. However, FIIs may invest in the capital of an Indian company under the FDI Scheme/Policy though 10% individual limit and 24% aggregate

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[41] S. Francis, (2010), "Foreign Direct Investment Concepts: Implications for Investment Negotiations," *Economic and Political Weekly*, Vol. 45, No. 22, p. 32.

[42] *supra* at 7 p. 1706

[43] *supra* at 41 p. 32.; K. Sharma, (2000), "Export Growth in India: Has FDI Played a Role?" Center Discussion Paper, Economic Growth Center, Yale University, New Haven, Connecticut, p. 7

limit for FII investment would still be applicable even when FIIs invest under the FDI scheme/policy.[44]

The problems with the classification of an asset class that is primarily portfolio investment as FDI in the national FDI definition can be two fold. First, the 'preferential' conditions of entry and operations that are offered to FDI are automatically extended to a class of investors whose are unidentifiable and may be beyond regulation even in home countries. Secondly, despite the fact that the contributions of such investors are negligible in development of host economy they enjoy the freedom for capital repatriation conferred on direct investors. This hampers the country's ability to control volatile inward and outward capital movement which can be disastrous, especially in times of financial crisis.

By inculcating such a broad national FDI definition, India would have gone against the stand it took in the investment negotiations at the WTO and made a mockery of developing countries' successful fight against Multilateral Agreement on Investment-type multilateral rules. It would have also lost most of the leverage in investment negotiations as this acceptance would do away with the need for developed country negotiators to define investment broadly. This would have led to multilateralisation of this standard by way of increasing engagement in Regional Trade Agreements.[45] Therefore, by taking away the clarification India has acted in consonance with its earlier stand of maintaining greater effective regulatory control over FPI as a separate class.

6. FDI: SIGNIFICANCE OF ENTRY STAGE

The importance of the entry stage is manifold. It allows for maximum regulatory space in sieving out investments and ensuring stringent controls on operations before the establishment takes place. "Many developing countries have now enacted legislation to setup screening bodies which permit entry to give incentives to investment which are

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[44] Department of Industrial Policy and Promotion (DIPP) (2010), *Consolidated FDI Policy*, Circular 1, Ministry of Commerce and Industry, Government of India, New Delhi, p. 14; A. Ames.(2008), "Foreign Institutional Investment in India: What a Portfolio Manager needs to know about the Past, Present and Potential Future of India," *Brigham Young University International Law & Management Review*, No. 143.

[45] *supra* at 41; p. 33.

approved by these bodies. Some have legislation designed to ensure that technology transfers are effected without too many restrictions on their use by the transferee."[46]

The pace of the FDI entry can be streamlined[47] through the inclusion of fewer administrative agencies at this stage. "The functions of these administrative agencies change from time to time. Their basic functions are to take administrative measures both to facilitate as well as to control foreign investment."[48] The investment treaties define all the administrative rights an investor acquires at entry or post entry stage, as constituting foreign investment. From the point of view of the capital exporting states, it is only logical that there be protection given to these administrative rights which are indispensable to the purpose of investment. However, "the inclusion of these administrative law rights within the definition of investments greatly restricts the right of the state to exercise regulatory control over the foreign investment"[49]. By regulating the number and form of administrative bodies at the entry stage itself, some semblance of regulatory control can still be maintained.

A host country like India, may impose various conditions to regulate the form of FDI and direct the flow of investments towards particular sectors in accordance with its development objective.[50] Foreign investors on the other hand, may seek maximum protection of their investment by invoking a broader definition of FDI and inclusion of international minimum standards in the domestic framework. Therefore the broad international and domestic legal framework regulating FDI needs to be studied in the narrow context of the entry stage. A brief overview of the regulatory framework relevant at the entry stage is discussed in detail hereafter.

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[46] *supra* at 15, p.63

[47] K. Singh, "FDI in India: A critical Analysis of FDI from 1991 -2005", Research Internship Programme, 2005 p. 8

[48] *supra* at 15, p.14

[49] *ibid*

[50] A. Sumner, (2005), "Is Foreign Direct Investment Good for the Poor? A Review and Stocktake," *Development in Practice*, Vol. 15, No. 3/4, p. 275.

6.1 Panoramic Overview of the Regulatory Framework

In the international arena presently, there is no global treaty and organization with broad competence in the field of FDI[51], though several organizations have limited jurisdiction.

> "Among the organizations, the World Bank is the organization with arguably the greatest competence. The World Bank has as one of its objectives the promotion of private foreign investment through guarantees and loans. Three members of the World Bank group deal specifically with providing projects finance for the private sector(International Financial Corporation, IFC , since 1956) with state investor arbitration(International Centre for Settlement of Investment Disputes, ICSID since 1965) and with insurance against non-commercial risks for foreign investors(Multilateral Investment Guarantee Agency, MIGA since 1985). The World Trade Organisation (WTO) has Trade Related Investment Measures Agreement (TRIMS) which was included in the international trade regime at Marrakesh on April 15, 1994."[52]

The WTO also deals with certain aspects of foreign investment in General Agreement on Trade in Services (GATS) and in the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

Besides these multilateral frameworks with limited competence there exists a plethora of Bilateral Investment Treaties (BITs) (more than 70 involving India) spelling out binding international commitments and international minimum standards like national treatment, Most-Favoured Nation (MFN) treatment to be undertaken by host countries for protection of foreign investment. Also, countries give tax concessions by entering bilateral agreements in the form of Double Tax Avoidance Treaties (DTATs) to attract FDI. These commitments, obligations and concessions primarily require changes in the domestic laws of the host country and hence have a direct impact on the national regulation of FDI. The more the standards are universalized in international law, the greater is the loss of regulatory space to domestic agencies. Also, violation of these international commitments can be challenged through binding ICSID arbitration and the WTO dispute settlement mechanisms.

[51] *supra* at 9; p. 9

[52] *ibid*; p. 10

India like many other developing countries has been competing to attract FDI since the year 1991[53] when the economic reforms process began as a response to the foreign exchange crisis and a weak economy. The domestic regulatory framework surrounding FDI has been successively liberalized in the field of investment, trade, financial sectors, exchange controls[54], licensing, competition law, intellectual property laws, etc.[55] Foreign Investment Promotion Board ("FIPB"), an arm of the Ministry of Finance, is the nodal agency for all matters concerning Foreign Direct Investment ("FDI") as well as its promotion in India. [56] Secretariat for Industrial Assistance ("SIA"), and Foreign Investment Implementation Authority ("FIIA"), functioning with the Department of Industrial Policy and Promotion,("DIPP") Ministry of Commerce and Industry, act as gateway to industrial investment in India.

Like many countries India does not have a single investment code encompassing everything. The recent Consolidated FDI policy is an effort in the direction of a single code. However as of now, investment concerning provisions are still scattered in various statutes, regulations, policy papers, etc. administered by different agencies such as DIPP, the Reserve Bank of India (RBI), etc. The constituent elements forming the broad framework regulating FDI are enumerated below.

- **The Consolidated FDI Policy 2010 issued by the DIPP and Revised on April 1, 2011** (consolidates the existing regulations on eligibility requirements, issue and transfer of shares, entry requirements, sectoral caps on investment, approval requirements, repatriation and reporting requirements, etc.)
- **Press Notes issued by the Ministry of Commerce and Industry, specifically the DIPP** periodically and made available online enumerating the various requirements, forms, processes, etc for different sectors and investors.

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[53] R.K. Luthra, . (2011), *Foreign Direct Investment in India: Evolution and the Legal Regime*, s. 4

[54] B. Dhar,(1988), *State Regulation of Foreign Private Capital in India*, Institute for Studies in Industrial Development (ISID), p. 21

[55] P. Suri,& Associates (2006), *FDI Notifications-An Anthology*, LexisNexis Butterworths, New Delhi, p.19.

[56] S.K. Chaturvedi,(2007), *Foreign Investment Law and its Impact on Labour*, Deep and Deep Publications, New Delhi, p.45

- **The Foreign Exchange Management Act, 1999 ("FEMA").** It is the parent act which gives the powers of issuing notifications to the RBI and SEBI for various reporting requirements concerning investors.
- **The Companies Act, 1952** along with relevant Press Notes;(Incorporation of a company, a joint venture, a wholly owned subsidiary)
- **The Industries (Development & Regulation) Act 1951** (sector specific industrial licenses);
- **Special Economic Zones Act, 2005**(incentives for Greenfield Investments)
- **The Competition Act, 2002** (deals with Mergers and Acquisitions).
- **The Indian Contracts Act, 1871** (governs formation of commercial contracts)
- **The Arbitration and Conciliation Act, 1996** (speedy disposal of commercial disputes)

The approval process requires submission of documents either prior to approval or through reporting requirements (in case of automatic approval) pertaining to ownership of the enterprise, the proposed investment, market research, environment impact assessments, insurance if any, and sometimes dispute resolution(commitments as to primacy of domestic law). Moreover, from a foreign investor's perspective, an examination of some other domestic laws also becomes essential prior to entry though the approval process may not require them.

- **The Income Tax Act, 1961**
- **The Copyright Act, 1957**
- **The Patents Act, 1970**
- **Trademarks Act 1999**
- **Workmen Compensation Act 1923**
- **Factories Act, 1948**
- **Child Labour (Prohibition and Regulation) Act,1986**

- **Land Acquisition Act, 1894**

7. RESEARCH METHODOLOGY

7.1 The Objective And Scope Of The Study

The present study aims to map out the above mentioned international and domestic regulatory framework regulating FDI in India at the entry stage. The impact that the international legal commitments have on the domestic laws has been probed through examining linkages at prior to entry, point of entry and approval stages of FDI. The impact has been examined in context of the loss of regulatory space available to the domestic agencies.The study focused on the provisions relevant to entry under FEMA, 1999, Regulations issued by RBI, the FDI policy issued by the DIPP, the international commitments undertaken under TRIMS, GATS, TRIPS and various BITs; role of administrative agencies like FIPB, SIA and international agencies like MIGA in entry and approval; modes of entry available under Companies Act, 1956, SEZ Act, 2005 and through mergers and acquisitions governed under the Competition Act, 2002; and dispute resolution under Arbitration and Conciliation Act, 1996, International Commercial Arbitration and BITs related to commercial disputes. A brief overview of the other relevant applicable laws, especially taxation (ITA, 1961; DTATs) relevant at the entry stage has been given. The legal framework in the fields of labour, land, environment, etc. has no direct bearings on the entry stage though they are relevant for successful establishment and hence have not been covered in this study. No case studies of specific investments like Vedanta and POSCO have been included. The investor-state dispute settlement mechanisms available under ICSID (primarily dealing with expropriations) that are relevant at the exit stage have not been addressed.

7.2 Research Questions

The research questions that are sought to be addressed through this study are

- What is the appropriate definition of FDI? How is it important in maintaining regulatory control over entry of FDI?

- What are the laws both domestic and international, governing entry stage of the FDI?
- Are the domestic laws applicable to FDI inconsistent with the international commitments undertaken for its protection? How far have the two regimes harmonised?
- Is there a loss of domestic regulatory space governing FDI entry due to international obligations undertaken and minimum standards imposed?
- What are the other issues that arise due to the interaction of the domestic and international regimes governing FDI?

7.3 Hypotheses

The present study was undertaken on the basis of the following hypotheses:

1. A restrictive definition of FDI is more suitable to effectively regulate entry of foreign investment.
2. There is a loss of domestic regulatory space governing the entry of FDI due to existence of international minimum standards.
3. The complexity of existing laws and legal structures doesn't allow greater harmonisation of international legal norms with the domestic laws regulating FDI.

7.4 Sources

The present study relies on secondary source materials like books; data published by public, private research institutes and organizations. Various acts, legislations, administrative instruments, press circulars, issued by the various ministries and concerned departments of the Government of India were also used to filter out relevant material. To have a critical insight into the related issues relevant articles from academic journals, practitioner's notes and jurisprudential inputs available both online and accessible in hard form have been used. The study has used the historical and analytical methods.

7.5 Chapterization

The primary research question about the appropriateness of the definition of FDI has been succinctly discussed earlier in this chapter. In the second chapter, the international legal framework dealing with FDI regulation is mapped out. The role of TRIMS, MIGA, BITs and DTATs has been examined in establishing a legal framework, setting out international minimum standards and attracting FDI. The role played by the international regime in protecting investor's interests has been briefly highlighted.

The third chapter maps out the domestic regulatory framework of FDI in India. FEMA, 1999 and its subsequent amendments, the Consolidated FDI Policy 2010 and revised on April 1, 2011, relevant press notes issued by the RBI, modes of entry available under the various acts such as the Companies Act, 1956, the Competition Act, 2002 and the SEZ Act, 2005 have been examined in the context of the entry stage. The single window system operational in India, the documents required to be submitted to the administrative agencies FIPB, SIA and the regulatory agency RBI, reporting requirements, etc have been suitably outlined. Other relevant laws applicable at this stage such as intellectual property, tax, etc., have been highlighted.

The next chapter examines the impact of the international norms applicable on the domestic legal regime mapped out in the previous chapters. The focus is on the shrinking domestic regulatory space and the harmonization of norms. The entry stage is examined in context of its three subdivisions pre entry, point of entry and approval. The problems posed for harmonisation of the international and domestic legal frameworks is also suitably addressed.

The last chapter summarizes the major findings of the present study in context of the research questions sought to be answered. It also gives suggestions for better streamlining of the regulatory framework at the entry stage and delineates pertinent issues projected during the course of this study.

CHAPTER 2

INTERNATIONAL LAW AND REGULATION OF FDI

1. INTRODUCTION

International law as a rule based regime has been grappling with the regulation of foreign investment in general and FDI in particular, in the past. The progress was slow earlier but from the mid 1990s, international law has had a major role to play in this process of regulation. In this chapter the various international mechanisms and institution having competence in the field of regulation of FDI have been mapped out. The questions that are being sought to be addressed are regarding the role and form of international institutions involved; the issues faced by them; the importance of bilateral and multilateral instruments in the process, the standards promulgated and the universality of such standards.

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The primary stakeholders i.e., the home countries, the foreign investors and the host countries have endeavoured to build an International Law on Foreign Investment regulating all stages from entry to exit of an investment. The role of the Customary International Law in this project has been inadequate and the states have grown conscious of this failure.[1] Since mid 1980s-90s the movement is towards liberalization of both entry and regulatory standards. Treaty based international law has heralded the movement to fulfill this need[2]. However, the zeal of the states to protect their sovereignty as regards foreign investment has ensured that there are no multilateral treaties containing substantive rules on foreign investment. The only closest attempt came in the form of a Multilateral Agreement on Investment under the auspices of OECD in the 1990s, but it failed because of the dissent within the developed countries and the opposition generated

[1] M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.159

[2] D.B. Bailey, and W. Don Jr. (1998), "The Inevitability of National Treatment of Foreign Direct Investment with Increasingly Few and Narrow Exceptions," *Cornell International Law Journal*, Vol. 31, No. 3, p. 628.

by the non-governmental organization[3]s to a code that took into account only the interests of the multinational corporations[4].

The existing multilateral treaties have only peripheral significance. [5] The primary importance is acquired by bilateral and regional treaties on foreign investment which lay down the rules between parties while still leaving space to maneuver control over investments. Also, there has been an emergence of international institutions who despite having limited competence on certain matters of foreign investment have acquired considerable significance. The noteworthy among them are the Multilateral Investment Guarantee Agency (MIGA) and International Centre for Settlement of Investment Disputes (ICSID) under the World Bank Group; and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), General Agreement on Trade in Services (GATS) and Agreement on Trade Related Investment Measures (TRIMS) discipline under the auspices of the World Trade Organisation (WTO). These disciplines and the plethora of International Investment Agreements (IIAs) including Bilateral Investment Treaties (BITs), Regional Trade Arrangements (RTAs) and Free Trade Agreements (FTAs) espouse the cause of certain international minimum standards which may restrict the regulatory space available under domestic laws. A more detailed discussion as regards these institutions and IIAs in the process of FDI and its regulation is undertaken in the section to follow.

2. INTERNATIONAL INSTITUTIONS AND FDI

International institutions are created for specific purposes and there is no single international institution with direct competence over FDI. The World Bank and the International Monetary Fund are the Bretton Woods institutions created to oversee development objectives, flow of funds and other financial matters involving states. The

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[3] *supra* at 1, p.66

[4] *ibid,* p.28.

[5] *ibid* p.137

World Bank has a proactive role in promoting FDI especially in developing countries and utilizes specially created legal and other devices to facilitate such promotion[6].

MIGA, one such device in the repertoire of the World Bank was created in the belief that "elimination of political risks to investment will result in greater flows of foreign investment into the developing countries leading to their economic development"[7]. An investor is willing to take commercial risks but political stability in a country goes a long way in assuring him about the safety of his investment. Similarly, ICSID was created with the purpose of providing neutral arbitration facilities to foreign investors to solve their disputes with host countries. This helps in building investor confidence about the fairness of such adjudication.

Another organization with marked competence in the area of foreign investment is the WTO. The Uruguay round of GATT which witnessed the formation of WTO was the first time that regulation of foreign investment was directly addressed. There was little progress towards a direct control regime over foreign investment due to an insistence by the developing countries that only trade issues in goods and services should be discussed. But various instruments which have an indirect bearing on foreign investment such as TRIPS, GATS and TRIMS came into being. TRIPS And GATS deal with intellectual property and services, areas that would traditionally fall under investment[8]. Efforts have also been made to have a direct regulatory regime on investments at the WTO. At the Singapore Ministerial Meeting of the WTO, the issue of an investment code was mooted but at Doha discussions on investment issues were made conditional to the development dimension[9]. At the Cancun Ministerial Meeting, which was concluded in September 2003, the larger developing countries opposed consideration of investment unless there was agreement to include issues of potential liability of the multinational corporations for the harm they may cause to the host state[10]. In the light of these disagreements further

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[6] *supra* at 1, p.71

[7] *ibid*, p.72

[8] *ibid*, p.73

[9] *ibid*

[10] *supra* at 1, p.28

progress has been stalled at the WTO. Therefore, the regulatory competence is restricted to the existing institutions which have limited yet complementary roles to play.

2.1 Multilateral Investment Guarantee Agency (MIGA)

Foreign investment involves both commercial and non-commercial risks. The non-commercial risk for a foreign investor is greater than a domestic venture and insurance against such risks can boost investor confidence. Capital importing and exporting countries recognized this need to safeguard foreign investors against those risks through effective multilateral insurance. Consequently, the MIGA was promoted on the belief that it would have 'considerable potential to remove barriers to international investment and give new vigor to the development process.'[11] The Convention establishing MIGA entered into force on April 12, 1988[12] and MIGA has gained a prominent role in providing non-commercial risk insurance globally by providing an alternative to national political risk insurance agencies[13]. The membership of MIGA is open to all standing members of the World Bank Group and Switzerland and members are listed in Schedule A of the Convention establishing MIGA (Article 39)[14].

"The basic purpose of MIGA is to encourage the flow of FDI to and among developing countries for productive purposes through two primary instruments. (1) guarantees against non-commercial risks and (2) technical assistance."[15] To seek insurance for a project from MIGA, both the host and the home country must be members and the proposed project must meet certain guarantee requirements. The proposed investment

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[11] *ibid*, p.53

[12] D.D. Bradlow, and A. Escher (1999), *Legal Aspects of Foreign Direct Investment*, Kluwer Law International, London; p. 47

[13] P.J. Donovan,(2004), "Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market", *Gonz. Journal of International Law*, Vol. 1, p.5 ; and A.L. Masser, (2009), "The nexus of Public and Private in Foreign Direct Investment: An Analysis of IFC, MIGA and OPIC," *Fordham International Law Journal*, Vol. 32, No. 5, p. 1710

[14] Convention Establishing the Multilateral Investment Guarantee Agency and Commentary on the Convention,(1985) Washington DC, U.N.T.S. 99, 24 I.L.M. 1605

[15] M. Ikawa, (1999), "Multilateral Investment Guarantee Agency." *ASIL Studies in Transnational Legal Policy*, no. 31, p. 21.

must be new, medium to long term in duration and adjudged by MIGA to be sound and contributory to the development prospects of the host[16]. Investment eligibility is outlined in Article 12 of the Convention[17].

> "Eligible investments include equity interests and medium term loans and guarantees given by the equity holder to the foreign enterprise concerned. Other eligible investments are re-invested earnings from existing investments and any transfer of foreign exchange made to modernise, expand or develop an existing investment".

The investor of a "new" investment must have filed a Preliminary Application with MIGA before committing and expending substantial funds to the project as guarantees are restricted to the investments registered with MIGA[18]. New investment contributions associated with the expansion, modernization, or financial restructuring of existing projects and acquisitions that involve the privatization of state-owned enterprises are also eligible. Non-shareholder loans (e.g. loans to unrelated borrowers) are also covered if they relate to a specific project where MIGA is covering or will cover one of the other types of eligible investments. Other forms of investment, such as technical assistance and management contracts, asset securitizations, capital market bond issues, leasing, services, franchising and licensing agreements, may also be eligible for coverage.[19]

Article 13[20] talks of the eligibility of the investor and lays down that the potential investor must be a natural or juridical person of a member other than the host country. The convention in rare cases also covers investors from the host country to protect the host from capital flight. Article 13 (c) states that "the pivotal requirement in such a case is that the investor must transfer the assets to be invested into the host country from abroad."[21]

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[16] P.J. Donovan,(2004), "Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market", *Gonz. Journal of International Law*, Vol. 1, p.17

[17] Convention Establishing the Multilateral Investment Guarantee Agency and Commentary on the Convention,(1985) Washington DC, U.N.T.S. 99, 24 I.L.M. 1605;and *supra* at 12; p. 48

[18] World Bank Group (2010), *Investment Guarantee Guide*, Multilateral Investment Guarantee Agency, Washington, p. 11

[19] *ibid*, p.5

[20] *supra* at 14

[21] *supra* at 16, p.17

Article 11[22] states the risks covered for insurance. As regards, its primary guarantee operations, MIGA is authorized to provide long term coverage(upto twenty years) against losses arising from four types of political risks[23]:

1. *Actions undertaken by the host government resulting in restrictions on currency transfers(repatriation of profits)*

Any action undertaken by the host country or one of its institutional organs restricting the transfer of its currency into a freely usable currency or another acceptable currency is covered. Also, a failure by the host to act within a reasonable period of time on an application for such transfer is indemnified.[24] Generally, such restrictions deal with the investor's ability to repatriate profits or the proceeds from the liquidation or sale of the investment's assets and both direct and indirect restrictions are covered.

2. *Outright or creeping expropriations through legislative or administrative action by the host country*

The second risk type covered under the MIGA guarantee scheme is expropriation and similar measures. It is defined under Article 11 (a) (ii)[25] as:

> "[A]ny legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories."

The Convention covers both direct and indirect, or "creeping" expropriatory actions taken by the host government such as "nationalization, confiscation, sequestration, seizure, attachment and freezing of assets". MIGA pays net book value of the investment insured in a total expropriation, pays the net book value of expropriated assets or the insured

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[22] *supra* at 14

[23] *supra* at 15, p. 22

[24] *supra* at 18., p. 6

[25] *supra* at 14

portion of funds concerning assets or funds taken in a partial expropriation and insures remaining principal and accumulated and unpaid interest for loans and loan guarantees.[26]

3. Breach of (state) contracts by the host government

Losses arising from the government's breach or repudiation of a contract with the investor are also indemnified. Breach of contract coverage may be extended to the contractual obligations of state-owned enterprises in certain circumstances. In the event of an alleged breach or repudiation, the investor first has to resort to a dispute resolution mechanism specified in the underlying contract and obtain a final arbitral award or judicial decision for damages. If, the award is not enforced and the investor not paid within a specified period of time,

MIGA pays the compensation. MIGA may make a provisional payment pending the outcome of the dispute.[27] It may pay compensation without an award in cases where there is no recourse to a dispute resolution forum or there is unreasonable government interference with the investor's legal rights.

4 . War and civil disturbance

The final risk covered under the MIGA guarantee program concerns loss suffered due to war and civil disturbance, which includes "any military action or civil disturbance in any territory of the host country to which this Convention shall be applicable as provided in Article 66."[28] This provision covers all nature of military conflict to include, "revolutions, insurrections, coups d'etat,"[29]

MIGA recognizes host country's sovereignty over the decision to allow FDI as it issues the guarantee contract only after the host government has approved it.[30] In accordance with Article 15, MIGA requests the host government approval on receiving a definitive

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[26] *supra* at 16, p.21 and World Bank Group (2010), *Investment Guarantee Guide*, Multilateral Investment Guarantee Agency, Washington, p. 6

[27] *supra* at 18, p. 7

[28] Article 11(a) (iii) of *supra* at 14

[29] *supra* at 16, p.22

[30] *supra* at 12; p. 49

application for coverage, thereby granting the host country the opportunity to approve the investment prior to the issuance of any guarantee.

After the investor has received payment of compensation or is assured of getting compensation, MIGA is subrogated to the place of the investor in terms of rights or claims against the host country. "As a result, MIGA, it re-insurance companies and the international community in general come to bear the risk of obtaining redress from the host state. This mechanism of subrogation minimizes the possibility of a political dispute between the home and the host state"[31] by converting into a public international law dispute. Disputes between MIGA as a subrogee and the host may be referred to an international arbitration. This enhances the likelihood of dealing with non-commercial risks associated with foreign investments in a non-political way giving MIGA advantage over the private risk insurance market or national political risk insurance system.

Article 21 of the MIGA calls for cooperation with other insurers to encourage such insurers to provide coverage of non-commercial risks in developing member countries on conditions similar to those applied by the agency. In lieu of its enlarging guarantee operations, MIGA has intensified its efforts to coordinate with other insurers to enlarge its own guarantee capacity. It utilises two methods: reinsurance and coinsurance in this endeavor. Over the years, MIGA has coinsured or reinsured national insurers form several countries, and also has worked closely with private insurers. The indemnification is not complete as an investor is required to remain at risk for a portion of any loss.[32]

> "MIGA can issue up to $180 million of coverage on its own account for a single project, and can cover significantly higher additional amounts through reinsurance arrangements. The agency can also mobilize additional coverage through coinsurance programs with other political risk insurers, including through its Cooperative Underwriting Program, in which MIGA is the insurer-of-record among participating underwriters."[33]

Besides its guarantee operations MIGA also provides technical and legal advisory services to help strengthen international standards of fair treatment and the rights of both

[31] *ibid*;

[32] *supra* at 15, p. 25

[33] *supra* at 18; p. 9

investors and host states.[34] This improves the country's attractiveness to foreign investors and boosts its operational effectiveness in attracting or promoting FDI inflows. "MIGA's capacity building, information dissemination and investment facilitation services have benefited more than 130 countries to date, and the good offices of the Agency's legal advisory services for intermediation of investments have been called upon by investors for approximately 20 countries."[35]

2.2 International Centre for Settlement of Investment Disputes(ICSID)

ICSID was established in 1966[36] and since then has gained wide acceptance as the primary forum for resolution of disputes between a foreign investor and the host state. In order to choose ICSID, both the home and host state must have ratified the ICSID convention. An international arbitration proceeding is used to settle disputes.

"International arbitration is a specially established mechanism for the final and binding determination of disputes, concerning a contractual or other relationship with an international element, by independent arbitrators, in accordance with procedures, structures and substantive legal or non-legal standards chosen directly or indirectly by the parties."[37]The perceived advantages of international arbitration are: avoidance of the home state's domestic adjudication process; using the advantageous international legal framework governing the enforceability of arbitration award; confidentiality; and cost and speed.[38] It is not necessary for the foreign investor and the host state to agree to ICSID arbitration in a single instrument. "The host state may offer to refer disputes to ICSID jurisdiction in its investment promotion legislation or in bilateral or multilateral investment treaties. The investor can accept this offer in writing."[39] The final awards of

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[34] *supra* at 12; p. 41

[35] *supra* at 15, pp. 22.

[36] *supra* at 34; p. 44

[37] L. Mistelis and C.Baltag(2008), "Trends and Challenges in International Arbitration: Two Surveys of In-House Counsel of Major Corporation", *World Arbitration and Mediation Review,* Vol. 2.No.5, p.86

[38] *ibid,* p.88

[39] *supra* at 12; p. 44

ICSID are automatically enforceable and do not require the recognition of domestic courts. Awards can only be denied enforcement on very limited grounds, essentially requiring a discovery of facts unknown to the party and the tribunal at the rendering of the award capable of reversing the award.[40] It is important to note that India has not ratified the ICSID convention.

2.3 GATT/WTO System

The GATT/WTO system from its Bretton Woods heritage in association with the OECD and the EU has striven for progressive liberalization. Though an attempt at a comprehensive single code having direct competence over the FDI has met with many hurdles especially regards the liability aspects of MNC's, regulation has often taken an indirect form.

2.3.1.Agreement on Trade Related Investment Measures (TRIMS)

TRIMS agreement was created by the WTO membership with a desire "to promote expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country members, while ensuring free competition."[41]

The agreement applies to investment measures related to trade in goods only. It is based on measures involving investments which cause 'trade restrictive and distortive effects' thus establishing direct competence over investment, but not comprehensive in nature. The TRIMS Agreement was a product of the GATT panel's decision in the FIRA case. [42]

> "In the GATT Panel Report on the U.S.-Canada Dispute on the Administration of Canada's Foreign Investment Review Act (Canada Act)[43], the United States alleged that the Canada Act resulted in differential treatment of imports by U.S.

[40] *ibid*

[41] Preamble, World Trade Organisation (1994), *Agreement on the Trade Related Investment Measures,* Marrakesh

[42] V. Mosoti, (2003), "The WTO Agreement on TRIMS and the Flow of FDI in Africa: Meeting the Development Challenge," *Pace International Law Review*, Vol. 15, p. 188

[43]*GATT Dispute Panel Report Concerning the Administration of Canada's Foreign Investment Review Act,,* L/5504-30S/140, 1983 GATTPD LEXIS 8. Cited in *supra* at 42

investors in manufacturing operations in Canada. The United States claimed this differential treatment prevented their imports from competing fairly with Canadian products. The GATT Panel found that the requirements of the Canada Act were inconsistent with the national treatment provisions of Article 111(4) of GATT[44]. The Panel's holding was limited to the issue of whether less favorable treatment was accorded to imported products than that accorded to like products of Canadian origin, but bore directly on FDI because the injured parties were U.S. investors and because the decision removed a "performance requirement" from foreign investment"[45].

The creation of TRIMS agreement also reflects the conflict between the developed countries such as Japan and those in Europe, led by the United States, and developing/least developed countries in Asia, Africa, and Latin America, led by India. The United States sought stronger investment protection language, including comprehensive and timely prohibitions of TRIMS upon accession to the WTO. Measures such as local content, local equity, trade balancing, technology transfer, licensing, remittance and manufacturing requirements, product mandating and incentives were sought to be controlled. These are instrumental in limiting imports into a host country, limiting exports from a host country or third country, or increasing artificial exports from a host country and were being employed by developing countries[46] to avoid a BoP crisis. The developing countries succeeded in negotiating a generous transition period for developing(5years) and least developed(7 years) countries upon accession and in limiting the scope of the Agreement to goods only. The final TRIMS Agreement neither added nor took anything away from existing GATT obligations and exceptions which may be seen as a victory for the developing world.[47]

The TRIMS agreement requires members not to apply TRIMS that are inconsistent with Articles III or XI of the GATT 1994. The term "trade related investment measure" is nowhere defined in the Agreement. Only an illustrative, non-exhaustive list of measures,

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[44]The Canada Act required foreign investors, such as those who sought to set up manufacturing operations in Canada, (a) to purchase goods of Canadian origin in preference to imported goods, and (b) to manufacture in Canada goods which would be otherwise imported.

[45] *supra* at 2, p. 620.

[46] *supra* at 1, p.295

[47] S.S.Quillin (2003), The WTO and its protection of FDI: The Efficacy of the Agreement on TRIMs, *Oklahoma City University Law Review*, Vol. 28, No. 2&3, p. 888.

such as local content and trade balancing requirements that are explicitly regarded as inconsistent with Articles III and XI of the GATT 1994 is provided.[48] The agreement allows the developing countries to "deviate temporarily" from several specified provisions of GATT while applying all exceptions of GATT. The aim of prohibiting the use of performance requirements is sought to be achieved for the PRs falling within the narrow focus of the limitations provided by the linkage between TRIMS and the old GATT provisions.[49] TRIMS permits measures usually employed by developing countries in regulating foreign investments, such as entry through joint ventures, employment of a specific quota of national and a minimum level of equity participation, etc. The likelihood of an extension of the list of the prohibited performance requirements in light of the opposition of the developing countries is remote.

TRIMS in force earlier than 1995 have been granted extensions from time to time even after the transition periods were over. The TRIMS Agreement also includes transparency and notification requirements, and it establishes the Committee on Trade –Related Investment Measures, mandated inter-alia to "consider whether the Agreement should be complemented with provisions on investment policy and competition policy."[50]

TRIMs violations are often listed in conjunction with other policies such as those violative of the Agreement on Subsidies and Countervailing Measures, TRIPS and the Agreement on Agriculture[51], etc. India has already been a respondent in two cases, the *India — Measures Affecting the Automotive Sector (Complainant: European Communities)* and *India — Measures Affecting Trade and Investment in the Motor Vehicle Sector (Complainant: United States of America)* besides participating as a third party in another 8 cases such as *European Communities — Regime for the Importation, Sale and Distribution of Bananas (Complainants: Ecuador; Guatemala; Honduras; Mexico; United States of America)* and others dealing with the automobile sector. As

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[48] *supra* at 42, p. 190

[49] *supra* at 47, p. 887;and *supra at 1*, p.303

[50] *supra* at 48

[51] D.H. Brooks, *et al* (2003), *Foreign Direct Investment in Developing Asia: Trends, Effects, and Likely Issues for the Forthcoming WTO Negotiations*, Economics and Research Department Working Paper, Series No. 38, Asian Development Bank, Manila, p. 21

respondent, the Panel reports ruled adversely against India and it had to comply with the ruling by withdrawing the disputed domestic measures[52].

Binding rulings of such nature requiring amendment or withdrawal of domestic regulations linked with investment constrain the regulatory space of countries and TRIMS agreement may be blamed for the same. But it may also be argued that TRIMS Agreement only confirms what was already prohibited under GATT 1947. It does not explicitly address performance requirements falling outside Articles III and XI of the GATT 1994, such as export requirements per se delinked from imports[53]. Also, it does not deal with foreign investment per se and its protection such as minimum standards in respect of expropriation. Therefore, the primary focus of TRIMS Agreement is trade in goods and it has no direct bearing on the inducement or protection of foreign investment. However, in so far that it prohibits PRs linked with investment, it will have indirect competence over foreign investment protection.

2.3.2. *Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS)*

TRIPS agreement under the WTO derives its significance in terms of investment regulation from the fact that intellectual property amounts to a type of foreign investment. As one of the perceived benefits of FDI is transfer of technology[54] and intellectual property to the host country, the regulation gains importance. The foreign investor is assured against misappropriation of his intellectual property by a strong intellectual property regime which TRIPS seeks to standardize and transpose into domestic laws.

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[52] *India – Measures Affecting the Automotive Sector,* WT/DS146/AB/R, WT/DS175/AB/R, 19 March 2002. This dispute concerned two of the conditions stipulated by Public Notice No. 60 issued by the GoI's Ministry of Commerce, on 12 December 1997 acting pursuant to the Foreign Trade (Development and Regulation) Act of 1992 and included in each MOU, namely: (i) an "indigenization" requirement, whereby each car manufacturer was obliged to achieve indigenization, or local content, of a minimum level of 50 percent by the third year from the date of its first import of cars in the form of completely and semi-knocked down kits ("CKD/SKD kits"), or certain automobile components, and 70 percent by the fifth year from that date; and (ii) a "trade balancing requirement", whereby each car manufacturer was obliged to balance, over the period of the MOU, the value of its imports of CKD/SKD kits and components with the value of its exports of cars and components.

[53] *supra* at 1, p.127

[54] K. Singh, "FDI in India: A critical Analysis of FDI from 1991 -2005", Research Internship Programme, 2005; p. 3

Intellectual property rights are created and applicable within the domestic law and their redress in case of violations can also take place through domestic law as mandated under TRIPS. [55] Only a failure of such redress constitutes violations of international obligations.[56]

"Since intellectual property is defined as falling within investments in regional and bilateral investment treaties, the link between TRIPS and investment treaties is made even clearer." [57] Unlike TRIPS, Investment treaties do create direct international obligations protecting intellectual property as investment.

The developing countries have opposed such comprehensive protection as sought to be universalized under TRIPS. They perceive the TRIPS mechanism as means of externalizing control over domestically created intellectual property rights through the creation of an international regime with dispute settlement functions. It involves "considerable loss of sovereignty over purely internal processes that may have vital economic significance to the state."[58] In the two areas of compulsory licensing and protection of indigenous knowledge, the conflict between developing countries and developed world has just begun to come forth. The acceptance of TRIPS itself can only be seen as an intrusion that was achieved in the context of the acceptance of economic liberalism as well as the exercise of pressure by the developed countries[59].

2.3.3. *General Agreement on Trade in Services (GATS)*

The GATS is another important instrument which came out of the Uruguay round. Its discreet involvement with foreign investment is visible in how it establishes WTO's competence over regulation of foreign investment in the services sector. The services sector accounts for a large percentage of the FDI and therefore GATS establishes WTO

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[55]*supra* at 1 p. 49 +302

[56]*ibid*, p.12

[57] *supra* at 1, p.302

[58]*ibid*, p. 49

[59]*Ibid*, p.302

competence over a substantial portion of the economy of each member state. It liberalises the barriers to entry in the services sector which have traditionally been quite high. There are four modes of supply of services covered by GATS and in the context of FDI, the mode of "commercial presence" is of utmost importance. This commercial presence may be established by the MNCs through the establishment of a juridical person or through a branch office for the supply of services within the territory of the host state.[60] Such service providers are clearly indistinguishable from foreign investors.

The core principles of GATS , non-discrimination and national treatment are not general in scope. They arise only from specific commitments made by the parties in their schedules. GATS spells out its commitment to national treatment in Article VI on Domestic Regulation which reads:

"In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner..."

National treatment applies only to those service sectors which are listed in each state's schedule and to the extent that no conditions are attached. There is a prohibition against the restrictions on the number of service suppliers allowed, the value of the transaction or assets, the total quantity of service output, the number of persons employed, the type of legal entity through which the services is supplied and limits on foreign equity if a sector is subject to GATS[61].

As regards the Most Favoured Nation (MFN) treatment there is a genuine concern that the provision under GATS can be used to take advantage of the beneficial provisions under BITs. The advantageous investor-state dispute resolution mechanism provided in investment treaties may be claimed on the basis of the MFN clause.[62] Therefore, GATS

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[60] *supra* at 1, p.300

[61] *ibid*, p.300

[62]*ibid*, p.301 ; This is also possible in the case of two BITs, a primary and a secondary. "A case in point is the *Maffezini* case which examined whether MFN clause in a primary treaty could be used to invoke a beneficial provision in secondary treaty. The dispute was whether the Spanish investor could use the MFN clause given in the Argentina-Spain IIA (primary treaty) to invoke a beneficial treaty provision given in the Chile-Spain IIA (secondary treaty).The Tribunal allowed the same" P. Ranjan (2008), "International

permits members to list exemptions to MFN treatment which will not last for more than ten years. The exemptions have been justified on the basis of restricting free riding which is available under an unconditional MFN rule where competitors located in countries with relative restrictive policies benefit from their sheltered markets while enjoying benefits in less restrictive export markets. Though GATS seeks liberalization of entry standards as a target, it does not take place in the form of pre-entry rights of establishment as required under investment treaties. Entry can be controlled by a host state in any sector by their non-inclusion in its schedule[63].

3.International Investment Agreements And FDI

The international law regulating FDI to a large part consists of IIAs which are used to promulgate international minimum standards governing the state parties to such agreements. The IIAs consist of BITs, FTAs, RTAs and a special form of IIAs called Double Tax Avoidance Treaties(DTATs).

3.1 *Bilateral Investment Treaties (BITs)*

It is a well accepted principle of international law that sovereignty over a purely domestic matter can be restricted by its inclusion in an international treaty. BITs serve the purpose of investment protection by invoking this principle and seek to impose certain agreed minimum standards on the contracting parties for the protection of FDI[64]. The spurt in the number of BITs in recent years can be attributed to the lack of consensus of the states in arriving at a multilateral framework with broad competence over foreign investment protection.

BITs are agreements between two sovereign states in the form of carefully negotiated compromises between investment protection and sovereign control over economic activity. The host country seeks to attract FDI while the home countries seek to protect

Investment Agreements and Regulatory Discretion: Case Study of India," *The Journal of World Investment and Trade*, Vol. 9, No. 2, p. 218

[63] *supra* at 1, p.300

[64] *ibid*, p.105

investors from political risks and instability in the territory of the other state which may be detrimental to the interests of their nationals. "BITs aim at encouraging FDI in developing countries and hence are primarily concluded between developed and developing countries as the former are virtually the only source of FDI and the latter are often perceived as having risky and volatile business environments."[65] The impact on FDI inflows is due to improvements of individual components of the policy and institutional framework for FDI in the host country, which results in improved investment climate.[66] The promulgation of certain minimum standards common to most BITs enables such an impact. The noteworthy are National Treatment (NT) & Most Favoured Nation (MFN) Treatment; Compensation in case of Expropriation; Repatriation of Investment and Returns; and Investor-State Arbitration at the instance of the Investor.

i. National Treatment and Most Favored Nation Treatment

This clause entitles the foreign investor to the treatment which shall not be less favourable than that accorded to domestic investors by the host. The MFN clause requires the contracting State to accord to investors of the other contracting State including in respect of returns on their investments, treatment which shall not be favourable than that accorded to investors of any third State. However, exceptions are allowed to this treatment. The contracting state is not obliged to extend any other benefit of any treatment, preference or privilege resulting from existing customs, or future customs or similar international agreement or any international arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly or mainly to taxation.

ii. Expropriation& Compensation for Losses:

These provisions protect the investments made by an investor from being nationalized, expropriated or subjected to measures having effect equivalent to nationalizations or expropriation in the territory of the other contracting State. However exceptions for a

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[65] L.E.Sachs, and K.P. Sauvant (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*, Oxford University Press, Oxford., p. 9

[66] UNCTAD (2009), *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, UNCTAD Series on International Investment Policies for Development, UN, New York and Geneva, p. 14

public purpose related to the internal requirements for regulating economic activity is often provided but on a nondiscriminatory basis and against fair and equitable compensation. The compensation payable should be the genuine value of the investment expropriated calculated in a manner fixed and payable without undue delay. Judicial or independent authority review is allowed to ensure the adequacy and promptness of the compensation. Compensation may arise in other contingencies such as destruction to assets during wars and civil commotion or unrest, national emergencies. Such compensation is payable on a nondiscriminatory basis i.e., foreign direct investor will have to be compensated as if the nationals of the State are compensated. Further on the requisition of the property by the forces or authorities or destruction by causes other than combat action or not required by the necessity of the situation, the investor is accorded restitution or adequate compensation. BITs ensure the freely transferability of such payments.

iii. Repatriation of Investment and Returns:

Repatriation of the investment and the resultant profits are an essential element of any FDI activity. Any act or action aimed at preventing repatriation of investment and profits or returns defeats the very purpose of foreign direct investment. Suitable provisions are made in a BIT for unrestricted transfer of the investment and returns. Transfers should be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the contracting State and at the exchange rate prevalent on the date of transfer.

The rights and protection which BITs promulgate may be categorized into substantive and procedural provisions.

> "The substantive rights typically include a guarantee of prompt, adequate, and effective compensation for expropriation, freedom from unreasonable or discriminatory measures, a promise of "fair and equitable treatment" in accordance with international law for foreign investments, guaranteed national and most-favored-nation treatment for investments, free repatriation of capital and profits and assured full protection and security of investments."[67]

[67] *supra* at 65

Together, these provisions are meant to boost investor confidence and the transparency of the policy environment. The procedural rights afford investors an adjudicatory mechanism to enforce substantive rights. Investors can choose between ICSID arbitration, other designated forums or ad hoc arbitration proceedings especially UNCITRAL.[68] This dispute settlement provision ensures that investors do not have to exhaust local remedies before resorting to international arbitration to redress unlawful or uncompensated actions of the host states. The third-party arbitration process gives them direct access to protection under international law and frees them of the inefficient or biased (perceived) local adjudicatory mechanisms. The ICSID arbitration is also beneficial for the host state because it eliminates the possibility of diplomatic protection by the investor's home country. ICSID Convention (Article 36.1) provides both host country governments of contracting states and investors of contracting states the right to initiate investment-dispute settlement proceedings which are limited by BITs to only investors. BITs reduce risks associated with investing in developing countries by guaranteeing investors a certain standard of treatment and establishing a mechanism for international dispute settlement.[69]

In addition, recent BITs of developed countries such as Canada, Japan and United States require liberalization of FDI regime of host by granting foreign investors certain rights such as NT and MFN concerning their establishment in the host country and prohibit host governments from imposing certain performance requirements such as local employment requirements on foreign investors.[70] The apprehension that recent BITs have expanded the rights of foreign investors to cover a wider range of host country activities in detailed and complex ways is not unfounded. These provisions limit the regulatory flexibility of host countries to pursue not only economic development policies but other public policies as well. However, a trend noticed in recent BITs is of more emphasis on certain public concerns, including health, the environment, national security, labor rights, and transparency in information exchange and rulemaking.

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[68] Franck, Susan D. (2007), "Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law," *Global Business and Development Law Journal*, Vol. 19, p. 344.

[69] *supra* at 65 p. 10

[70] *supra* at 66, p. 14

While BITs are largely similar in their substantive content and structure, recent innovations in their provisions have led to greater variation. There are three broad approaches that have emerged: the liberalization approach, used mostly by the United States, Canada, Japan and the Republic of Korea (and some other Western Hemisphere countries). It extends national treatment and most-favored-nation obligations to the pre-establishment phase of investment; the protection approach, mostly followed by European countries; and the more qualified protection approach, used mostly between developing countries. These two approaches traditionally cover only the post-establishment phase. BITs between developing countries and the European BITs are quite similar, except in regards to greater emphasis on exceptions and inclusion of clauses providing choice between litigation in the host country or in an international tribunal in case of a dispute to the parties.[71]

"Despite the perceived objective of developed states in strengthening the international minimum standard of treatment in BITs they do not entirely succeed in achieving the aim at a universal level."[72] BITs have grown in recent years but whether they constitute customary international law is still a contested view. The repetition of rules in numerous treaties alone does not create customary international law when there are variations in the details of the BITs in which the rules are embedded[73].

3.2 Regional Treaties (RTAs), Preferential Trade And Investment Agreements (PTIAs) & Free Trade Agreements (FTAs)

Besides the plethora of BITs dominating the landscape there are several regional treaties on foreign investment. Chapter 11 of the North American Free Trade Agreement (NAFTA) contains the strongest liberalizing provisions drawing their source in the model BIT of the United States. A framework for the free movement of investments within the NAFTA region (the US, Canada and Mexico) is created. Increase in investment opportunities is aimed through the application of the NT and MFN principle and high

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[71] *supra* at 65 p. 9

[72] *supra* at 1, p.159

[73] *ibid*, p.89

protection standards such as reduction of performance requirements like export goals or local content measures. It provides a strong investor-state dispute resolution mechanism, giving the investor a unilateral right to invoke arbitration against the host state. A final award would be binding between the parties and could be enforced.[74]

The ASEAN Treaty on Protection and Promotion of foreign investment also contains strong provisions, but restricting protection to approved investments provides sufficient room for regulatory control over the entry of FDI. The later ASEAN framework agreement on investment however permits freedom of movement within the ASEAN area to any entity or person who falls within the definition of the specially created concept of the ASEAN investor[75]. The regional treaties, such as the MERCOSUR Agreement, similarly create regional agreements with protection granted in varying degrees to the foreign investment of the participating regional states.

Many PTIAs have included rules on FDI entry and there is a recent push for inclusion of liberalization rules in the form of pre-establishment and MFN commitments. The older PTIAs either established a framework for cooperation on investment matters or moved towards liberalization through a gradual process taking place after their entry into force (e.g. ECOWAS or the Central American Common Market) or by changing – over time – previously restrictive regulations (e.g. the Andean Community).[76]

The disagreement between aggressive liberalization sought through incorporation of international minimum standards and retention of sovereign economic control is brought out the best in FTAs currently being negotiated globally. The investment chapters in FTAs seek to accord national treatment and most-favored nation treatment to foreign investors entitling them to equality of treatment in "like circumstances". This may create unforeseen problems as is visible in the current financial crisis wherein a country's ability to carry out stimulus measures and carry out bailouts can be challenged on the ground of denial to a foreign investor of "fair and equitable treatment." Such a situation is not without precedence as a foreign firm complained that the Czech Republic violated its

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[74] *supra* at 12; p. 14

[75] *supra* at 1 p.89+321`

[76] *supra* at 66 p. 62

rights by excluding a small bank in which it had invested from a bailout program made available to larger "too big to fail" Czech banks.[77]

There is a trend of inclusion of broad definition of investment visible in the US FTAs, the EU FTAs and Japan's Economic Partnership Arrangements (EPAs). Portfolio investment is included in definition of FDI in the EU FTAs with developing countries such as EU-CARIFORUM and EU-South Africa. This curbs host country controls over capital flows. There are apprehensions that the EU may obtain similar non-discrimination rules in its FTAs with ASEAN and India as incorporated in its FTA with CARIFORUM. Consequently, ASEAN and India will have to provide EU investors similar treatment as agreed in more flexible bilateral agreements with third country parties made in the future. "Thus, if both India and ASEAN agree to EU-CARIFORUM type MFN treatment to EU investors and if India and ASEAN include more flexible rules on investment in the ASEAN-India investment/services[78] chapters in the name of South-South cooperation, all these countries will need to treat EU investors in a similar manner."[79] This is a clear case of restricting the economic maneuverability of a sovereign state and is thereby resented.

3.3 Double Tax Avoidance Treaties (DTATs)

DTATS are a special category of IIAs addressing the concerns of foreign investors regarding being taxed for the same income by both the home country and the host country. All international tax considerations raise the issue of allocation of revenue generated from taxes imposed among the countries. DTATs deal with this issue by setting out detailed allocation rules for different categories of income.[80] Tax definitions are standardized transfer pricing limited, tax evasion combated (notably through the exchange of information), risk of treaty shopping reduced , non-discrimination rules

[77] S. Francis, (2010), "Foreign Direct Investment Concepts: Implications for Investment Negotiations," *Economic and Political Weekly*, Vol. 45, No. 22, p. 36.

[78] R. Sen, Rahul, *et al* (2004), "ASEAN-India Economic Relations: Current Status and Future Prospects," *Economic and Political Weekly*, Vol. 39, No. 29, p. 3306.

[79] *supra* at 77, p. 37.

[80] *supra* at 66, p. 19

provided, and specific conflict resolution mechanisms and arbitration procedures established for resolution of tax disputes in the DTATs.

Furthermore, while unilateral measures often eliminate double taxation on their own, DTATs are still useful in "borderline" situations, such as in cases in which the source of income is disputed. DTTs are important as they provide greater legal certainty to foreign investors with respect to the tax treatment of their cross-border activities in both the host and the home country.[81]

Capital-exporting countries, foreign investors and capital-importing countries all benefit from DTATs. The expansion of foreign enterprises is made easier due to the relief of potential double taxation and mitigation of risks like improper tax evasion and fraud, which is beneficial to home countries.

Foreign investors as DTATs generally include more comprehensive tax protections for investors than available under the domestic tax rules of either host or home countries, which also are prone to sudden changes. Furthermore, DTATs often have preferential rates[82] assured to contracting state firms as regards the maximum rates of taxation that can be imposed by a host country. Capital-importing countries benefit because they use tax protection and tax sparing provisions (whereby residence countries would grant double tax relief for the tax that would have been due in the host country were it not for a tax incentive offered to the investor) in DTATs as incentives for investors. DTATs also include an exchange-of-information provision that allows the developing country to obtain information exchanged from capital-exporting countries, which can help find and tax capital stashed by their rich residents overseas.[83]

The developing countries have used DTATs to attract more foreign investment and in the process reduced their tax revenue as source-based taxation of the host country is shifted to the home country. Most developing countries are net capital importers. As one author notes, though "the contraction of taxing jurisdiction is technically reciprocal in the treaty document, the one-sided flow of capital toward LDC [less-developed country] as source-

[81] *supra* at 65, p. 17

[82] N. Karve, (2007), *Regulatory and Tax Aspects of FDI in India*, KPMG, Dublin.p.24

[83] *supra* at 65 p. 17

country ensures that only that country experiences a true contraction of its taxing jurisdiction."[84] The reduced tax revenues of developing countries can only be offset by higher FDI flows to prove the worth of DTATs. In absence of the proof to the validate generation of greater FDI flows, developing countries need to decide whether it is better for them to preserve their tax jurisdiction over foreign investors in order to maximize their tax revenue[85], or to agree to relieve source-country taxation in order hopefully to attract more FDI.

4. CONCLUSION

The international law on foreign investment combines the above mentioned elements and standards set out and repeated in various documents and instruments, both bilateral and multilateral. The competence at the entry stage of each individual international law regime is varied. MIGA allows for sovereign control over entry by insuring only pre-approved projects by the state and limiting its coverage to applications made in the early stages of the foreign investment. ICSID has only a limited role to play at the entry stage. Its relevance is limited to the choice it provides as a forum for the investors at the point of entry itself. If chosen the investor feels secure as the pro-investor leanings of the World Bank Group are bound to influence the decision making at ICSID. The role of the GATS for FDI entry is quite explicit as no deviation is allowed from the commitments made in the schedules covering foreign investment caps in the services sector. TRIPS, on the other hand only plays a peripheral role at entry. Harmonisation with TRIPS standards may be seen as an incentive for the investor to invest in a particular country, but its significance is restricted to the feasibility studies or due diligence exercise that a foreign investor undertakes. The TRIMS agreement has already phased out local content requirements but whether export performance requirements used by states in consonance with incentives can be challenged prior to or at point of entry itself is not clear as no discrimination can be proved in absence of pre-entry rights. The movement in recent

[84] *ibid*, p. 18

[85] A. Sumner, (2005), "Is Foreign Direct Investment Good for the Poor? A Review and Stocktake," *Development in Practice*, Vol. 15, No. 3/4, pp. 280. -

BITs by capital exporting states for pre-entry rights is in recognition of the fact that the multilateral frameworks are not adequately espousing this cause and the bilateral fora can be used to ensure changes. BITs and other IIAs lay out the general standards of treatment. There immediate use at the entry stage will be relevant in relation to the other agreements signed as part of an investment project such as production sharing arrangements, etc. The standards set out by them are general in nature and not project specific. The DTATs however, are a class apart, as their existence enables the investors to make an informed choice regarding incentives offered and concessions made in the domestic tax regimes which increase profitability of the venture. As the successful DTATs prove, international standards can only become effective if they bring some changes in the domestic regulatory framework of the member countries. This entails a process of harmonization and to understand this harmonization and the consequent loss of regulatory control it is imperative that the domestic regime of a member country is examined in this study. The next chapter proceeds to such an examination of the domestic regulatory regime of India.

CHAPTER 3

DOMESTIC REGULATION OF FDI: INDIAN LEGAL FRAMEWORK

1. INTRODUCTION

After examining the international legal framework regulating and promoting FDI, especially to developing countries, it is pertinent to deal with the domestic regulatory regime in one of the countries to have a clearer understanding. The country chosen is India, an emerging economic power globally from the developing world. For influx of FDI, a good investment climate is a pre-requisite. India is a major recipient of FDI in the developing world and it is important to understand the reasons for fostering a good investment climate. A good investment climate is dependent on three local determinants: institutional, infrastructural and legal aspects of a host country. The institutional determinant analyses institutions which foster political stability[1] and encourage sound economic growth. Infrastructure refers to the human resources and physical facilities available in a certain country. The third determinant concerns the administrative and regulatory framework of a host state which deals with foreign investors, and the settlement of investment disputes[2]. In this chapter we take a look at the third aspect, the regulatory framework. It cannot be categorized into water tight compartments as the institutions and legal rules and instruments have a bearing at all the stages. Before outlining the existing regulatory framework, a brief evolutionary history is traced.

1.1 Brief History

Traditionally Indian businesses were not well organized, consisting of small businesses catering to limited domestic markets. Most of the big sectors like telecom, aviation,

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[1] Arguments are available for both autocratic and democratic forms of governance favouring the flow of FDI, however empirical studies suggest that democratic regimes are far more effective in establishing a rights based regime for protection of investors rights and property. Q. Li, and A. Resnick (2003), "Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries," *International Organization*, Vol. 57, No. 1, p. 178.

[2] D.D. Bradlow, and A. Escher (1999), *Legal Aspects of Foreign Direct Investment*, Kluwer Law International, London; p. 27

refining of petroleum and petroleum products were reserved for Public Sector Units(PSUs) who worked as monopolies, drawing their power and funds from the government. In order to give them time to gear up for forthcoming competition, the government provided regulations inter-alia for the screening and registration of foreign investments.; the prohibition or restriction of foreign participation in specified sectors; the restriction of foreign capital to minority holding in certain sectors.[3] Also in order to extract maximum benefit from any foreign investment that did enter government provided regulations for the control of takeovers; specific regulation of technology agreements; the prohibition of restrictive business practices and performance requirements for subsidiaries of transnational corporations, such requirements relating to exports and integration with the domestic economy.

Globally the era for self-sufficiency industrial model came to a close in the late 1980s-1990s. The era of liberalization saw heavy competition for investment in the early 1990s which resulted in a race to the bottom[4]. Controls were relaxed and incentives given to attract foreign investment. India went through its own monetary crisis and in the year 1991, under pressure to improve its grave Balance of Payments (BoP) situation[5], the economic reforms were initiated[6]. Gradually, legal reforms were initiated to lower or remove restrictions on burdensome screening procedures on the admission of foreign investors, extensive performance requirements for foreign owned enterprises and limitations on repatriation of profits.[7] Also tax and other incentives have been used to entice foreign investors. The essential ingredients for the growth of any economy include

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[3]P. Suri,& Associates (2006), *FDI Notifications-An Anthology*, LexisNexis Butterworths, New Delhi, p.33; and M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.106

[4] D.H. Brooks, *et al* (2003), *Foreign Direct Investment in Developing Asia: Trends, Effects, and Likely Issues for the Forthcoming WTO Negotiations*, Economics and Research Department Working Paper, Series No. 38, Asian Development Bank, Manila, p. 14;and M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.107

[5]R.R. Gandhi, (2002), "FDI and Indian Experience," Report submitted to the *OECD Emerging Asia Investment Policy Dialogue Exploratory Meeting*, Shanghai, December 2002, p. 3

[6] K. Singh, "FDI in India: A critical Analysis of FDI from 1991 -2005", Research Internship Programme, 2005, p. 5

[7] *supra,*, at 2; p.6

availability of land, labour, good infrastructure, capital and entrepreneurial ability.[8] Realizing the shortage of capital[9], the Indian government brought about reforms in the fields of investment, trade, financial sectors, exchange controls, financing, competition and intellectual property laws. The function of investment authorities has been changed from a monitoring and surveillance agency to an investment promotion agency.[10]

These reforms however, have not completely eroded sovereign economic control over FDI. They contain devices to screen foreign investment and permit only that FDI which is considered desirable. Sectoral caps, criteria laid down for eligible investors and investments, sector specific eligibilities function as entry and potential barriers for companies. However, to fully understand the regulatory framework a look at the corporate, tax, labour, intellectual property, environment, antitrust and administrative law to name only the most important related areas is also important[11]. The current regulatory framework is now elucidated and comparisons have been drawn to past standards wherever deemed essential.

2. INSTITUTIONAL STRUCTURE AND ADMINISTRATIVE AGENCIES GOVERNING FDI

There are various institutions and administrative agencies which govern the entry, screening, approval and monitoring of FDI into the country. The various ministries of the Government of India (GoI) are involved in this process. Though the Ministry of Finance formulates the broad policies with respect to FDI, the industries and sectors into which specific FDI flows are governed by the Ministry of Commerce and Industry.[12] The

[8] S.D. Franck. (2007), "Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law," *Global Business and Development Law Journal*, Vol. 19, p. 349.; P. Suri,& Associates (2006), *FDI Notifications-An Anthology*, LexisNexis Butterworths, New Delhi, p.19.

[9] M. Sweeney, (2010). "Foreign Direct Investment in India and China: The Creation of a Balance Regime in A Globalised Economy," *Cornell International Law Journal*, Vol. 43, p. 210.

[10] *supra,*, at 2; p. 6

[11] *ibid*; p. 3

[12] P. Suri,& Associates (2006), *FDI Notifications-An Anthology*, LexisNexis Butterworths, New Delhi, p.29

institutions and agencies that play a noteworthy role are the RBI, FIPB, FIPC, DIPP and SIA.

2.1Reserve Bank Of India (RBI)

India's federal bank , the Reserve Bank of India (RBI) was setup in April, 1935 and is governed by the Reserve Bank of India Act, 1934 (RBI Act). The RBI is tasked with all the important functions of a central bank under the said Act. RBI's primary task is to regulate both monetary and non-monetary functions which include promotion of an efficient financial system.[13] This function is mainly supervisory in character, which is important for formulating and implementing policies to boost India's economic growth, besides keeping a check on the financial markets to control fraudulent activities.

Furthermore, the Foreign Exchange Management Act of 1999 (FEMA, 1999) entrusts RBI as the essential approval authority over FDI inflows. "By allowing the RBI to restrict and to regulate the transfer or issue of any security by a person resident outside India, FEMA Section6 (3)(b) authorizes the RBI to set guidelines to determine if and when a person resident outside India may purchase shares of an Indian company".[14] The RBI therefore issues regulations from time to time which lay down eligibilities, procedural and reporting requirements, approval procedures, etc for inward FDI. RBI permission is required in many cases requiring transfer of capital instruments from a resident to a non resident by wale of sale or gift based on certain guidelines.[15]

2.2 Foreign Investment Promotion Board (FIPB)

The FIPB under the Ministry of Industry is the nodal, single window agency for all matters relating to FDI as well as promoting investment into the country.[16] Its objective is to promote FDI into India by[17]

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[13] *supra,*, at 12, p.119

[14] R. Sachdev, (2006), "Comparing the Legal Foundations of FDI in India and China: Law and the Rule of Law in the Indian FDI Context," *Columbia Business Law Review*, Vol. 167, p. 187.

[15] Department of Industrial Policy and Promotion (DIPP) (2010), *Consolidated FDI Policy*, Circular 1, Ministry of Commerce and Industry, Government of India, New Delhi, p. 20

[16] A. Agarwal, (2009). "Inbound Investments into India: Structuring the Deal," *Journal of International Banking Law and Regulation*, Vol. 24, No. 7, p. 375

i) Undertaking investment promotion activities in India and abroad,

ii) Facilitating investment in the country by international companies, non-resident Indians and other foreign investors,

iii) Purposeful negotiations/discussions with potential investors

iv) Early clearance of proposal submitted to it, and

v) Review of policy and putting in place appropriate institutional arrangements, transparent rules and procedures and guidelines for investment promotion and approvals.

The FIPB plays a proactive role in promoting and attracting FDI into the country and further facilitates expeditious clearance to the proposals submitted to it. In order to remove bottlenecks it has also decided to take on the additional responsibility of monitoring implementation of mega projects[18]. The FIPB is composed of the Secretaries of the Department of Economic Affairs (the Chair), the Department of Industrial Policy and Promotion, the Department of Commerce, the Division of Economic Relations within the Ministry of External Affairs; and the Ministry of Overseas Indian Affairs.[19]

2.3 Foreign Investment Promotion Council (FIPC[20])

The GoI has also constituted a Foreign Investment Promotion Council (FIPC) in the Ministry of Commerce and Industry with the specific aim of FDI promotion and enlists the help of professionals from industry and commerce. The setup enables to have a more target oriented approach towards FDI promotion as the Council identifies specific sectors/projects within the country that require FDI and target specific regions/countries of the world for its mobilization.

2.4 Department of Industrial Policy and Promotion (DIPP)

The DIPP under the Ministry of Commerce and Industry Policy issues Press Notes/Press Releases/Clarifications reflecting the current policy framework on FDI[21]. As of April 1,

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[17] S.K. Chaturvedi,(2007), *Foreign Investment Law and its Impact on Labour*, Deep and Deep Publications, New Delhi, p.45

[18] *supra,*, at 17, p.45

[19] *supra,* at 15, p. 34

[20] *supra,* at 17, p.47

2010 the Consolidated FDI Policy issued by the DIPP has come into effect which consolidates and subsumes all Press Notes/Press Releases/Classifications issued earlier by the DIPP.[22] Besides notifying the policy guidelines, the DIPP also operates Country Focus Windows for countries with sizeable investment interest in India where facilitation and assistance services are provided by a senior officer of the Department. At present, the focus window covers countries such as USA, Germany, France, Switzerland, Australia, Japan and Korea.[23]

2.5 Secretariat For Industrial Assistance (SIA)

SIA has been established by the GoI in the DIPP under the Ministry of Commerce and Industry to provide a single window for entrepreneurial assistance, investor facilitation and receiving and processing all applications which require Government Approval.[24] The SIA conveys government decisions on application filed, assists entrepreneurs and investors in setting up projects including liaisons with other organizations and state governments besides monitoring the implementation of such projects[25]. It also collects and notifies the government policy relating to investment and technology and provides complete information specific to sectors and State Governments. Its two monthly newsletters the 'SIA Newsletter" and the "SI Statistics" and its informative website disseminate information and data useful for prospective investors.[26] It was setup as an investor friendly agency, providing information and assistance to Indian and foreign companies in setting up industry and making investments. It assistance can be enlisted even for finding joint venture partners.

The Entrepreneurial Assistance Unit(EAU) of the SIA provides assistance and attends enquiries of entrepreneurs on various subjects concerning investment decisions. It furnishes clarifications and arranges meetings with nodal officers in concerned

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21 *supra*, at 16, p. 375

22 *supra*, at 15, p. 2

23 *supra*, at 17, p.50

24 *ibid*, p.47 +98

25 *supra*, at 6; p. 18;and *supra*, at 17, p.47

26 *supra*, at 17, p.47

Ministries/Organisations. The unit also provides information regarding the current status of applications filed for various industrial approvals.[27]

A greater clarity as regards the functioning of the above mentioned institutions and agencies can be had by studying them in consonance with the regulatory framework they lay down.

3. SUBSTANTIVE REGULATORY FRAMEWORK GOVERNING FDI

India now has moved towards a single code for foreign investment but it is yet not comprehensive and enlists the help of other applicable laws in governing different aspects of FDI, including investments, industries, securities and corporations. The FEMA 1999 and regulations there under, the Industries(Development and Regulation) Act of 1951, the Companies Act, 1956 and the Takeover Code of the Stock Exchange Board of India(SEBI) all directly or indirectly regulate important aspects of FDI inflows[28]. The Press Circulars issued by the DIPP from time to time form an integral part of the FDI policy framework enumerating guidelines for foreign investors and listing other applicable relevant laws in the matter.[29] They have all been consolidated into one FDI policy document as on April, 2010 and a revised edition has become effective from April 1, 2011. This Consolidated Policy is set for review every six months and a new one becomes effective the first of April of the next year. The substantive provisions relevant to the purposes of the study in both the Consolidated Policy 2010 and its revised edition of 2011 are the same and the main differences come out in the sectoral caps and revisions made therein. While the study uses the substantive provisions from the Consolidated Policy, 2010 as it marks a watershed in India's regulatory framework, the sectoral caps have been updated from the revised figures available in the 2011 edition.

There are two routes for FDI entry in India, viz, Automatic and Approval route. Under the automatic route FDI maybe directly made in the Indian entity, by the foreign investor

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[27] *ibid*, p.48

[28] *supra*, at 14, p. 187.

[29] United States Government Accountability Office (USGAO) (2008), *Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries*, Report to the Committee on Banking, Housing, and Urban Affairs, US Senate, p. 71

without any permission from the government. Under the approval or government route FDI maybe only made after prior permission from the government has been obtained. The government has specified the sectors for which prior approval is required. This may either be in relation to specific sectoral caps or in cases where FDI exceeds beyond a certain percentage. Generally the rule is that FDI falls under the automatic unless provided otherwise by the government.[30] The sectoral caps specify the percentage of a company that can be owned by a foreign investor in individual sectors. Foreign ownership caps are usually set at one of the following levels: zero percent (prohibited), 26 percent (allowing the foreign investor a sufficient share to block major decisions), 49 percent (maintaining that a majority of shares are held by Indian nationals), 74 percent (maintaining that Indian nationals hold a sufficient share to block major decisions), or 100 percent (completely open). The limits on foreign ownership vary from sector to sector and are subject to continuous review based on domestic and economic concerns, and international pressure from interested investors.

3.1 FEMA, 1999 AND CONSOLIDATED FDI POLICY, 2010 (POLICY,2010)

The GoI introduced the Foreign Exchange Management Bill 1999 in the Parliament to repeal the Foreign Exchange Regulation Act, 1973. The Government notified the Foreign Exchange Management Act (FEMA) w.e.f. June 1, 2000.[31]The new legislation departs from the previous act by containing provisions relating to Current Account Transactions, Capital Account Transactions and determination of residential status on the basis of physical stay in the country. FEMA was passed in the time when the liberalization movement was gaining momentum in India and it enabled a movement from a control regime to a flexible management approach and regulation through periodic guidelines issued by the RBI and the GoI. FEMA broadly regulates the foreign exchange market and provides the GoI the legal authority to restrict foreign investment.

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[30] *supra*, at 12, p.28

[31] S.K. Dixit, and P. Grover (2003), *Developments in Corporate Laws*, Presented at the 31 Convention of The Institute of Company Secretaries of India, p. 7

The Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000, passed by the RBI under powers granted under FEMA, 1999[32] primarily governs Foreign Direct Investment. This statute notified as FEMA 20/200-RB dated 3.5.2000 dealt, inter alia, with the issue of shares under automatic approval by an Indian Company to a non resident under Foreign Direct Investment (FDI) Scheme. Schedule-I of the above stated regulation contained the FDI Scheme. Schedule 1 has two annexure; namely Annexure A and B. Annexure-A contains two parts: Part (A) listing activities not falling under Automatic route and Part (B) listing activities or items in which FDI is prohibited. Annexure-B of the Schedule lists the activities falling under the Automatic route along with their ownership caps.

A company engaged in any activity specified in Annexure-A; proposing to issue shares beyond the sectoral limits listed in Annexure-B; and which is not otherwise eligible to issue shares to a person resident outside India can do the same after securing prior approval of the GoI through the SIA)/ (FIPB).

The FEMA Regulations allow the channeling of all FDI (up to 100 % equity participation) through the automatic route except in four instances[33]: (1) investments requiring an industrial license; (2) new investments where the foreign investor has a previously existing venture in the same field; (3) acquisition of shares in an existing Indian company; (4) investments falling beyond sectoral caps or in prohibited sector. In these instances, government (FIPB) approval is required before RBI approval, the final and necessary approval can be given[34]. Chapter 5 of Policy, 2010 takes the place of Annexure A and B of the FEMA Regulations specifying sectoral FDI caps prevalent in individual sectors along with the requirement of the automatic and approval route. Among the changes made, not all sectors requiring an industrial license are channeled under the approval route anymore. Investments that receive FIPB approval are granted the general permission of the RBI without a separate approval process.[35]

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[32] *supra,* at 14, p. 188.

[33] *supra,* at 29

[34] *supra,* at 14, p. 201

"FEMA also covers all issues related to foreign exchange management such as issue/valuation/transfer of shares, divestment of original investment, foreign technology collaboration payments, repatriation of profits, acquisition and disposal of immovable property by foreigners."[36] As FEMA did not include implementing regulations Indian foreign investment policy was primarily established through a series of public notices or Press Notes, approved by the cabinet and released by the DIPP, issued separately for each sector. DIPP has also published a comprehensive summary of individual Press Notes.[37]

However with the coming into effect of Policy 2010 on 1st April, 2010, the earlier press notes of the Central Government stand rescinded, while the various regulations issued by the RBI still continue to operate. It states in its objective

> "This circular consolidates into one document all the prior policies/ regulations on FDI which are contained in FEMA, 1999, RBI Regulations under FEMA, 1999 and Press Notes/Press Releases/Clarifications issued by DIPP and reflects the current 'policy framework' on FDI. It is clarified that this is a consolidation/compilation and comprehensive listing of most matters on FDI and is not intended to make changes in the extant regulations."

The new policy reflects the current framework, modifies the sectoral caps in many sectors, opens up new sectors to FDI and increases the number of sectors under the automatic route. These caps have been revised under the new Consolidated FDI Policy Document, which became effective from April 1, 2011. There are still some sectors and circumstances where prior FIPB and RBI approval is required before making an investment and this route will be studied in the next section.

3.1.1 Approval/Government Route

There are certain areas of investment where prior approval of the government is required before FDI may be infused. These areas have been outlined under FEMA Regulations and updated under Policy 2010. A more detailed view is as follows.

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[35] *supra,* at 29

[36] A. Virmani, (2004), *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, New Delhi, p 26

[37] *supra,* at 29

1.) INVESTMENTS THAT REQUIRE AN INDUSTRIAL LICENSE[38]

Industrial licenses are regulated by the Industries(Development and Regulation) Act, 1951(IDRA).[39] Section 29 B of IDRA provides the Central Government with power of exemptions which it utilized to shorten the list of sectors either totally barred or restricted for FDI, including the industries reserved for the public sector; industries requiring compulsory industrial licensing; and items reserved for exclusive manufacture in the small scale sector.[40] The Policy2010 has almost done away with the approval route for industrial licenses, except in very limited circumstances.

a) Distillation and brewing of alcoholic drinks earlier under the approval route requiring an industrial license has now been put under the automatic route with 100 percent FDI allowed;
b) Cigars and cigarettes of tobacco and manufactured tobacco substitutes is still under the approval route(100 percent FDI allowed) subject to obtaining industrial licenses;
c) Electronic aerospace and defense equipment , all types, FDI is allowed upto 26 percent under the approval route subject to industrial license and other limiting conditions ;
d) Industrial explosives, including detonating fuses, safety fuses, gun powder, nitrocellulose and matches also removed from approval route and put under automatic route(100 percent FDI) subject to industrial license;
e) Manufacture of hazardous chemicals such as Hydrocyanic acid and its derivatives; Phosgene and its derivatives Isocynates and di-isocyanates of hydrocarbon, not elsewhere specified(example Methyl ISocyanate) have been now placed under the automatic route(100 percent FDI allowed) subject to obtaining an industrial license.

Earlier an approval was required to be obtained if a non-SSI (Small Scale Industry) unit proposed to manufacture items reserved for the small scale sector. For investment in the

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[38] *supra,* at 12, p.30, 31

[39] *supra,* at 14, p. 188

[40] *ibid,* p. 189

small scale industries, not more than 24 percent of the total equity could be held by any industrial undertaking, either foreign or domestic. The SSI status was lost upon exceeding 24 % equity[41]. Under the Policy, 2010 any industrial undertaking which is not a Micro or Small Scale Enterprise, but manufactures items reserved for the MSE sector would require Government approval where foreign investment is more than 24% in the equity capital. Such an undertaking would also require an Industrial License under the Industries (Development & Regulation) Act 1951, for such manufacture. The issue of Industrial License is subject to a few general conditions and the specific condition that the Industrial Undertaking shall undertake to export a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of three years.[42] Small Scale Units must be registered with the Directorate of Industries/District Industries centre of the State government. Such units may manufacture any item including those requiring an industrial license but excluding the prohibited ones.

Under the IDRA, Industrial Licenses are also required for proposals which attract locational restrictions. A project within 25 kms of any city with a population of one million or more as of 1991 census requires an industrial license. Exceptions are for areas designated as an "Industrial Area" before the 25th July, 1991 and for specific industries such as Electronics, Computer Software and Printing and any other industry which may be notified as non polluting industry in the future.[43]

2.) INVESTMENT WHERE THE FOREIGN COLLABORATOR HAS AN EXISITNG FINANCIAL/TECHNICAL COLLABORATION IN INDIA IN THE SAME FIELD

As per press Note 10 dated April 1999, 'same field' has been defined as the activity classified under the four digit NIC, 1987 Code[44] and the Policy, 2010 follows the same classification. NIC code classifies all the industrial and service activities, and places them

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[41] R.K. Luthra, . (2011), *Foreign Direct Investment in India: Evolution and the Legal Regime*, s. 13

[42] *supra*, at 15, p. 38

[43] *supra*, at 41, s. 12

[44] *supra*, at 17, p.36

under various digits. The broad classification of the activities is generally allotted three digit codes and all the activities under these heads fall under Allied Activities. These activities are further divided into sub-categories which are allotted four digit and fall under the category of same field.[45]

If the foreign investor has an existing joint venture or financial/technical collaboration in India and wants to invest in another venture in India which falls under the same field of activity, then in such a case, it has to obtain prior approval from the government by submitting an application to the FIPB as per the provisions of the Press Note 1(2005 Series) dated 12 January 2005. The onus of proof assuring that the new venture is not detrimental to the interests of the existing JV or technology/trade mark agreement vests equally on the existing Indian partner and the foreign collaborator.[46]

Exceptions to prior approval for activity under the same field are[47]:

1) Investment is to be made by a venture capital fund registered with the Securities and Exchange Board of India(SEBI)
2) The existing JV investment by either parties(India/Foreign) is less than 3 percent
3) The existing JV is defunct or sick.

Further, the future joint venture agreements may embody a 'conflict of interest clause' in order to safeguard the interests of the JV partners in the event one of the partners wants to set up another JV or a WOS in the 'same' field of economic activity. This has become an "expected" requirement under the new Policy 2010.[48]

Moreover, investment proposals in the information technology sector, investments by multinational financial institutions such as Asian Development Bank(ADB), International Finance Corporation(IFC), Commonwealth Finance Corporation (CDC), Deutsche Entwicklungs Gescelschaft (DEG) etc. and in the mining sector of the same area have been expressly exempted from the applicability of Press Note 1 dated 12 January 2005

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[45] *supra,* at 12, p.34

[46] J. Bronfman, J, *et al.*(2006), "International Investment", *International Law,* Vol.40, No. 2, p. 376.

[47] *supra,* at 12, p.34

[48] *supra,* at 15, p. 28

vide Press Note 3 (2005 Series) dated 15 March 2005 and the same has been continued in the Policy 2010.[49]

3.) APPLICATION FOR ACQUISITION OF SHARES IN AN EXISITNG INDIAN COMPANY

Government approval/FIPB approval is required in all cases where:

> "(i) The control of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition etc. or
>
> (ii)The ownership of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition, etc."[50]

Acquisitions are governed by the Stock Exchange Board of India(Substantial Acquisition of Shares and Takeovers) Regulations, 1997(SEBI). Some of the notable provisions concerning acquisitions are (1) a public offer is essential for acquisitions of more than specified equity stake; (2) the formula for pricing of shares would be either average of 26 weeks or 2 weeks whichever is higher and (3) takeover of the management is prohibited before the completion of takeover code formalities.[51] The acquisition must meet the provisions of the Companies Act, 1956 as equity shares are involved and also the provisions of the listing agreements with the Indian stock exchange if securities are listed[52]. The sectoral caps promulgated under Policy 2010 still apply. Also applicable would be the provisions of the Competition Act, 2002 discussed later in the chapter.

Section 3.5.4 of the Policy 2010 states that

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[49] *supra,* at 15, p. 28

[50] *ibid*

[51] *supra,* at 41, s. 18

[52] *supra,* at 14, p. 189.

"Mergers/demergers/ amalgamations of companies in India are usually governed by an order issued by a competent Court on the basis of the Scheme submitted by the companies undergoing merger/demerger/amalgamation[53]. Once the scheme of merger or demerger or amalgamation of two or more Indian companies has been approved by a Court in India, the transferee company or new company is allowed to issue shares to the shareholders of the transferor company resident outside India, subject to the conditions that:

(i) the percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and

(ii) the transferor company or the transferee or the new company is not engaged in activities which are prohibited under the FDI policy."[54]

4.) INVESTMENT FALLING OUTSIDE SECTORAL CAPS OR IN SECTORS WHERE FDI IS PROHIBITED

A comparison is drawn between the earlier FDI sectoral caps and the latest restrictions under Chapter 5 of the Revised Consolidated Policy Document, effective from April 1, 2011[55]. Most of the manufacturing sectors have been for many years on the 100 per cent automatic route. Foreign equity is limited in production of defense equipment (26 per cent). In oil marketing it is 100 percent under automatic route (earlier 74 per cent) and government owned petroleum refineries it is 49 percent under approval route (earlier 26 per cent). Most of the mining sectors are similarly on the 100 per cent automatic route, with foreign equity limits now on atomic minerals being 100 percent under approval route (earlier 74 per cent), coal & lignite 100 percent under automatic route (earlier 74 per cent), exploration for oil 100 percent automatic (earlier 51 per cent to 74 per cent) and diamonds and precious stones 100 percent under automatic route (earlier 74 per cent). 100 per cent equity is also allowed in non-crop agro-allied sectors and crop agriculture under controlled conditions (e.g. hot houses).

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[53] S. Chakravarthy, (2004), "India's New Competition Act 2002: A Work still in Progress," *Business Law International*, Vol. 5, No. 2, p. 262

[54] *supra*, at 15, p. 23

[55] Department of Industrial Policy and Promotion (DIPP) (2011), *Consolidated FDI Policy*, Ministry of Commerce and Industry, Government of India, New Delhi.

In the case of infrastructure services, also the dichotomy has nearly faded. While highways and roads, ports, inland waterways and transport, and urban infrastructure and courier services were already on the 100 per cent automatic route, caps in telecom have been raised to 74 percent under approval route beyond 49 percent (earlier cap 49 per cent), airports have been raised to 100 percent(earlier 74 percent) under automatic route in case of Greenfield ventures and existing projects (government route beyond 74 per cent), civil aviation has been raised to 49 percent under automatic route in scheduled air transport services (40 per cent) and oil and gas pipelines 100 percent on automatic route (51 per cent) have foreign equity limits. India also has a clear policy of FDI in services. There is 100 per cent automatic entry into many services such as construction, townships/resorts, hotels, tourism, films, IT/ISP/ email/voice mail, business services& consultancy, renting and leasing, Venture Capital Funds/Companies (VCFs/VCCs), medical/health, education, advertising and wholesale trade. The financial intermediation sector has sector caps with banking at 74 percent including investments by FIIs(earlier 49 per cent) and insurance at 26 per cent under automatic route.[56]The sectoral caps specify the equity participation allowed. However, ownership caps are independent of government approval requirements. For example, a sector open to 100 percent foreign ownership may still require government approval as in the case of tea plantation, while a sector capped at 49 percent maybe open through the automatic route[57].

3.2 Modes of Entry of FDI

The next important step in the regulatory framework is the mode of entry chosen by a foreign investor and the regulatory framework dealing with it. Different modes of entry can be chosen by an investor based on his convenience, purpose and incentives offered by the host. A foreign company can commence business operations in India by incorporating a company under the Companies Act, 1956 and based on the share holding pattern it may either be classified as a wholly owned subsidiary (holding all shares) or a

[56] A. Virmani, (2004), *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, New Delhi, p. 14

[57] *supra*, at 29, p. 73

Joint Venture company (holding some shares). A Foreign investor can also establish a Project/Site Office, a Liaison Office or a Branch Office by under The Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000[58]. Also, the investor has the choice to avail incentives under the special schemes of the government such as the Special Economic Zones(SEZs), Export Oriented Units(EOUs), etc.

3.2.1.Incorporated Entities

The incorporation of companies in India is governed by the Companies Act, 1956 and the preferred types are private and public limited companies.[59] The applicable provisions under the Companies Act, 1956 in relation to establishment of a place in India by foreign companies and filing requirements that such companies have to comply with the RoC are given in Part XI of the Act comprising Sections 590-602.

The distinction between private and public companies is based on the extent of the applicability of the various provisions of the Companies Act, 1956 and the exemptions and privileges available to a private company. The characteristics of a private company are given in Section 3 of the Companies Act, 1956. A general overview[60] is as follows:

(i) Restriction on the shareholders' right to transfer shares.

(ii) The limit on number of shareholders is fifty.

(iii)No invitation can be made to the public for the subscription of any shares or debentures.

(iv)A minimum paid up capital of Rupees One Hundred Thousand is essential.

(v) Business can be commenced by a private company immediately on incorporation.

(vi)A minimum of two members and two directors is required.

A public company is defined as a company which is not a private company and its subsidiaries are also public companies. For foreign investors it is important to note that the operation of the subsidiary in the form of a public company or a private company is

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58 *supra,* at 12, p.127

59 *ibid,* p.20

60 *ibid.*

dependent upon the status of the parent under Indian law. A parent recognized as a public company under Indian law cannot have its subsidiary in the form of a private company. A minimum paid up capital of Rupees Five Hundred Thousand; minimum seven shareholders-members and at least three directors; and obtaining of a certificate of commencement of business is essential for a public company[61].

As regards the name of a company, a person (Promoter) desiring to incorporate must prefer an application to Registrar of Companies (RoC) seeking disclosure of availability of company names. Three names in order of preference may be submitted in such application. The availability of the proposed company name is subject to the provisions of Emblems and Names (Prevention of improper Use) Act, 1956 and circulars and guiding instructions of Department of Company Affairs, Government of India. The usage of certain words influences the minimum authorized capital requirements such as the word 'India' as part of the company name (not as the initial word), requires Rupees Five Hundred Thousand, even if the company is to be incorporated as a private company. The subsidiaries of foreign companies can use the name of their parent company in its totality with the addition of the word "India" to its name as per the applicable instructions. To avoid time lags and procedural hassles, the parent company generally provides a No Objection through a board resolution in favor of some Indian persons allowing them to use its name and to subscribe to its shares. Subsequently, such shares are transferred in the name of the parent company and this process saves time on consularization of every document required to be filed during the incorporation process.[62]

After, the proposed company name is made available for incorporating a company, the Memorandum and Articles of Association of the proposed company are drawn up and an application for registration is submitted to the Registrar of Companies (RoC) containing the following documents:

1. Memorandum of Association;

2. Articles of Association;

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[61] *supra*, at 12, p.21

[62] *Ibid, p 22*

3. A declaration signed by a person named in the articles of the proposed company as a director, manager, or secretary of the company, or by an advocate of the Supreme Court or High Court, or by an attorney entitled to appear before the High Court, or by a chartered accountant practicing in India stating that all the requirements of the Companies Act 1956 and the applicable rules with respect to the registration and other matters have been complied with;

4. A list of persons who have consented to act as directors of the company.

5. If the proposed company is a public company, consent of every person prepared to act as a director must be submitted in a prescribed form;

6. Information about directors, managing directors and managers and secretary must be submitted in a prescribed form;

7. Information about the registered office must be submitted in a prescribed form;

8. Power of Attorney in favor of one of the promoters or any other person, authorizing him/her to make corrections in the documents submitted to the registrar of the companies, if it becomes necessary; and

9. Applicable registration fee payable to the Registrar of Companies (RoC).

After, filing, the documents are scrutinized and verified by the RoC and upon satsifaction, a certificate of incorporation is issued bringing the company into existence.

"The incorporated entities may be in the form of a Wholly Owned Subsidiary (where substantial capital of the company is held by the foreign investor and the second shareholder is only for the purpose of fulfilling the statutory requirement), or joint venture companies (where some equity is held by the Indian shareholders)."[63] Joint Venture Companies are preferred routes of investment in sectors where the equity holdings are restricted by the FDI policy.

A. <u>Wholly Owned Subsidiaries (WOS)</u>

The government permits setting up of a WOS by foreign investors in various sectors, where 100 percent FDI is allowed including information technology, development of

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[63] *supra,* at 12, p.23

integrated township, and mass rapid transport services under the automatic route. In other instances such as FDI in existing airport development projects (74 percent via the automatic route) may be raised up to 100 percent by obtaining prior FIPB approval.[64] A WOS offers advantages over other types of entities in the form of total control over funding, managerial affairs,[65] and profits. But the disadvantage is that the benefit of local knowledge, customs and methods, laws, rules and regulation is denied to the foreign investor and the learning curve can prove to be a steep one in light of the great variety of rules requiring compliance in different states in India[66].

B.Joint Venture

Joint Ventures in India generally take the form of a public or private companies limited by shares. The foreign investor gets the distinct benefit of understanding of local knowledge and issues that can be managed by the domestic partner. The Joint Venture agreement entails the incorporation of adequate provisions for disclosed and undisclosed liabilities concerning the parties. Some of the key documents negotiated and signed in a JV are share (stock) purchase agreement; a joint venture agreement containing the shareholding pattern; the technical collaboration agreement and trademark or corporate name agreement. All these agreements must be carefully drafted, clearly and unequivocally spelling out the duties and liabilities of the partners towards each other and towards third parties, and providing for an exit mechanism in the future. "The interest of a foreign entity is usually protected by a proper indemnification clause with respect to future liabilities, for which an escrow arrangement could be worked out where it is apparent that risks are very real"[67]. Also, the JV agreement is "expected to have a conflict of interest clause, to determine/ safeguard the interests of joint venture partners in the

[64] *ibid*, p.24.

[65] R. Nagaraj, (2003), "Foreign Direct Investment in India in the 1990s: Trends and Issues," *Economic and Political Weekly*, Vol. 38, No. 17, p. 1708

[66] *supra*, at 12, p.24.

[67] *supra*, at 12, p.25

event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the same field of economic activity." [68]

3.2.2. Unincorporated Entities

These are entities formed for specific purposes and are regulated by the Foreign Exchange Management(Establishment in India of Branch or Office or other Place of Business) Regulations, 2000.

A.Branch Office

If the foreign investor desires to undertake commercial activities (manufacturing/trading, etc) similar to its head office/parent company located abroad, then it may consider setting up a branch office. Any liability of the branch would be the liability of the parent foreign entity as it is not a separate legal entity[69]. Profits may be remitted outside India net of applicable Indian taxes, subject to production of prescribed documents to the satisfaction of the Authorised Dealer(AD) banker through whom the remittance is affected. A branch office can be established for any of the following purposes[70]:

a) Export-import of goods;
b) Rendering of professional/consultancy services;
c) Conducting Research for the parent company;
d) Promotion of technical/financial collaboration between Indian companies and parent or overseas group companies;
e) Representative purposes such as the buying and selling agent for the parent company;
f) Rendering information technology services ;
g) Providing technical support for the products supplied by the parent company[71]

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68 *supra*, at 15, p. 17

69 *supra*, at 66

70 *supra*, at 41, s. 30; M.B. Baker, (2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p 406

71 *supra*, at 17, p.51

Foreign airlines/shipping companies may also setup branch office in India to maintain their presence.[72] The prior permission of the RBI is essential in setting up a branch office and the application is made in Form FNC 1 to the Chief General Manager, Exchange Control Department (Foreign Investment Division), RBI, Mumbai.[73]

B.Liaison/Representative Office

A liaison office comparatively requires a light structural setup as it only represents a point of contact between Indian customers and the foreign company. The role is limited to research and data collection regarding possible market opportunities and familiarizing the local customers with the products of the company.[74] A liaison office can act as a facilitator for import/export and technical/financial collaboration between the foreign parent and the Indian companies. Engaging or undertaking any trading or commercial activity directly or indirectly, earning income in any form is strictly prohibited[75]. The expenses of the liaison office have to be met by the overseas head office. RBI's prior approval is again required to setup a liaison office in India.[76] However in cases of insurance companies incorporated outside India who have taken prior approval from the Insurance Regulatory and Development Authority (IRDA), a general permission is in place.[77]

C.Project/Site Office

These are temporary offices setup for carrying out specific project work secured from Indian companies. Any activity not incidental to the execution of the project is strictly prohibited. Financing of such project offices can be made from direct inward remittances from abroad, bilateral or multilateral funding from an international financing agency,

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[72] *supra,* at 12, p.25

[73] *supra,* at 17, p.97 ; *supra,* at 12, p.26

[74] *supra,* at 12, p.27

[75] *supra,* at 41, s. 31

[76] M.B. Baker, (2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p 406

[77] This general permission is granted vide AP(DIR Series) Circular No. 39 dated 25th April, 2005; *supra,* at 12, p.26

from loans obtained by the Indian Company entailing the specific work or from a public financial /institutional/bank in India[78].

3.2.3 Special Economic Zones (SEZs) and Export Oriented Units(EOUs)

The policy for establishing SEZs in India was introduced by the GoI on 1 April, 2000[79] with an objective of establishing a competitive export environment. Industries located in the SEZs are provided with incentives such as tax holidays; exemptions from custom duties making it a duty free enclave; infrastructure facilities including roads, water and electricity supply, etc[80]. These zones have been established in various Indian states. The Special Economic Zones Act 2005 was passed by the Indian Parliament to standardize the SEZ policy. The Units allowed in a SEZ may be for manufacturing of goods; trading; or rendering of services.

The units in SEZs are not subjected to any pre-determined value addition or minimum export performance requirements nevertheless they have to be net foreign exchange earners.[81] There are restriction on sales in the Domestic Tariff Area (DTA) by SEZ units and if allowed they are subjected to payment of full custom duty and import policy in force.[82] Prior approval of the RBI is not an essential condition for setting up a branch office in a SEZ provided it is established on a 'standalone basis', with its activities restricted only to the SEZ[83]. This general permission is additionally subjected to the following criteria:

a) The sector in which Unit is proposed permits 100 percent FDI.
b) Part XI of the Companies Act, 1956 SS 590-602 is complied with.
c) On winding up entailing remittance of the proceeds winding up the unit must approach the AD with the requisite documents.

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[78] *supra,* at 75,, p 406

[79] *supra,* at 12, p.35

[80]N. Bajpai and J. D. Sachs (2000), "India's Decade of Development," *Economic and Political Weekly*, Vol. 35, No. 16, pp. 1365.; *supra,* at 17, p.54

[81] *supra,* at 17, p.55

[82] *supra,* at 12, p.36

[83] E. Shabshelowitz, E (2007), "Opening for Business in India: Retailer's Options." 31 *Suffolk Transnational Law Review*, p. 167.

Export Oriented Units

Export Oriented Units (EOU)s undertake to export their entire production of goods and services, beyond permissible sales in the DTA in accordance with the prescribed limit contained in the Foreign Trade Policy(FTP). The Electronic Hardware Technology Park (EHTP) scheme and the Software Technology Park (STP) Schemes are two special variants of the general EOU scheme which shows a desire of the GoI to enhance India's competitiveness in the technology sector[84]. This scheme aims for a net export surplus situation thereby reducing the trade deficit of the economy. EOU operations allow manufacture of goods including repair, re-making, re-conditioning, re-engineering; rendering of services like development of software data processing and conversion; data management; and call centre activities.[85]

A. Electronic Hardware Technology Park (EHTP)

EHTPs are administered by the Ministry of Communications and Information Technology. These are also duty-free, bonded areas, like the SEZs and are also given exemptions on customs duty for products imported by them. An EHTP may be an individual unit by itself or a unit located in an area designated as an EHTP complex. The Central or State government, public or private sector undertakings or any combination of them can setup an EHTP complex.

B .Software Technology Park of India (STPI)

STPI is an autonomous society established by the Department Of Communications & Information Technology, Government of India, in 1991. The STP scheme is a 100 percent EOU scheme for undertaking software development for export using data communication links or in the form of physical media including export of professional services. The units which become part of this scheme are generally captive outsourcing units engaged in research and design engineering activities for their parent companies using the internet to transmit their work products. Other permitted activities pertain to re-

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[84] *supra,* at 75,, p 402

[85] *supra,* at 12, p.39

conditioning, repair, re-making, testing, calibration, quality improvement, upgradation of technology, and re-engineering activities.

3.2.4 *Issue of American Depository Receipts (ADR), Global Depository Receipts (GDR), Foreign Currency Convertible Bonds (FCCBs)*

Another mode of entry of FDI in India is by the issue of GDRs, ADRs and FCCBs. Indian Companies allowed to raise equity capital in the international market through the issue of GDRs/ ADRs/FCCBs.[86]

Section 2.1.9 of the Policy 20101 defines DRs as

> "'Depository Receipt' (DR) means a negotiable security issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded anywhere/elsewhere are known as Global Depository Receipts (GDRs)."

Section 2.1.11 of the Policy 2010 defines the FCCBs as

> "'Foreign Currency Convertible Bonds'(FCCB) means a bond issued by an Indian company expressed in foreign currency, the principal and interest of which is payable in foreign currency. FCCBs are issued in accordance with the Foreign Currency Convertible Bonds and ordinary shares (through depository receipt mechanism) Scheme 1993 and subscribed by a non-resident entity in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part".[87]

The Policy 2010 does not provide for any ceiling or end use restrictions on investment and GDR/ ADR/ FCCB issue proceeds except prohibiting real estate and stock markets. Also, no monetary limit up to which an Indian company can raise ADRs/GDRs is set out.[88] Government clearance is required when sectoral cap is exceeded, or for a project not falling under Automatic Route. 25% of the FCCB proceeds can be used for general corporate restructuring.[89]

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86 *supra,* at 16, p. 375

87 *supra,* at 15, p. 8

88 *ibid,* p. 17

89 *supra,* at 41, s. 20

3.3 Mergers And Acquisitons (M&A): Competition Law

One very important mode of entry for foreign investors is either through merger with an existing firm or through an acquisition of an existing venture. These M&A activities may have an adverse effect on competition and therefore may not be good for new investors or domestic industries and small businesses. [90] Therefore a need for an appropriate competition law to protect fair competition and to control, if not eliminate anti – competition practices in the trade and market was recommended by the Expert Group[91]. Apprehensions regarding the surfacing of many anti-competition practices during the implementation of the WTO agreements emboldened the need for an effective competition law. Thus, the GoI introduced in the Parliament the Competition Bill, with the objective of ensuring fair competition by prohibiting trade practices which cause appreciable adverse effect in the markets within India.[92] It sought to establish a quasi-judicial body to be called the Competition Commission of India(CCI) in order to undertake competition advocacy; impart training on competition issues and curb negative aspects of competition. The powers of investigation were to be granted to the Director-General for the Commission besides empowering the CCI to levy penalty for contravention of its orders, failure of compliance with its directions, making of false statements or omission to furnish material information, etc. the A fund called the Competition Fund was also sought to be established[93].

The Competition Act, 2002 was passed by the Parliament keeping in view the economic development of the country. It repealed Monopolies and Restrictive Trade Practices Act, 1969 (MRTP,1969) repealed[94]. The CCI also has the responsibility to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets

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[90] M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.102

[91] *supra,* at 53, p. 289

[92] *ibid*

[93] *ibid,* p. 244

[94] *supra,* at 31, p. 9

in India. The Act covers four substantive areas: competition advocacy; anti-competitive agreements; abuse of dominance and combinations regulation[95].

The Commission in terms of the advocacy provisions in the Act, is enabled to participate in the formulation of the country's economic policies and to participate in the reviewing of laws related to competition at the instance of the Central government. A reference can be made to the Commission to examine the possible effect of a policy under formulation or of an existing law related to competition, to which it is mandated to proffer its opinion to the Central Government within 60 days. The Commission's opinion is not binding but constitutes an important input in finalising the law or policy as regards its impact on competition. The Act seeks to bring about a direct relationship between competition advocacy and enforcement of competition law.[96]

As regards its other functions the Act lists the factors to be accounted when adjudicating the appreciable adverse effects of an agreement or activity on the competition in the market. They include: creation of barriers to new entrants; driving out existing competitors; foreclosure of competition by hindering entry; benefit accrual to consumers; improvements in production or distribution of goods or provision of services; and promotion of technical, scientific and economic development.[97]

The provisions relating to anti competition agreements does not however restrict the right of any person to restrain any infringement of intellectual property rights or to impose reasonable conditions necessary for the protection of any of his rights, conferred on him under the domestic intellectual property rights laws effective in India.[98] The rationale provided for this exception is that intellectual property rights contain, a bundle of rights which should not be disturbed, in the interests of creativity and innovative power of the human mind. This bundle of rights may have an anti-competitive character, even bordering on monopoly power but their protection is necessary to provide incentives for innovation, new technology and enhancement in the quality of products and services. It

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[95] *supra,* at 53, p. 241.

[96] *ibid,* p. 244

[97] *supra,* at 53, pp. 257

[98] *ibid,* p. 247

may be noted that unreasonable conditions forming a part of protection or exploitation of intellectual property rights are still not permissible under the Act. Therefore, licensing arrangements likely to affect adversely the prices, quantities, quality or varieties of goods and services can still fall within the contours of competition laws.[99]

Section 32 of the Act gives it extraterritorial reach to deal with practices and actions outside India which have an appreciable adverse effect on competition in the relevant markets in India.[100] "The Commission has the power to investigate an agreement or an abuse of a dominant position or combination if it has or is likely to have an appreciable adverse effect on the competition in the relevant market in India, notwithstanding that: an agreement has been entered outside India; any party to such agreement is outside India; any enterprise abusing the dominant position is outside India; a combination has taken place outside India; or any other matter or practice or action arising out of such agreement or dominant position or combination is outside India."[101] These provisions are based on the "effects doctrine", implying that even if an action or practice outside the shores of India has an appreciable adverse impact or effect on the competition in the relevant market in India it can be brought within the ambit of the Act.[102]

4. APPROVAL AND REPORTING REQUIREMENTS GOVERNING FDI

The process of approval and reporting forms an integral part of the entry. The various routes and modes of entry of FDI in India essentially have approval and reporting requirements and this forms the procedural part of the regulatory framework in a clear distinction from the substantive part discussed before. The institutions and instruments prescribing this procedural framework however continue to be the same. An investor has to secure approval under the Approval Route regarding his investment. As discussed earlier there are four circumstances regarding FDI that necessitate government approval.

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[99] *ibid*

[100] J. Thilak, (2004), "Regulating M&A: An Insight into Competition Laws in India", *International Business Lawyer*, No. 161, p. 164.

[101] *supra*, at 53, pp. 243

[102] *ibid*

In these cases, investment proposals are submitted to the SIA which after evaluation transfers it to the FIPB for review. It generally takes 30 days to receive a decision on a submitted proposal. Section 4.9 of the Policy 2010 states that

> The following approval levels shall operate for proposals involving FDI under the Government route i.e:
>
> (i) The Minister of Finance who is in-charge of FIPB would consider the recommendations of FIPB on proposals with total foreign equity inflow of and below Rs.1200 crore.
>
> (ii) The recommendations of FIPB on proposals with total foreign equity inflow of more than Rs. 1200 crore would be placed for consideration of CCEA. The FIPB Secretariat in DEA will process the recommendations of FIPB to obtain the approval of Minister of Finance and CCEA.
>
> (iii) The CCEA would also consider the proposals which may be referred to it by the FIPB/ the Minister of Finance (in-charge of FIPB).[103]

The FIPB enjoys complete discretion in rendering its decisions, and exercises full authority to negotiate with investors to maximize FDI inflow. However, this same flexibility may slow down the process because it allows the FIPB to consider a host of factors in determining whether or not to approve FDI proposals. The Guidelines for the consideration of proposals by the (FIPB) are enumerated in Section 4.7 of the Policy 2010. Some of the factors it may consider in rendering its decisions are sectoral requirements, the advantages and disadvantages of granting industrial licenses, the nature of technology collaboration, and export requirements. Priority is prescribed for investment proposals, outside the automatic route falling within sector limits, involving infrastructure projects, having export potential or likely to increase employment. The board is also advised to scrutinize proposals for the amount of equity held by foreign investors and the resultant balance of equity ownership and, whether the induction of capital is characterized by new foreign equity or merely by expansion of the entity through the purchase of existing shares.[104]

The ministry with industry jurisdiction for each case contributes to the FIPB decisions. Guidelines suggest that applications submitted to specific ministries should be brought before the FIPB within 15 days of submission, and that government approval or rejection

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[103] *supra*, at 15, p. 34

[104] *ibid*, p. 31

should be communicated within 30 days.[105] However, an investor should plan on a 3-month review and approval process. Grievances or complaints can be filed to the Grievances Officer-cum-Joint Secretary within the DIPP or to the Business Ombudsman within the Ministry of Commerce and Industry[106]. A grant of approval from the FIPB automatically enables the grant of the general permission of the RBI without any additional review[107]. However, the companies must notify the RBI within 30 days of receipt of inward remittances and within 30 days of the issue of shares to the foreign investors[108].

After the foreign investor obtains RBI or government approval and before the foreign owned entity's operations can commence, the investor must apply for and secure numerous other clearances at both central and state levels.

> "At the central level, investors must obtain registeration and license approvals from the SIA, the Central Excise Department and the Inspector of Boilers, as well as, the necessary clearances from the Factory's Inspector Environmental Authority, and the Pollution Control Board. Then at the state level, the investor must: (i) register with the Sales Tax Commissioner and Provident Fund Commissioner; (ii) obtain permission for land use/construction from the State DI, Department of Town and Country Planning, Local Authority/District Collector, and the municipality; (iii) secure a power connection from the Electricity Board; (iv) acquire a water connection from the Water Department; (v) procure a fire license from a Fire Service Department; and (vi) meet clearance protocols established by the State Pollution Control Board, Chief Controller of Explosives, and Chief Inspector of Boilers."[109]

As regards, the automatic route, the reporting requirements concern notification to RBI within 30 days of receipt of inward remittances and filing of required documents such as FORM FC-GPR with the concerned regional office within 30 days of issuing of shares to foreign investors.[110] The notification information is for statistical purposes. There are no

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[105] *ibid*, p. 32

[106] *supra*, at 29, p.75

[107] *supra*, at 14, p. 201

[108] World Bank (2010), *Investing Across Borders, 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies*, Investment Climate Advisory Services, Washington., p.123

[109] *supra*, at 14, p. 204.

[110] World Bank (2010), *Investing Across Borders, 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies*, Investment Climate Advisory Services, Washington, p.123; M.B.

measures in place to ensure compliance with the notification requirement but potentially harsh penalties deter investors from avoiding requirements[111].

The Approval and Reporting Requirements for various modes of entry are given under the various applicable provisions of the Companies Act, 1956, FEMA guidelines, SEZ Act, 2005, etc. As for an incorporated company, Section 591(2) of the Companies Act, 1956 subjects a foreign corporation to all provisions of the Companies Act with respect to the business carried on by it in India, if 50% (or more) of the corporation is owned by Indian citizen(s) and/or Indian corporation(s). However, if less than 50% of the foreign corporation is owned by an Indian citizen(s) and/or corporation(s), the foreign corporation only must submit certain information to the Registrar of Registrations.

Foreign corporations, with less than 50% India ownership and which establish a place of business within India, must deliver the following information to the Registrar in the Office of Registration within 30 days of the opening of the office:

(1.)a certified copy of the charter and articles of the corporation or other instrument constituting or defining the constitution of the corporation;

(2.)the full address of the registered or principal office of the corporation;

(3.) a list of the directors and secretary of the corporation;

(4.) the name and address of one or more persons resident in India, authorized to accept service of process on behalf of the corporation; and

(5.)the full Indian address of the office of the corporation which is to be deemed its principal place of business in India.[112]

A foreign investor also has to authenticate the documents of the parent company in its country of origin in addition to other requirements which are similar for domestic investors. A company engaged in international trade must also obtain an Importer/Exporter Code issued by the Director General of Foreign Trade. Companies in

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Baker,(2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p 393.

[111] *supra,* at 29, p. 73

[112]M.J. Reidy,(1995), "Legal and Practical Considerations in Structuring Business Transactions in India," *Cardozo Journal of International and Comparative Law*, Vol. 3, pp. 338.

India are allowed to open and maintain a foreign currency account (Exchange Earners Foreign Currency Account) with an Authorized Dealer[113].

The approval and reporting requirements for setting a Branch Office, Liason Office, Project Site Office are given under the FEM (Establishment in India of Branch or Office or Other Place of Business) Regulations, 2000. Prior approval of the RBI is required for the same[114]. For setting up a unit in a SEZ, 3 copies of the application in the Form Appendix 14-I-A have to be submitted to the Development Commissioner (DC) of the concerned SEZ. Approval may be granted by the DC within 15 days except in cases of investments requiring an industrial licence which are granted approval after clearance by the SEZ Board of Approval and the DIPP within 45 days. A Letter of Permission/Letter of Intent (LOP/LOI) is issued to the SEZ unit by the DC on approval which is construed as a licence for all purposes including procurement of raw material and consumables.[115] As with other investments, EOUs may be setup under the automatic route or by securing an approval. The DC of the SEZ accords automatic approval to projects where:

a) compulsory licensing is not attracted by the proposal or it falls in the services sector except software and information technology enabled services.
b) Location conforms to prescribed parameters
c) Undertaking to achieve positive Net Foreign Exchange is rendered.

The DC forwards proposals requiring approval to the Board of Approval, Department of Commerce, for consideration which renders a decision within six weeks.[116] EHTP and STP units can be setup under both the automatic and approval route. Under the automatic route, an approval from the Director of the STPs in respect of the STP proposals and the designated officers in respect of EHTP proposals is required. It is granted within 2 weeks if the following conditions are complied with:

a) Compulsory licensing is not attracted;

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[113] World Bank (2010), *Investing Across Borders, 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies*, Investment Climate Advisory Services, Washington, p. 123

[114] *supra,* at 75,, p 406

[115] *supra,* at 12, p.38

[116] *ibid*, p.40

b) Location conforms to prescribed parameters;

c) The unit is amenable to bonding by customs, and all the manufacturing operations are carried out in the same premises and any raw material or intermediate products are not sent out of the bonded area for any other manufacturing or processing activity.

Under the approval route, the proposals are considered and approved by the Inter-Ministerial Standing Committee consisting of ministers from the Ministry of Communications and Information Technology (MCIT) and the Department of Information and Broadcasting. The application has to be submitted to the MCIT and the decision again takes six weeks.[117]

5. OTHER RELEVANT LAWS APPLICABLE TO FDI

Often before an investment is made, a foreign investor conducts a due diligence exercise. In a Greenfield venture, the nature of the exercise may be general and M&A may entail a specific due diligence of the Indian company or business to be acquired. Such a diligence exercise must be exhaustive and depending on whether a transaction is an asset purchase or simply share purchase, the scope of the review may be set. Typically, legal due diligence covers some aspects of the target company's financials and tax matters while focusing on issues relating to corporate matters, including litigation, employees, intellectual property rights, contracts(including contracts with customers), verification of assets, environment and regulatory permissions, etc[118]. Therefore the laws governing these areas also have significance at the entry stage.

5.1 Intellectual Property

India being a member of the WTO has tried to fulfill its obligation by giving effect to the various provisions of the TRIPs Agreement of WTO. The process of harmonisation of intellectual property law in India with that of international standards has been undergoing

[117] *supra,* at 12, p.44-45

[118] *ibid*, p.24

for long. The Government with a view to meet the time frame provided under TRIPs agreement, has expedited this process by placing before the Parliament various Bill, either to amend the existing laws, or to enact new legislations. The Government amended the Patents Act in the year 1995, 1999 and 2002; and the Copyright Act in the year 1994 and 1999. The Government has also enacted following new legislations in the area of Intellectual Property:

1. Trade Marks Act, 1999
2. Geographical Indications of Goods(Registration and Protection) Act, 1999
3. Designs Act, 2000
4. Semi Conductor Integrated Circuits Layout Design Act, 2000
5. The Protection of Plant Varieties and Farmer Rights Act, 2001

In April 2005, the Parliament enacted the Patents Act (2005 Amendments) amending the Indian Patents Act of 1970, with effect from January 1, 2005. The 2005 Amendments were done to comply with the phased implementation of TRIPS and the provisions for both product and process patents in almost all fields of technology have been made. Specifically with regards to the pharmaceutical sector, a patent can now be granted to a product [119](specified molecule) as well as to a process of a general class (the manufacture of such molecule). The protection is granted for 20 years.[120]

5.2 Taxation

Income Tax

As regards income tax, a company is included in the definition of "person" in the Income Tax Act of 1961(ITA).[121] Income tax in India is also expressed in terms of residency[122].

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[119] P.Ranjan(2008), "International Investment Agreements and Regulatory Discretion: Case Study of India," *The Journal of World Investment and Trade*, Vol. 9, No. 2, p. 216

[120] *supra*, at 46, p. 379

[121] B. Dhar,(1988), *State Regulation of Foreign Private Capital in India*, Institute for Studies in Industrial Development (ISID), p. 33

[122] P.Durand-Barthez, and T. Khindria (1988), "Investment and Transfer of Technology in India," *International Business Law Journal*, No. 2, pp. 192

A company is considered an Indian resident if it is an Indian company or if the control and management of its affairs are situated wholly in India during a given year. Therefore, a company incorporated in India qualifies as an Indian resident and is liable to India for its worldwide income. A foreign investor obviously wants to avoid such taxing burden.[123]

The income of a non resident company is either defined by a tax DTAT between the company's home country[124] and India or by Section 5(2) of the ITA[125]. To resolve the uncertainty around a foreign company's tax liability to India a system of advance tax rulings has been introduced which simplifies the assessment. In order to benefit from these rulings, a foreign company must determine the part of its income subject to tax in India.[126] This income includes both the income derived outside of the country if it is received or deemed to be received in India and the income which accrues or is deemed to accrue in India. Thus if a foreign company delivers goods to its joint venture in India, the income has been accrued in India and is subject to the Indian income tax even though no payment has been exchanged.[127] Tax on the income of a company is charged in accordance with the Finance Act for the relevant assessment year and the provisions of the Income Tax Act, 1961. The amount so payable is subject to an education cess at 2 percent.

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[123] *supra,* at 75, p 399.

[124] *supra,* at 121, p. 202.

[125] S.5 (2) which reads as follows:

"(2) Subject to the provisions of this Act, the total income in any previous year of a person who is a nonresident includes all income from whatever source derived which

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1: Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact it is taken into account in a balance sheet prepared in India.

Explanation 2: For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India"

cited in Department of Revenue, Ministry of Finance, Government of India(1961), *Income Tax Act, 1961[as Amended by Finance Act,2011]* no. 43 of 1961, New Delhi

[126] *supra,* at 75, p 400

[127] *ibid,* p. 399.

The tax paid to India does not necessarily relieve the foreign company from any tax liability on its income owed to the company's home country. Therefore India has signed DTATs with countries like Mauritius, Cyprus, etc.[128] which resolves these issues and prevail over any inconsistent provisions of the ITA. The corporate tax applicable can be the lower rate prevailing in either of the two countries if a DTAT is in existence.[129] Consequently it is essential for a foreign company to determine if its home country has a DTAT with India before commencing business.

5.3 Contract Law

The Indian Contracts Act of 1872 (Contracts Act) and its subsequent amendments and Adoption Orders, codify the general principles of the law of contracts. Thus, the Contracts Act covers such areas as: the communication of the offer, acceptance, and revocation of the offer; voidable and void contracts; contingent contracts; performance of contracts; consequences of breach of contracts; indemnity and guarantee; bailment; and agency.[130] The Contracts Act permits foreign parties to an agreement in India to negotiate which law will govern any dispute. Nevertheless, in practice, the Government of India is more likely to approve a foreign investment agreement governed by Indian law.[131] India's legal and regulatory framework in the area of enforcing of contracts has advanced in the last two decades.[132] In 2008, the Supreme Court of India allowed for electronic case filing. E-filing systems are being planned for the various State High Courts in the near future and eventually in the District courts as well[133]. However, the preferred method of dispute resolution is still arbitration due to its convenience and speed in settlement of

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[128] *supra,* at 16, p. 376

[129] *supra,* at 75, p 400.

[130] M.J. Reidy (1995), "Legal and Practical Considerations in Structuring Business Transactions in India," *Cardozo Journal of International and Comparative Law*, Vol. 3, p. 336.

[131] *supra,* at 121, pp. 189.

[132] A.Perry-Kessaris,(2003), "Finding and Facing Facts about Legal Systems and Foreign Direct Investment in South Asia," *Legal Studies*, Vol. 23, pp. 665.; World Bank (2009), *Doing Business in India, 2009*, Washington. p. 15

[133] World Bank (2009), *Doing Business in India, 2009*, Washington. p. 15

commercial disputes[134].

5.4 Dispute Resolution

A foreign investor in India faces many instances where he relies on domestic courts. It does so to protect its intellectual property rights against infringement and for the enforcement of contractual rights against local suppliers or customers under the Indian Contract Act, 1872. Also, the local work force will normally have access to domestic courts and may resort to them against the foreign supplier. Similarly, disputes concerning corporate taxes or property taxes do not allow for international means of dispute resolution. "It is crucial for the success of a foreign investment to carefully design and provide means for resolving disputes"[135].

Arbitration as an alternative means of dispute resolution is popular as it offers parties great autonomy. The Arbitration and Conciliation Act (1996) based on the UNCITRAL model law governs the domestic and international arbitrations in India. Certain federal acts and acts enacted by different Indian states have mandatory statutory arbitration provisions[136]. The Act does not include a definition of domestic arbitration and only states that any award made when the place of arbitration is in India will be considered a domestic award. Most commercial disputes can be submitted to arbitration, but there are certain exceptions, such as the nonpayment of admitted debt or income tax, and industrial disputes.[137] Arbitration agreements must be in writing and parties are free to select the applicable law; appointment and number of arbitrators of any gender, nationality, or professional qualifications; the forum and other details of arbitration in both domestic and international arbitrations. However, only licensed practitioners may represent parties as advocates in arbitration proceedings. The parties have the choice between ad-hoc and institutional arbitration. There are several arbitral institutions in India, including the

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[134] *supra,* at 121, p. 190

[135] *supra,* at 2; p. 43

[136] *supra,* at 107, p.123

[137] *ibid.*

Indian Council of Arbitration in New Delhi.[138] Institutional arbitrations are slowly gaining momentum, although parties still tend to prefer ad hoc proceedings.

As regards the enforcement of awards, India is a party to the New York International Convention of Recognition and Enforcement of Foreign Arbitral Awards of 1958. The Convention requires each country to recognize and enforce arbitral awards based on agreements in writing that include an arbitral clause in a contract or arbitration agreement, executed by the parties or contained in an exchange of letters or telegrams.[139] Indian courts also play an important role in assisting arbitration by providing interim relief. Decisions enforcing or denying enforcement of arbitration awards may be appealed to the Mumbai High Court and the Supreme Court of India. On average, it takes around 33 weeks to enforce an arbitration award rendered in India, from filing an application to a writ of execution attaching assets (assuming there is no appeal), and 43 weeks for a foreign award[140].

6. CONCLUSION

India has one of the most transparent and liberal FDI regimes among the emerging and developing economies. The FDI regime covers restrictions applying to foreign national and entities separate from those applicable on Indian national and Indian owned entities.

The difference in the treatment accorded is limited to a few entry rules containing the equity caps in place for the foreign investors which are explicit and well known.[141] Apart from the sectoral caps, other criteria may be need to be fulfilled which are laid down by the respective Ministries with relevant jurisdictions in each sector. For example, "though FDI up to 49 percent is allowed in the domestic aviation industry, there is a precondition imposed by the Ministry of Civil Aviation, which bars foreign airlines to hold equity stake or participate via management control directly or indirectly in the domestic aviation companies. However, in recent years the government in order to boost FDI levels in the

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[138] *ibid*

[139] *supra,* at 129,

[140] *supra,* at 107, p.123

[141] *supra,* at 56, p 14

country has largely cut down the sectoral caps and the list is under constant review".[142]Since liberalization the approval route has been gradually transformed, with most sectors falling under the automatic route.[143]

At present, only a limited sectors such as retail trading (except single brand retail), Transferable Developments Rights(TDRs), lottery and gambling businesses, etc. are prohibited for FDI and all other sectors are open for foreign investment, subject to sectoral caps or industrial licensing requirements. A foreign company can set up a registered company in India subject to the foreign equity restrictions and operate under the same laws, rules and regulations as applicable on any Indian owned company. Unlike many countries including China, India extends National Treatment to foreign investors.[144] No discrimination is practiced against foreign invested companies registered in India or in favour of domestic owned ones[145] except for minor restrictions for entry in the same field in case of an existing joint venture. "If they (i.e. the parent) want to set up another company in the same sector it just needs prior approval from the FIPB. This condition is explicit and transparent unlike many hidden conditions imposed by some other recipients of FDI. [146] Further, in case of transfer of technology, payment of lump sum fee and royalty to the foreign technology provider is permitted including that by a WOS to its offshore parent company. Payment of royalty on use of trademarks and brand name without transfer of technology is also permitted. Also, the foreign investors are often given more favourable treatment like tax holidays, infrastructural incentives and JV requirements are waived off in they are willing to setup in SEZz. Even in other sectors, there is a steady movement towards 100 percent FDI participation and the process of granting approvals and the delays plaguing the process are being streamlined.

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[142] *supra,* at 12, p.34

[143] *supra,* at 12, p.121

[144] *supra,* at 14, p. 194

[145] R.R. Gandhi, (2002), "FDI and Indian Experience," Report submitted to the *OECD Emerging Asia Investment Policy Dialogue Exploratory Meeting*, Shanghai, December 2002, p. 6; *supra,* at 14, p. 202

[146] *supra,* at 56, p 15

The era of liberalization has ensured that the Indian domestic regime harmonises itself with the international standards. The entry stage has witnessed this harmonization. The laws that are relevant at the entry stage are now all enumerated under a single code. The sectoral caps are constantly reviewed and the policy is being synchronized on the basis of the international obligations owed. But this harmonization raises issues concerning both the foreign investors and the host state. The necessity and extent of such harmonization may be debatable and the next chapter explores this dimension.

CHAPTER 4

IMPACT ASSESSMENT AT ENTRY STAGE: HARMONISATION OF NORMS AND LOSS OF REGULATORY SPACE

1. INTRODUCTION

The previous chapters have outlined the regulatory regimes concerning FDI, operational at the international and the domestic levels in India. These regulations do not work in isolation as the International Law on Foreign Investment also takes effect through harmonization of standards in the domestic law. In case of India, there has been a continuous movement towards this harmonization[1]. This chapter analyses the impact of this harmonization of the regimes on the regulatory space. The chapter first takes a look at interests of investors and the role of legal systems in garnering FDI. The thrust on effective legal systems has been the driving force for changes in international law ushering in international minimum standards. These international minimum standards are examined and a resultant loss of regulatory control of the domestic authorities is probed. After this the harmonization of Indian domestic law with these international minimum standards has been studied. The effectiveness of the same and the issues that arise have been outlined.

2. INVESTORS'S PERSPECTIVE: FDI DETERMINANTS

The basic reason for any investment is the profit motive of the investor. A foreign investor will invest in a market and in the specific sectors of an economy based on the profitability of the venture[2]. The ease of market access, a stable political environment and a clear and transparent legal system are some other factors that play a key role in determining the influx of FDI. Each of these factors alone is not sufficient for taking a

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[1] M. Sweeney, (2010), "Foreign Direct Investment in India and China: The Creation of a Balance Regime in A Globalised Economy," *Cornell International Law Journal*, Vol. 43, p. 207.

[2] S.D. Franck,(2007), "Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law," *Global Business and Development Law Journal*, Vol. 19, p. 356.

decision for the investors and the sum of all these factors should ensure a profitable venture of the investor.

Profitability can be ensured by decreasing costs. A corporation always works to reduce transaction costs[3] which can be examined in two distinct classes 1) *ex ante* 2) *ex post*[4]. In terms of FDI ex-ante costs can be described as the cost of the creation of the enterprise. It includes the cost of negotiating the undertaking; feasibility studies prior to entry; any necessary government licenses, approvals or permit required to conduct operations, etc. The ex-post costs are those that are incurred after the initiation of the business enterprise and include the costs of policing the original agreement and settling the disputes. The success of attracting FDI is a reduction in these transaction costs and legal systems play a vital role in this process. It is argued that the effectiveness of a legal system can affect FDI flow based on the assumption that economic actors both, should and do, structure their activities to reduce transaction costs. In theory, the role of the law and legal systems is to reduce those search and information, bargaining and enforcement costs associated with undertaking any transaction.[5] The neo-institutional economic theory predicts that the foreign investors are attracted to the states with "effective" (relatively low transaction costs) and avoid states with "ineffective" legal system (i.e. relatively high transaction costs).[6]

However, there is little empirical evidence to suggest that they are so attracted and in practice not only legal systems fail to reduce existing transaction costs but tend to impose additional transaction costs on economic actors.[7] However, the role of legal systems cannot be totally ruled out. The investors and the home states have pushed for reforms and insisted on a rule based regime for protection of foreign investment and securing

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[3] D.H. Brooks, and L. R. Sumulong (2003), *Foreign Direct Investment: The Role of Policy*, Economics and Research Department Policy Brief, Series No. 23, Asian Development Bank, Manila, p. 4

[4] P.J. Donovan,(2004), "Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market", *Gonz. Journal of International Law*, Vol. 1, p. 7

[5] A. Perry, (2000), "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," *International and Comparative Law Quarterly*, Vol. 49, p. 782

[6] A.Perry-Kessaris,(2003), "Finding and Facing Facts about Legal Systems and Foreign Direct Investment in South Asia," *Legal Studies*, Vol. 23, p. 651.

[7] *supra* at 6,p. 675.

maximum rights for investors, including market access and low transaction costs. The home countries have tacitly accepted this reform while trying to fight for whatever foreign regulatory control that they can retain and secure. There are no winners in this complex situation.

3. INTERNATIONAL MINIMUM STANDARDS AND LOSS OF REGULATORY CONTROL

The real force behind the reforms in International law has been economic liberalism. The demand for market access and open economies has seen the demise of barriers and sovereign economic control. The need of developing countries to attract capital to which they lack has seen them accept economic liberalism as an ideal[8]. The principle of openness and integration of markets has advocated that domestic regulations should not close or restrict access to sectors of the economy for FDI.[9] Home countries should instead provide freedom to inflow and outflow of foreign investment for their own benefit and limit the exceptions to national security[10] and similar overwhelming interests. This principle seeks incorporation in all stages of foreign investment transactions from the pre-establishment to the dissolution phase.

The home countries have not yet completely succumbed to this pressure of economic liberalism. They have maintained that the prerogative of a sovereign state regarding imposition of conditions on the entry of aliens is an accepted principle of law.[11] This principle has been used to counter the liberalizing forces and to retain control over the process of FDI. The modern state despite its adherence to an open economy contains a

[8] M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.100

[9] D.D. Bradlow, and A. Escher (1999), *Legal Aspects of Foreign Direct Investment*, Kluwer Law International, London; p. 65

[10] K. Yannaca- Small, (2007), "Essential Security Interests under International Investment Law," in Organization for Economic Cooperation and Development (OECD), *International Investment Perspectives: Freedom of Investment in a Changing World*, p. 68

[11] *supra* at 8, p.100

substantial amount of regulatory mechanisms which control the economy but increasingly these mechanisms have to face the onslaught of international minimum standards.

As discussed in chapter 2, the international institutions like the World Bank Group including MIGA and ICSID, the WTO system including TRIMS, TRIPS and GATS and the bilateral and multilateral treaty frameworks included in International Investment Agreements such as BITs, FTAs and regional treaties all promulgate certain international minimum standard. The noteworthy among them are National Treatment and the MFN treatment for investors; prohibition on local content requirements, export requirements and other Trade Related Investment Measure; Repatriation of investments and profit; Compensation in case of expropriation and investor's right to invoke International Commercial Arbitration in case of a dispute and transparency requirements. The effect of such standards is to tighten regulatory control. A new push has also come for extension of international minimum standards at the pre-entry stage and establishment of a right to entry in the latest IIAs. A state can surrender its rights over a purely internal matter by a treaty and if the treaty provides pre-entry rights to a foreign investor, it completely extinguishes the right of the state to control entry of the foreign investment.[12] The various international minimum standards[13] and their effect on domestic regulatory control are discussed hereafter.

3.1. National Treatment(NT) and Most Favoured Nation(MFN) Treatment

Many IIA's particularly BITs and other international agreements such as GATS and TRIPS, contain the non discrimination clauses governing the foreign investor's relation to other investors, both foreign and national. These clauses are being used to achieve a higher degree of liberalization in the national investment regime. National treatment requires that a host country treat a foreign investor or investment no less favourably than their own national investors or investments made by their own nationals. Exceptions are

[12] *ibid*, p.97

[13] W. Shan, "Calvo Doctrine and the Changing Landscape in International Investment Law," *Northwestern Journal of International Law and Business*, Vol. 27, No. 3, p. 658.

often based on security concerns and public morals. [14] Also included in the non discrimination clauses is the MFN treatment which means that a host country may not treat an investor or investment form a BIT partner or a member country of GATS any less favourably than it treats investors or investments from any other country. The MFN provision allows the foreign investor to take advantage of the highest standard of treatment provided to a country in any BIT to which the host country is a party. Exceptions are however made for the Free Trade Areas and Customs Union and tax matters. BITs may also contain a clause which combines both these standards and may require the host to grant investors NT or MFN treatment whichever is the 'most favourable'. [15]

Reservations to the non-discrimination principle based on domestic policy considerations have often been made by state parties. Some countries, especially developing, in recognition of the disparity in financial and technological resources between domestic enterprises and foreign businesses have sought limitation on the scope of NT guarantees in BITs. In particular, they have tried to avoid giving foreign investors the benefit of incentives and subsidies available to domestic industries essential for their strengthening. This resistance gains prominence in the present economic climate, where countries such as Argentina (responding to the financial crisis) are being prevented by these non-discrimination standards from providing protection to nascent local industries through measures construed as violations of investor rights.[16] Also, certain incentives given by the host state such as tax incentives, tax holidays, etc. to desirable investors only again raise the issue of discriminatory treatment, specifically MFN. Violations of NT and MFN may be alleged but if an adequate basis for differential treatment such as need to attract certain

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[14] *supra* at 9, p. 61

[15] J. W. Salacuse, and N. P. Sullivan (2005), "Do BITs really work?: An evaluation of Bilateral Treaty Regime and their Grand Bargain," *Harvard International Law Journal*, Vol. 46, No. 1, p. 85.

[16] L.E.Sachs, and K.P. Sauvant (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*, Oxford University Press, Oxford., p. 13

types of technology or to direct the foreign investor into certain channels of production, is shown, no illegality can be established[17].

3.2. Prohibition on Performance Requirements

Performance requirements (PRs) consist of stipulations imposed on investors requiring the fulfillment of certain specified goal with regards to their operations in the host country. They have been used by the developed and the developing countries in consonance with other policy instruments, such as trade policy[18], screening mechanisms and incentives to enhance various development objectives. The UNCTAD has classified performance requirements into three categories:

i) Those prohibited by the WTO Agreement on TRIMS because they are inconsistent with Article III and Article XI of the GATT

ii) Those that are prohibited or discouraged by regional or bilateral agreements

iii) Those which are not subject to control by any international investment agreement[19]

The most common PRs are local content requirements and export performance requirements.[20] Local content provisions entail purchasing of a specific proportion of their inputs from local suppliers by the foreign firms and a failure to comply may result in increased tariffs on imported inputs.[21] Trade balancing measures are another form of PRs where restrictions on the import of inputs by a corporation are either complete or relative to the level of its exports. Some foreign exchange balancing requirements follow a similar scheme whereby a corporations permitted imports are tied to the value of its

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[17] *supra* at 8, p.116

[18] UNCTAD (1999), *Comprehensive Study of the Interrelationship between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI),*" UN, New York and Geneva, p. 15

[19] S.P.Kumar, (2009), "Rethinking the Linkages between Foreign Direct Investment and Development: A Third World Perspective," *NALSAR Student Law Review, p. 49*

[20] *supra* at 3, p. 8

[21] *supra* at 21,, p. 18

exports to ensure net foreign exchange earnings.[22] Another set of PRs are local equity and local employment requirements. These restrict the equity participation of the foreign investor in specific sectors and ensure that entry is made through the establishment of a joint venture with a local partner. "Partnerships with local partners ensure that some profits stay at home, the local partner acquires expertise in business as well as technology and if a state entity is a partner, local control over investment is also effectively ensured"[23]. The requirement pertaining to local employment in the foreign enterprise may be done to enhance employment at the local level or to ensure key managerial positions remain in local hands to ensure control. Often differential internal taxes and subsidies are given by the states to attract foreign investors to particular sectors of the economy and they are linked to other requirements such as export performance requirements or local employment requirements.

Most countries go for unilateral reductions in local equity requirements based on their development needs and also offer other incentives to attract FDI in particular sectors[24]. States are increasingly permitting foreign investors the incentive of setting up wholly owned enterprises or increase their equity ownership considerably provided they are prepared to locate in certain underdeveloped regions of the state or willing to export larger percentages of their manufactured products. Wholly owned enterprises are also allowed in industries that are new or in sectors where the states prefer FDI[25]. States have by and large still maintained regulatory control through local equity requirements.

As regards local employment requirements BITs sometimes provide treatment standards with respect to certain operational conditions such as the investor's right to employ foreign nationals. For the investor it is important that his employees are able to enter the host country in order to manage and operate the investment. There is no automatic grant of the right to enter and stay for employees in the host country. "German BITs, for

[22] *ibid*

[23] *supra* at 8,, p.45

[24] Q. Li, and A. Resnick (2003), "Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries," *International Organization*, Vol. 57, No. 1, p. 90

[25] *supra* at 8, p.130

example, provide that each contracting party will give sympathetic consideration to applications for entry and US BITs give `nationals' of contracting parties the right to enter the other contracting state for purpose of establishing or operating investments subject to the laws of the host country."[26]

As for differential taxes linked to other performance requirements there are no international instruments restricting their use. Tax incentives may violate provisions of TRIMS Agreements as they may be used to mask prohibited performance requirements. Assuming, the incentives are not associated with performance requirements tax incentives per se are permissible in law.[27]

The WTO TRIMS Agreement requires the discontinuance of several PRs especially pertaining to local content by the members. Similarily, the WTO SCM Agreement requires the member countries (with exception) to eliminate subsidies contingent on export performance. Countries have also done away with performance requirement to comply with programs of World Bank and IMF[28] and to be participants in schemes of regional economic integration such as EU and NAFTA.[29] Local equity requirements are not per se prohibited under TRIMS or under BITs. However under GATS sectors placed on positive lists by members have to be liberalized and opened to participation in accordance with the commitments made there under. Any restriction below the commitments offered is prohibited and can be challenged through dispute settlement mechanisms. Countries have discontinued the use of performance requirements in order to fulfill their international obligations but this does not mean that there is a consensus on their negative effects.

Developing countries have used performance requirements extensively to regulate FDI and now fear that their removal would deprive them of a major means of exercising control over foreign firms operating locally. Surveys have noted that the largest incidence of performance requirements has been in large developing countries such as Brazil,

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[26] *supra* at 15,p. 86.

[27] *supra* at 8, p.116

[28] *ibid*, p. 53

[29] *supra* at 19, *p. 51*

China, India and Russia.[30] A widespread belief is that policies such as local content requirements are essential policy tools for industrialization and flexible use of TRIMS should be allowed for development needs.[31]

> "A month prior to the Seattle WTO talks the Indian government argued for the TRIMs Agreement to be substantially revised and circulated a set of proposals on behalf of Cuba, Dominican Republic, Egypt, El Salvador, Honduras, Indonesia, Malaysia, Nigeria, Pakistan, Sri Lanka, and Uganda with this end in mind. The proposal even went as far as stating that developing countries should be exempted from the disciplines on the application of domestic content requirement by providing for an enabling provision in Article 2 or Article 4 to this effect."[32]

The existing WTO TRIMs mechanism was seen as a challenge to the developing countries capacity for national development. In establishing uniform obligations for all members, the TRIMS agreement failed to take into account the structural inequalities and disparities in levels of development; technological capabilities; or social, regional, and environmental conditions of its members and did not incorporate a meaningful development dimension.[33]

At the Doha Ministerial Conference, a number of countries maintained their stance on the use of domestic content requirements as effective links between FDI and domestic economic activities, thereby contributing to the development process. The indigenization effect of the joint venture requirements was also endorsed. It must be noted that there is only mixed evidence as to the effect of performance requirements on investor decisions. Studies have claimed both positive and negative effects.

> "Kumar's study on Japanese and US TNCs noticed performance requirements to negatively affect FDI in case of US FDI but not in the case of Japanese FDI. This was corroborated by another study for the period of 1982-1988 which claimed a negligible negative effect of local content requirements and Export performance requirements in case of US Investors but a positive effect in case of Japanese Investors."[34]

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[30] *supra* at 19, *p. 50*

[31] *supra* at 21, p. 23

[32] *ibid*, p.24

[33] *ibid*, p. 23

[34] *supra* at 19, *p. 52*

A general assumption of the negative effect of PRs on FDI does not sustain in light of the fact that China managed to attract huge volume of FDI despite stringent PRs enforced in context of exports, ownership as well as local content. Also, Indian auto industry attracted nearly all global auto majors to set up their plants in the country despite many PRs imposed on them during the 1990s.[35]

3.3. Repatriation of Investment and Profits

One of the standard clauses mentioned in the BITs concerns free repatriation of investment and profits. No currency controls or lock-in periods are allowed foreign investment and this is enacted as a binding obligation on the member countries and essential for boosting investor confidence. The typical condition in an Indian BIT would read as

> "(1) Each Contracting Party shall permit all funds of an investor of the other Contracting Party related to an investment in its territory to be freely transferred, without unreasonable delay and on a non-discriminatory basis. Such funds may include:
>
> (a) Capital and additional capital amounts used to maintain and increase investments;
>
> (b) Net operating profits including dividends and interest in proportion to their share-holdings;
>
> (c) Repayments of any loan including interest thereon, relating to the investment;
>
> (d) Payment of royalties and services fees relating to the investment;
>
> (e) Proceeds received from sale of their shares;
>
> (f) Proceeds received by investors in case of sale or partial sale or liquidation;
>
> (g) The earnings of citizens/nationals of one Contracting Party who work in connection with investment in the territory of the other Contracting Party.
>
> (2) Unless otherwise agreed to between the parties, currency transfer under paragraph 1 of this Article shall be permitted in the currency of the original investment or any other convertible currency whichever is more favourable to the

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[35] R. Nagaraj, (2003), "Foreign Direct Investment in India in the 1990s: Trends and Issues," *Economic and Political Weekly*, Vol. 38, No. 17, p. 1707

> investor. Such transfer shall be made at the prevailing market rate of exchange on the date of transfer."

Besides BITs, MIGA is also involved in ensuring there is free repatriation of investment and profits and there are no blocks on currency transfers. It provides insurance against such blocks, so that the investor doesn't suffer in case of such restriction by the host government. MIGA derives its unique strength from the World Bank Group, and from its structure as an international organization whose shareholders include most countries of the world. This enables MIGA to provide an umbrella of deterrence against government actions that could disrupt projects, and assist in the resolution of disputes between investors and governments.[36] The host country being a member of MIGA will have to repay MIGA in case the insurance is claimed by the investor, though the payment may be delayed. But the investor will not have any problems in transfer of funds meanwhile, thereby allowing normal business to function.

3.4. Compensation in case of Expropriation

Though not of much concern at the entry stage, most IIAs provide for prompt and adequate compensation to the foreign investor in case of expropriatory measures taken by the host country. This obligation is binding and is present to ensure that investors are not at the discretion of the host government and have a guarantee of compensation as regards their investment. The expropriatory measures cannot be taken arbitrarily or in a discriminatory manner. Generally expropriation can be done only for national security concern or public good. The BITs also provide for a right to invoke international arbitration proceedings against the state, if the compensation is not provided or disputed expropriation is discriminatory to ensure compliance.

This standard has gained relevance at the entry stage through its inclusion in the non commercial risk insurance program of MIGA. By providing insurance against both, outright or creeping expropriation[37] brought on by legislative or administrative actions of

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[36] World Bank Group (2010), *Investment Guarantee Guide*, Multilateral Investment Guarantee Agency, Washington, p. 3

[37] *Supra* at 4, p. 10

the host state, MIGA ensures that investors are secure at the point of entry itself. Also as MIGA is subrogated to the position of the investor, nature of the dispute transforms to a public international law dispute, where the international community is more involved and hence compliance is strengthened.

This standard has been vital to boost investor confidence against political instability in the developing countries. Besides a clear and effective legal regime, investors want a stable political environment for functioning. A weak regulatory system may still be acceptable to investors but an unstable political environment full of uncertainty is a bigger deterrent and through compensation in case of expropriation, a safety net is provided via a rule based regime.

3.5. Investor's right to resort to International Commercial Arbitration in case of a dispute

IIAs are responsible for the predictability and stability of an investment regime due to the legally binding international obligations that they establish on the host country. Reinforcement of the same is achieved through binding international investor-state dispute settlement procedures.[38] The BITs provide the investors with recourse to an international arbitration unilaterally against the actions of the host state in violation of the treaty obligations. Such a right allows autonomous claims to be brought against hosts without regard to the wishes of the home country. This enables investors to convert a "conflict" (i.e., a perceived difference of interests) with host governments capable of being settled through informal means or domestic courts, into a public international law "dispute" (i.e., a conflict that is activated by the parties) and is settled by an international tribunal beyond the jurisdiction of the host.[39] The trend among more recent BITs is to provide a separate international arbitration procedure, often under the auspices of ICSID. The two states give the required consent needed to establish ICSID or other arbitral

[38] UNCTAD (2009), *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, UNCTAD Series on International Investment Policies for Development, UN, New York and Geneva, p. 26

[39] J.W. Salacuse, (2007), "Is There a Better Way? Alternative Methods of Treaty-based, Investor-State Dispute Resolution," *Fordham International Law Journal*, Vol. 31, No. 1, p. 138.

jurisdiction over any dispute between an alien national and the state party by signing a BIT. Although the investor must first try to resolve the conflict through negotiation and may have to exhaust remedies available locally, it ultimately has the power to invoke compulsory arbitration to secure a binding award.

A public policy question lies at the heart of many investor-state disputes. The host government through certain measures such as legislative or administrative acts tries to preserve the environment, regulate business or impose a tax vital to the public interest which is challenged by the investor. The resulting arbitration decision or other form of settlement has significant implications for the host's domestic regulatory space. If an arbitration tribunal ultimately judges such measures to be illegal under the applicable international law, the resulting award may require the payment of substantial damages. Besides the heavy arbitration costs incurred during the process, the host government may have to repeal or modify such measures in order to avoid similar arbitration claims from other foreign investors.[40]

3.6. Transparency requirements

Increasing number of IIAs impose transparency obligations on the host government to enable the foreign investor get a clear picture of the rule making process. IIA's also enhance transparency through the clear enunciation of the basic rules of protection and treatment applicable to foreign investors. "IIA's also include specific transparency obligations on the contracting parties, e.g. concerning transparency in the domestic rule making process of the host countries, enabling interested investors and other stakeholders to participate in that process."[41] The developing countries generally adopt a warm attitude towards transparency requirements in the belief that they can help streamlining the process of FDI and tackle roadblocks such as corruption[42]. The foreign investors however

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[40] *ibid*, p.140.

[41] *supra* at 38,, p. 26

[42] R.R. Gandhi, (2002), "FDI and Indian Experience," Report submitted to the *OECD Emerging Asia Investment Policy Dialogue Exploratory Meeting*, Shanghai, December 2002, p.10; and M.B. Baker, (2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p 423

may use these provisions to meddle in local affairs and influence domestic policy matters through lobbying in total disregard of the domestic concerns.

4. REGULATORY CONTROL: HOST COUNRTY'S PERSPECTIVE

A carrot and stick approach is frequently observed in the regulatory framework of the host countries. On the one hand incentives like tax concessions, tax holidays, tax credits, accelerated depreciation on plants and machinery, export subsidies and import entitlements are used to attract FDI[43] towards desired locations, sectors, and activities. On the other, regulatory control is maintained through regulations such as limitations on foreign equity ownership, local content requirements, local employment requirements, and minimum export requirements. These measures are designed to maximize the transfer of benefits arising from the presence of FDI to the local economy.[44] From the perspective of the host country FDI needs to work within the regulatory framework of the host state. If the admission of a foreign investment is conditional, the failure to meet those conditions justifies denial of entry. If licenses need to be obtained are made conditional, the failure to meet those conditions justifies the withdrawal of the licenses.[45] "When a corporation enters a state with a commitment progressively to reduce its control by divesting shares to locals, that corporation cannot complain if the host state requires it to abide by its commitments. Also as regards the requirement that entry be made with local collaboration, there is a voluntary assumption of conditions by the foreign corporation. A state, in pursuance of its sovereignty is entitled to impose such conditions."[46] There can be no doubt regarding the domestic legality of the measures if the procedures mandated by the law have been followed.[47] Internationally the support for domestic regulatory control can be found in Section 3 of World Bank Guidelines, specifically Guideline II which makes it clear that "States maintain the right to regulate the entry of foreign

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[43] *supra* at 3, p. 6

[44] *supra* at 21,, p. 13

[45] *supra* at 8, p.131

[46] *supra* at 8, p. 131

[47] *ibid*

investments. It is based on the recognition that some restrictions on entry exist in all legal systems."[48]

The host country specifies the legal vehicles through which foreign investment maybe made, the nature of the capital resources that may be brought from outside the state, the planning and environmental controls that the manufacturing plant may be subject to, the circumstances of the termination of the foreign investment and other like matters.[49] The host country may also maintain screening controls over FDI. As long as such screening rests on sound economic grounds and is not discriminatory, it cannot be deemed wrongful.[50] The host country generally takes care in ensuring that high technology industries beyond the capacity of local entrepreneurs are opened to entry to FDI while reserving low technology labour intensive areas for nationals.[51] Developing countries prefer to have negative lists in their investment laws prohibiting FDI and ensuring exclusion of sectors for their own nationals while gradually increasing the amount of foreign equity participation in others.[52] The GATS route is an exception where positive lists with sectors open to entry and other conditions are outlined for foreign investors.

Administrative agencies are responsible for screening of entry. The administrative agencies may require a feasibility study to be performed about the potential benefits of the proposed foreign investment for the local economy. Since many of the states permit entry only through joint ventures in many sectors, the making of feasibility studies is considered a sound preliminary exercise even between purely private parties to such joint ventures.[53] Foreign investors may also prefer joint ventures as it diversifies the risk, giving the foreign investor a lower visibility and providing them with a local partner whose expertise[54] will be effective in mediations with the local government.[55] Joint

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[48] *supra* at 9, p. 95

[49] *supra* at 8, p.100

[50] *ibid*, p.160

[51] *ibid*, p.118

[52] *ibid*, p.307

[53] *supra* at 8, p.117

[54] R.K. Luthra, . (2011), *Foreign Direct Investment in India: Evolution and the Legal Regime*, s. 25

ventures in the manufacturing and mineral sectors as well as the production sharing agreements in the minerals sector are legal vehicles structured with the aim of maximising local control over the investment.[56] These contractual forms are more in the nature of public contracts than ordinary commercial contracts and hence more amenable to public control[57]. The amount of control that may be asserted through these legal techniques depends on the relative bargaining strength of the parties[58]. A state desperate for investment is not going to assert weary of scaring away the investment, whereas a state which perceived as safe and profitable will seek to garner maximum benefits for itself while ensuring that the foreign investor has adequate incentives to remain and do business.[59] Exceptions to the requirement of entry through local participation are made in the form of incentives where local infrastructure development and net foreign exchange earnings are guaranteed.[60] The local content requirements are prohibited under TRIMS yet states may use them in conjunction with incentives which mask their real purpose, such as freedom from custom duties.

As regards the investor's right to invoke international arbitration against the host state, the host states opt for a clause in the BITs which requires exhaustion of local remedies before recourse to international arbitration[61]. There are a plethora of examples from Latin American countries that show regulatory measures of sovereign states being successfully challenged by individual foreign investors in international arbitral bodies. However, only certain types of foreign investment conflicts can be submitted to international arbitration. Conflicts can also arise either with a local partner in a joint venture, with the domestic government, or the public agency which is in charge of handling investment matters or

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[55] *supra* at 8, p. 121

[56] *ibid*, p.131

[57] *ibid*, p.132

[58] *supra* at 35, p. 1711; *supra* at 8, p.135

[59] *supra* at 8, p.130

[60] *ibid*, p.121

[61] *supra* at 19, *p. 39*

sector-specific licenses.[62] Since the joint venture entities are always locally incorporated; problems of corporate nationality and shareholder protection can be tricky. It may pose a problem in the arbitration proceedings as character of the same will be disputed as being either domestic or international. The host may contest the corporate entity's nationality and its standing before an international tribunal and wish the matter to be resolved before its domestic courts.[63] On the other hand foreign investors will want to avoid domestic courts of the host state since they do not fully trust their competence, speed and impartiality. However national courts are an important complement to the resolution of investment disputes.

> "Arbitration does not occur in vacuum and the existence of investment treaty arbitration does not eliminate the need of a court system where rights are adjudicated in an impartial, fair, and predictable manner. Fostering development of the rule of law in national courts not only develops local judicial institutions, but it also promotes confidence in the overall process of resolving investment disputes."[64]"In any case, it is felt that by agreeing to international enforcement mechanisms and institutions, developing countries have neglected domestic legal institutions and mechanisms which may lead to lower institutional quality in future years."[65]

The FDI entry entails the formation of many contracts and in general the interests of both states and foreign investors are secured if these contracts are comprehensive. They should cover provisions on such basic issues as the applicable law, the choice of forum including means of dispute resolution, liability for breach of contract and its duration and termination. [66] "In FDI transactions many contracts are judged by the law of the host state and international standards and the laws of the home state have limited application. Insurance and financing arrangements with domestic institutions, either public or private ones, most likely follow the domestic law."[67] International law standards are applied only when such contracts are concluded with MIGA, the IFC, the IBRD, regional development

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[62] *supra* at 9, p. 43

[63] *supra* at 8, p.121

[64]S.D. Franck, (2007). "Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law," *Global Business and Development Law Journal*, Vol. 19, p.368

[65] *supra* at 16, p. 13

[66] *supra* at 9, p. 39

[67] *ibid*,

banks or international private banks. The foreign investor may desire to integrate international standards in the other contracts whereas the host may prefer the domestic standards. As a compromise in all foreign investment contracts, an internal balance between internationalization and localization is struck during the process of bargaining preceding the drafting of the agreement. The balance keeps changing, depending on multifarious factors such as fluctuations in the demand for the products, political changes in the country and the health of the global economy as a whole.[68]

The World Bank Guideline also caution against restrictive approaches and in particular against use of certain performance requirements (such as minimum local ownership and staffing of export targets) as conditions of admission of foreign investment.[69] 'As Section 3 of Guideline II explains, experience indicates that the imposition of such requirements may deter investments or encourage abuses such as corrupt behaviours by the investors applying for admission.'[70] The entry of a foreign investor in a state subjects him and the investment to the laws of the host state as he voluntarily assumes the same. However, the unqualified right to exclude the alien prior to the entry becomes qualified after entry to the extent the investor enjoys protection by international law.[71] For example, in case of export performance requirements the host may prefer terminating the foreign investment if the commitments are not upheld as it will be unwilling to permit sales on the local market which it may have reserved for its own industries. However, if the host has affirmed absolute national treatment at the pre-entry stage in a BIT this termination may be successfully challenged as discriminatory[72]. Therefore despite reluctance on part of the host states, harmonization of domestic regimes to international standards is inevitably being done to avoid disputes and attract maximum FDI for the developing countries.

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[68] *supra* at 8, p.131

[69] *supra* at 9, p. 95

[70] *ibid*

[71] *supra* at 8, p.98

[72] *supra* at 8, p.122

5. HARMONIZATION BETWEEN INTERNATIONAL LAW AND DOMESTIC REGIME IN INDIA: STATUS AND ISSUES

IIAs which include BITS, regional arrangements such as NAFTA, Free Trade Agreements (FTAs) and other international agreements such as GATS, TRIMS, TRIPS etc. contain internationalization clauses. These clauses aim at securing foreign investor against the uncertainties of domestic laws by subjecting host countries to a set of international legal rules that must be respect when dealing with FDI.[73] "The weak credibility of the domestic regulatory regime and multiple and conflicting role of the agencies and government has an adverse impact on the FDI investors and is one of the primary reasons for the push of incorporation of international standards in the local regulatory regime. On the other hand, it is the intent and objective of the host government to promote FDI through a policy framework which is transparent, predictable, clear & simple thereby reducing regulatory burden.

Two types of domestic rules on FDI can be distinguished. The first type consists of regulations dealing with registeration requirements and almost every country has some form of law reserving the national right to control, limit and restrict foreign owned businesses. The second type embraces all the regulations aimed at the promotion and attraction of FDI.[74] A clear, transparent, stable and enforceable legal framework is deemed more important for a good investment climate than a mere set of fiscal incentives which can be reversed unpredictably. It is argued that a decrease of regulations both in the national and international level specifically dealing with FDI is also advantageous to the host countries since this minimizes legal conflicts between rules for national and foreigners.[75]

Such a decrease may be achieved by effective harmonization of international standards in the domestic regulatory regime. This section studies the extent and impact of such harmonization in India by dividing the process of entry of FDI in three different stages: i) Pre-entry; ii) Point of entry ; and iii) Approval

[73] *supra* at 9, p. 41

[74] *ibid*, p. 28

[75] *supra* at 9, p. 28

5.1 Pre-Entry

Many regional treaties and BITs made in recent times provide for the right of entry and establishment of FDI achieved by extending national treatment to the pre-entry phase. Where there is pre-entry right of establishment provided by a treaty, screening legislation will not be consistent with the treaty obligations as to national treatment.[76] Such pre-entry rights are provided for in the US and Canadian BITs as well as NAFTA. The European states do not use such provisions and there is little likelihood of agreement between the developed states themselves of using these rights universally.[77] The Admissions clause of a BIT stipulates under what conditions investors are allowed to enter a country. By granting unconditional MFN and national treatment at pre-entry stage foreign investments are treated like domestic ones even before entering the country giving unrestricted market access to foreign capital. Indian BITS do not extend national treatment to the pre-entry stage. Furthermore, this right is not recognized as an absolute right as even the parties to the treaties giving this right continue to make sectoral limitations to entry.

In case of India, it imposes restrictions on foreign equity ownership in many sectors, and in particular in the service industries. Sectors such as railways, lottery and gambling businesses, retail trade (except single brand retail) are completely closed to foreign equity participation. With the exception of certain specified activities, foreign ownership in the agriculture sector is also not allowed. In the financial services sector, FDI in local banks is limited to 74% and in insurance companies to 26%. Furthermore, foreign ownership in the telecommunications sector is limited to 74%.[78] India's restrictions on foreign equity ownership are greater than the average of the countries covered by the Investing Across Sectors indicators in the South Asia region and of the BRIC (Brazil, Russian Federation, India, and China) countries.[79] "However India's policies and practices are typically more

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[76] *supra* at 8, p.116

[77] *ibid*, p.307

[78] World Bank (2010), *Investing Across Borders, 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies*, Investment Climate Advisory Services, Washington, p.123

[79] *ibid*, p. 123

open than what has been committed to in international agreements like GATS."[80] For example, India has committed to allowing 51% foreign equity ownership in software, construction, and tourism under its GATS commitments. But in national law and practice, it permits 100%. In telecommunications India's GATS commitment is 25%, but in national law and practice it is 74% or more. Most tellingly, while India has not even listed commitments in transport, the sector is not closed. Indeed, India allows 100% foreign ownership in road and maritime transport.[81] As India is not under the obligation to extend national treatment to pre-entry stage such sectoral limitations are not in derogation of international standards.

5.2 Point of Entry

The World Bank guidelines encourage states to make admission a largely automatic process by confining exclusions or approval requirements to specified types of investment that are classified as either prohibited or require screening or licensing. At the same time Section 3 of Guidelines II lays down that investments not requiring specific approval are not automatically exempted from the host state's general laws and regulation, which may require registration etc.[82] Developing countries are increasing enacting a single piece of legislation stating all the pertinent rules regarding making of a foreign investment. This serves the purpose of facilitating promotion while enabling the investor to acquaint himself with the domestic laws of a state governing FDI more easily.[83] As has been discussed in detail in Chapter 3, the Consolidated FDI Policy of 2010(Policy 2010) tries to achieve precisely the same and the Indian regulations are in conformity to this internationally acceptable approach. By allowing the two routes viz automatic and approval and routing most of the incoming FDI through automatic route, the Indian law is harmonized with international best practices. However, there are

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[80] *Ibid*, p. 80

[81] *ibid* p. 80

[82] *supra* at 9, p. 95

[83] *supra* at 8, p.100

specific provisions of the consolidated FDI policy 2010 which may be construed as violations of international minimum standards and may pose problems. They are:

1) According to Policy 2010, original investments going in the development of townships, housing, built-up infrastructure and construction and development projects cannot be repatriated before a period of three years from completion of minimum capitalization. Original investment means the entire amount brought in as FDI. The lock in period of three years is applied from the date of receipt of each installment/tranche of FDI or from the date of completion of minimum capitalization whichever is later.[84]

However, this domestic regulation is inconsistent with the provision on capital transfer contained in India's BITs.[85] Free repatriation of profits or other funds related to investments by the investors to their home country is provided in most of the Indian BITs. Exceptions are restricted to national security or situations of extreme emergency. No exception of a mandatory lock-in period of three years for the township and housing sector can be found in any of the Indian BITs. If an international dispute arises between a foreign investor and India on repatriation of investment in the township sector, India cannot invoke regulations contained in the Policy 2010 as a defence to escape liability from treaty violations. Such a provision is sustainable only in the case where either the specific BIT itself allows for such an exception or this regulation is selectively enforced on foreign investors from countries with whom India is not party to a BIT.[86] However, these fine distinctions are missing in the Policy 2010 which leaves a big gap in the overall regulatory policy framework. The only saving grace allowed is that the investment is permitted to exit earlier with prior FIPB approval. However if such an approval is not granted, the investor can still successfully challenge this regulation as violation of treaty obligation.

2) In the telecom sector, a security regulation on all foreign telecom companies is imposed that the chief officer-in-charge of technical network operations and the chief

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[84] Department of Industrial Policy and Promotion (DIPP) (2010), *Consolidated FDI Policy*, Circular 1, Ministry of Commerce and Industry, Government of India, New Delhi, p. 50

[85] P.Ranjan, (2010), "Indian Investment Treaty Programme in light of Global Experiences," *Economic and Political Weekly*, Vol. 45, No. 7, p. 72

[86] *supra* at 85,p. 72

security officer should be resident Indian citizen.[87] Also, as regards FDI in defence subject to Industrial licenses, the management of the applicant company/ partnership should be in Indian hands with majority representation on the Board as well as the chief executives of the firm being resident Indians.[88] While the rationale behind a policy regulation like this maybe fully appreciated, it may go against India's international regulatory framework contained in its BITs. A foreign telecom or defense investor can challenge the regulation as violation of fair and equitable treatment under the BIT, especially if the foreign investor does not get reprieve from the domestic courts.

In *Bycell Telecommuncations India Private Limited and another vs Union of India and others,(2010 INDLAW DEL 1094),* the security clearance of the petitioner was withdrawn and the approval granted by the FIPB was revoked on the basis of secret information regarding the holding pattern of the said company. The funds were believed to be tainted and sourced from undesirable aliens. The Delhi High Court dismissed the petition stating that

> "In matters of foreign investments in the country, what the decisive parameters should be, is part of the policy decision of the UOI. Some of the inputs that go into the decision-making process is bound to be of a confidential nature. Unless the decision is shown to be malafide, which in the present case is not, there is no basis to doubt that the assessment of information received on the security aspects is both relevant and sufficient to support the decision taken"

This case is demonstrative of the fact that domestic courts maybe moved by national security concerns when deciding such cases relating to holding patterns or local employment requirements. The aggrieved investor may decide to challenge the same in an international arbitration, especially if approval once granted has been revoked and maybe violative of the MFN principle and discriminatory in nature. "Critics may dismiss the argument by pointing out that except for the Dabhol power project case[89], there has not been any BIT dispute involving India." However, the fact that there was little or no dispute in the past does not mean that such disputes cannot arise in future.

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[87] *supra* at 84, p. 58

[88] *ibid*, p. 39

[89] P. Ranjan (2008), "International Investment Agreements and Regulatory Discretion: Case Study of India." *The Journal of World Investment and Trade*, Vol. 9, No. 2, pp. 214.

3) FDI permitted in tea plantations is 100 per cent but subject to compulsory divestment of 26% equity of the company in favour of Indian partner/Indian public within a period of three years. [90] If the foreign investor doesn't fulfill this requirement the government may cancel the FDI. But the foreign investor may challenge such an act as an expropriatory measure and demand compensation from the government.

4) In case of FDI for production of manufacture of items reserved for production in micro and small enterprises, the issue of industrial licenses is subject to a few general condition and the specific condition that the industrial undertaking shall undertake to export a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of 3 years.[91] This may be successfully challenged as a minimum export requirement under the TRIMS or as violative of the national treatment standards under a BIT.

Besides the Policy 2010 there are other aspects of domestic regime which may be in conflict with international standards. In the draft Foreign Education Institution (Regulation of Entry and Operation) Bill, 2010[92] there are restriction on repatriation of original investment and profits of the foreign education providers. Under Section 5 of the proposed Act, they are required to invest the profit in the further development of their infrastructure in India. These restrictions in the Draft Bill are again violative of the BITs obligations and may be challenged in the future, despite the voluntary assumption of the same on entry. Another provision that may be of some concern is where the foreign investor who proposes a new investment in the same field in which it has an existing joint venture. The foreign investor seeking to take benefit of the relaxation of equity restrictions in a particular field may wish to establish a WOS but this requires prior approval of the FIPB. Such an approval may not be forthcoming especially if it is perceived that the interests of the JV partner may be harmed. If challenged domestically, the Indian courts may favour the interests of the local partner of the JV.

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[90] *supra* at 84, p. 37

[91] *ibid*, p. 38

[92] Government of India, Ministry of Human Resources Development,(2010),*The Foreign Educational Institutions (Regulation of Entry and Operations)Bill, 2010*, No. 57 of 2010, New Delhi.

A case in point is *Modi Rubber Limited v Guardian International Corporation (2007 INDLAW DEL 1266 Delhi High Court).* The petitioner had filed the petition under Section 9 of the Arbitration and conciliation Act, 1996 urging that the action of the respondent in proposing to set up a wholly owned subsidiary is in absolute breach of the SHA, and that the same would negatively impact the interest of the joint venture and jeopardize its business and profitability thereby causing irreparable loss and damage to it. The court found in favour of the petitioner. The investor may choose to contest such disapproval through international commercial arbitration if the contract of JV contains a 'conflict of interest' clause as was done by the respondent in the above case. Also, such a denial of approval by the FIPB may be challenged as violative of the NT standards, as such a requirement is not made on an Indian shareholder of a corporation if he wishes to open another subsidiary independently in the same field in the absence of a conflict of interest clause.

A dichotomy in the process of harmonization can be observed in the BITs signed by India. On the one hand they allow more favourable treatment to be given to a foreign investor and investment if there are provisions of the law of either contracting party or obligations under international law allowing such treatment. A typical provision in the Indian BIT would read as

> "If the provisions of law of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Parties in addition to the present Agreement contain rules, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by the present Agreement, such rules shall to the extent that they are more favourable prevail over the present Agreement."[93]

On the other hand, there are also provisions which allow for invoking of dispute settlement mechanisms provided under BITs viz. international arbitration only in the absence of local judicial remedies. This dichotomy is a minor proof of the struggle to maintain regulatory control in the era of investment liberalization. However it may be

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[93] Agreement Between The Government of The Republic Of India and The Government of [Country] For The Promotion and Protection of Investments, (2003)

safe to state that the liberalization process is winning [94] and the incorporation of international standards and best practices is progressing at a steady pace.

The establishment of the FIPB as a single window authority for streamlining the process of incoming FDI and the enactment of the Policy 2010 are indicators of this process. Even the definitions adopted by the FIPB and concerned ministries as regards certain investment activities and sectors are those as promulgated by international institutions such as WTO. A case in point is *Federation of Associations of Maharashtra and Others v. Union Of India and Others (2004 INDLAW DEL 1384, Delhi High Court)*. In this case the petitioners challenged the permission given to Metro Cash and Carry Project to allow business to business sales as violative of the FDI policy since it constituted retail trade and FDI in retail is not allowed. The Department of Commerce, which was the Administrative Ministry for the Metro Cash & Carry Project, have confirmed the definition adopted by the World Trade Organisation (WTO), according to which:

> " Wholesaling consists of the sale of goods/ merchandise to retailers, to industrial, commercial, institutional, or other professional business users or to other wholesalers and related subordinated services."
>
> "Retailing services consists of the sale of goods/ merchandise for personal or household consumption either from a fixed location (e.g. Store, kiosk, etc.) or away from a fixed location and related subordinated services."

It was asserted that the definition clearly states that

> "the quantity of sale is not the detriment for wholesale trade, but it is the type of customer who determines whether the trade is wholesale or retail. Further, it is apparent that industrial, commercial, institutional and professional business users are also considered as wholesale customers, even if they are consumers. This, in fact, was the basis of the clarification issued to Metro Cash & Carry that business-to-business sale was permissible under the extant policy."[95]

The petition was dismissed by the Delhi High Court which held that it was the prerogative of the executive to decide economic to decide economic policies and wisdom and advisability of economic policies are ordinarily not amenable to judicial review

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[94] K.P. Sauvant, (2005), "New Sources of FDI: The BRICs- Outward FDI from Brazil,, Russia, India and China," *The Journal of World Investment and Trade*, Vol. 6, No. 5, p. 653.

[95] Para 6 of the Judgement

unless it can be demonstrated that the policy is contrary to any statutory provision or the Constitution.[96]

Competition Act

The zeal with which the government of India is harmonizing its domestic laws and the problems which it causes is visible clearly in the Competition Act 2002 which deals with anti-competitive practices. India had been opposing the incorporation of the National Treatment standards i.e. non-discrimination between domestic and foreign suppliers in the WTO Agreement of Competition.[97] "Foreign investors entering a host state may engage in anti-competitive behavior like price fixing or predatory practices towards local suppliers. Mergers may completely change the national market structure for certain kinds of products or services even resulting in edging out local competitors through misuse of a dominant position."[98] Host countries like India did not want to rely on extra territorial application of antitrust laws by the home states in such situations and hence domestic competition laws seemed the effective solution.[99]

The Competition Act contains what amounts to a per se prohibition of 'hard core' cartels, exactly the kind targeted by the EU (and more broadly, the OECD) and the 'public interest' gateways of the MRTP Act have been taken away[100]. It may not be hard to imagine a situation in which Amul, for example, may be targeted as a price-fixing cartel before the Competition Commission and if successful, may pave the way for massively subsidised European exports which have destroyed unorganised small-scale dairy farmers in many developing countries.[101] India's investment regime and competition law can be categorized as WTO-plus-plus and by enshrining both de jure National Treatment and a per se prohibition of hard core cartels, the Competition Act has conceded the EU's main

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[96] Para 93 of the Judgement

[97] A. Bhattacharjea, (2003), "India's Competition Policy: An Assessment," *Economic and Political Weekly*, Vol. 38, No. 34, p. 3572

[98] *supra* at 9, p. 57

[99] *ibid*, p. 57

[100] *supra* at 96, p. 3570

[101] *supra* at 96,p. 3572

objectives of a multilateral agreement at WTO.[102] Also, the Act reintroduces import restrictions as a remedy for foreign anti-competitive practices which are probably WTO-incompatible.[103]

"In what seems to be a direct response to the Haridas judgment, a new subsection 33(2) has been inserted, which allows the commission to issue temporary injunctions to restrain any party from importing goods, if the import is likely to contravene the Act's sections on anti-competitive agreements, abuse of dominance, or combinations"[104].

Imports can be targeted for being priced too high (eg, by a foreign merger or cartel), or too low (by a dominant foreign firm engaged in predatory pricing). Such injunctions can be given *ex parte.*

> "Paragraphs 56 and 72 of the Haridas judgment required notice to the respondent, an enquiry to prove an RTP, as well as a public interest test, as prerequisites for granting injunctive relief under the MRTP Act. Sections 3 and 4 of the Competition Act, in contrast, make certain types of collusive agreements and abuse of dominance illegal per se. This is subject to the ambiguous exceptions, but even these cannot be effectively considered at the injunction stage if the opposite party is not given a hearing".[105]

Even if a prima facie case can be established import prohibitions are not the appropriate remedy. The threat of an import restriction might compel foreign defendants to cooperate with the investigation and to pay the fine in case of an adverse ruling. But to shut out the goods for the entire duration of the case may probably be held inconsistent with Article VI of the GATT and the Anti-dumping Agreement, which lay down a procedure for dealing with low-valued imports, and require domestic laws to be brought into conformity with that procedure.[106]

> "In 2000 the WTO Dispute Settlement Body held that the US 1916 Anti-dumping Act was inconsistent with these requirements, and could not be exempted on the grounds that it was a national competition law. Ironically, India included itself as a third party in that case, on the side of the complainants, the EU and Japan. The

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[102] *ibid*, p.3571

[103] *supra* at 96, p. 3572

[104] *ibid*, p. 3567.

[105] *ibid*

[106] *supra* at 96, p. 3568.

> US can get away with defying such rulings, but India is likely to be hit by retaliatory tariffs."[107]

India has been leading the charge against automatic extension of NT vital in respect of trade in goods to competition policy at the WTO. It pointed out the lack of resources in developing countries to prosecute the anti-competitive practices of firms located abroad and argued that only domestic firms will bear the brunt of a 'non-discriminatory' competition law in practise. But just a few months later the Parliament of India passed the Competition Act, which is silent on the question of discrimination, thereby conceding de jure NT.[108]

The above discussion suffices in highlighting the lack of policy synchronization in many areas which may become a fertile ground for international investment disputes in the future. However, the harmonisation or the lack of it has only been discussed in the context of substantive provisions and it is also important to include procedural aspects which are part of the approval stage.

5.3Approval

The approval stage is one of the most important stages from the point of view of reducing transaction costs and incorporating international transparency standards[109].

> "In many cases when foreign investors enter a host state, they have to deal with different authorities for the promotion, admission or registeration and supervision of foreign investment. The competence of those agencies is designed according to the national view as to whether and to what degree foreign private capital should play an important role in achieving the domestic development agenda."[110]

The FIPB was established with the aim of being a more cost effective way to deal with FDI than having various agencies granting incentives[111]. It sought to streamline the process of FDI by reducing delays. The FIPB considers application on the basis of

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[107] *ibid.*

[108] *ibid*, p. 3571

[109] *supra* at 3, p. 7

[110] *supra* at 9, p. 32

[111] *ibid*

notified guidelines and disposes them within a 6-8 week timeframe, as has been laid down by the Cabinet. The entire process of FIPB applications, starting from their registration through to listing on FIPB agenda and their final disposal and despatch on official communication is placed on the web site, which adds to the transparency of decision-making and enhances investor confidence. Similarly, the advisory support in the form of online chat facility and dedicated email facility for existing and prospective investors creates an investor friendly image. The delays mentioned by foreign investors are not at the stage of FDI approval per se i.e. at the entry point whether through RBI automatic route or FIPB approval. A FICCI Study on "Impediments to Investment" (January 2002) has acknowledged the fact that the FIPB clearances have been successfully streamlined and the FIPB approval system has been rated as world class by independent surveys conducted by CII and JICA.[112]

It is the approval and monitoring process relating to the necessary licenses that is not transparent and reasonably fast. Reality does not confirm to the written laws and regulations and corruption takes place in various forms. As shown by a CII study, of the three stages of a project, namely general approval (e.g. FDI, investment licence for items subject to licence), clearance (project specific approvals e.g. environmental clearance for specific location and product) and implementation, the second was the most oppressive. The feasibility studies which are made prior to the entry of FDI require an assessment of the environmental impact of the investment and permissions will be denied if harsh effects on the environment are probable. But, environmental standards in India are often overlooked[113] and often corruption is rampant at this stage in giving clearances.

> "Three-fourth of the respondents in the survey indicated that (post-approval) clearances connected with investment were the most affected by India's red tape. According to a CII study, a typical power project requires 43 Central Government clearances and 57 State Government level (including the local administration)

[112] A. Virmani, (2004), *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, New Delhi, p 22

[113] *supra* at 8, p.124

clearances[114]. Similarly, the number of clearances for a typical mining project are 37 at the Central Government level and 47 at the State Government level".[115]

Thought the process at Central level has been streamlined, the major implementation hurdles are encountered at the State level[116].

6. CONCLUSION

The harmonization of international minimum standards into the domestic regime got a major push in the middle of 1990s when fervor for economic liberalism had reached a high point. Ideas pertaining to rights of entry and establishment dominated discussions of investment principles[117] and standards such as national treatment and MFN became part of IIAs and multilateral regimes under the auspices of WTO. The ability of the foreign investor to invoke binding arbitration and increase in number of arbitration awards added further precedents to the law [118] affecting domestic regulatory space. IIA's have established binding obligations on host country authorities, displaced and in some cases replaced the relevant domestic laws of the country in some aspects. This aspect of development of international investment law has generated and continues to generate controversy within both developed and developing countries, as it places host country concerns about national sovereignty and right to control the activities of foreign investments in opposition to investor concerns about protection from unjustified interference in their investments.[119] This contest is playing itself out at the entry stage of FDI. The movement towards pr-entry rights in the BITs and FTAs is a struggle to ensure that any semblance of regulatory control that home countries have is destroyed. Once the

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[114] R.R. Gandhi, (2002), "FDI and Indian Experience," Report submitted to the *OECD Emerging Asia Investment Policy Dialogue Exploratory Meeting*, Shanghai, December 2002, p. 9

[115] *supra* at 111, p 21

[116] R. Sachdev, (2006), "Comparing the Legal Foundations of FDI in India and China: Law and the Rule of Law in the Indian FDI Context," *Columbia Business Law Review*, Vol. 167, p. 200

[117] *supra* at 8, p.27

[118] *Ibid*

[119] *supra* at 15, p. 70.

foreign investors are treated as national investors even before entry, there can be no effective screening of investments. Also, a broader definition of FDI which includes portfolio investment further restrains control over volatile FIIs. The entry stage is where the host government makes a distinction between desirable and non-desirable investors and by taking away that distinction internationally, these new IIA s are working to the detriment of the home countries. The investors as of now are winning as host countries like India are bringing about changes in the regulatory regimes to attract FDI and harmonizing themselves with international standards. A lot of confusion is still visible but the movement towards complete harmonization has begun in India.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

In the era of liberalization, the world is a global market. The recent financial crisis testifies to the interconnectivity of the world economy.FDI is a major factor in this global economy and its inflows and outflows are important determinants of economic growth. There is a consensus among the developing countries regarding the need of attracting FDI which has increased the competition for importing capital. Also, there is a recognition regarding the erosion of sovereign economic control once such FDI enters and establishes base. A tussle has ensued between the foreign investors seeking a free hand and host government wanting to ensure some regulatory control over its vulnerable economic space. The role of legal systems in this tussle is vital as they are believed to be helpful in both attracting FDI and ensuring sustainable benefits from it. Though the extent to which the legal systems affect the flow may be disputed[1] but their role is important both directly and indirectly.

The present study sought to study the current regulatory regime encompassing the legal systems present at the international level and at the domestic level in India to answer some of the relevant questions regarding the process of FDI. The entry stage was chosen for its primary role as the first stage of interaction between the foreign investor and the host state and the opportunities it provides for regulation. In this chapter, the conclusions drawn from the study will be shared in the specific context of the research questions sought to be answered and the hypotheses propounded. Also, pertinent issues that were encountered during the course of this study but beyond its mandate will be highlighted. Some suggestions will also be offered in reference to the conclusions drawn.

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[1] A. Perry, (2000), "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," *International and Comparative Law Quarterly*, Vol. 49, p. 786

1.EVALUATION OF THE RESEARCH QUESTIONS

The study began with the examination of a definition of FDI. After studying the variety of definitions at the international level, essentials of a basic definition were identified. Also the forms of FDI and the benefits driven from them were highlighted. The appropriateness of the definition of the FDI revolved around the inclusion of portfolio investment in its fold. Therefore, the distinction between FDI and portfolio investment was duly stressed. As regards the first research question, it can be concluded that blurring the lines between direct and portfolio investments complicates the proper assessment of the true benefits, form and consequences of FDI inflows. The consequences of having a broad national FDI definition without a clear distinction between direct and portfolio investments can be problematic. As has been established that North- South FTAs and BITs often have provisions requiring free transfers of funds related to investment without hurdles or delays. Due to the inclusion of portfolio investment in the definition of FDI these transfers include contributions to capital, profits, capital gains, dividends, interest, loan repayments, etc. The use of capital controls as a policy measure is restricted to only emergency situations such as "serious difficulties" with monetary or exchange rate policy or balance of payments and allowed only for a temporary period of time. This is clearly detrimental for the developing countries who may want to prevent a BoP crisis by using capital control measures rather than engage in fire fighting later.[2] The entry stage is perfect for taking these preventive measures but by taking away the capacity to distinguish, the wings of the host countries are effectively clipped. Therefore a broad definition of FDI is harmful to domestic regulatory control[3] and a restrictive definition should be preferred.

In the case of India, resorting back to the narrow definition in the Consolidated FDI Policy, 2010 ensures that there is no adverse affect on the remaining policy space related to investment policies and capital controls. Furthermore, a lack of clarity in national FDI definitions would have taken away any leverage India has in investment negotiations with

[2] S. Francis, (2010), "Foreign Direct Investment Concepts: Implications for Investment Negotiations," *Economic and Political Weekly*, Vol. 45, No. 22, p. 35.

[3] P. Ranjan(2008), "International Investment Agreements and Regulatory Discretion: Case Study of India," *The Journal of World Investment and Trade*, Vol. 9, No. 2, p. 215

developed countries in Free Trade Agreements (FTAs), Economic Partnership Agreements (EPAs), etc. and would have contributed to a wider process of multilateralisation of investment rules.

The second and the third chapter have outlined the current regime regulating FDI at the entry level in the sphere of international law and domestic legal framework of India: The second research question probing the current international and domestic regulatory regime governing FDI in India has been adequately addressed through these two chapters. As has been seen, a foreign investor has primarily to deal with domestic law when the foreign investor enters into various contractual arrangements with other private and public entities in the host state. However, the foreign investor has also to consider the relevant international investment instruments to draw benefits provided to him under international law.

Customary international law has recognized that decisions relating to the entry of foreign investment are entirely a matter of the prerogative of the sovereign state. Liberalizing instruments on foreign investment however have sought to bring a change to this aspect. The bilateral and multilateral treaties though concluded between states are relevant to foreign investors as they champion their cause and guarantee them rights[4]. The existence of a BIT between the host state and home state can be important for the investor since the access to markets, national risk and export financing schemes and other incentives depend in many countries on the conditions present in such treaties. Many BITs now make a distinction between the treatment to be accorded to an investor pre establishment and post establishment by pushing for pre entry rights[5]. No BIT gives a blanket right to entry and market access to all types of foreign investors in the markets of a host country. Most countries have special laws governing the entry of FDI, and BITs generally provide that host countries may admit investments in accordance with their laws.[6] International

[4] D.D. Bradlow, and A. Escher (1999), *Legal Aspects of Foreign Direct Investment*, Kluwer Law International, London; p. 43

[5] M. Sornarajah, (2004), *The International Law on Foreign Investment*, Cambridge University Press, Cambridge, p.116

[6] J. W. Salacuse, and N. P. Sullivan (2005), "Do BITs really work?: An evaluation of Bilateral Treaty Regime and their Grand Bargain," *Harvard International Law Journal*, Vol. 46, No. 1, p. 91.

institutions such as ICSID and MIGA are important for dispute settlement and risk insurance, thereby boosting investor confidence against a politically unstable environment in the host. As regards other multilateral instruments, it must be noted that though TRIMS, the shortest of the three multilateral agreements to come out of the Uruguay Round, is itself not a comprehensive investment agreement, but in conjunction with GATS and TRIPS has the potential to act as a comprehensive multilateral agreement effective for the protection of foreign investment. While it may be true that the TRIMS Agreement will neither add nor detract from GATT provisions until review and a subsequent decision by the Council[7] to amend or complement it, the Agreement has the potential to do a lot more.[8] It remains to be seen if the TRIMS agreement is amended and complemented by the WTO but even in the present position it is an effective tool especially against performance requirements and its strength is reinforced by the binding WTO dispute settlement system. The progress in international investment law belies the notion of states being the only actors deciding the content of international law as foreign investors themselves are considerable bases of power[9]. Private power, in the form of both multinational corporations and more recently non-governmental organizations funded by these TNCs, have a significant role in the shaping this area of international law[10]. The accommodation of such private power in international law is already making noticeable changes such as visible in the new liberalizing push in recent FTAs.

As foreign investment takes place within the state the states feel it is their prerogative to control it. The state uses legislation, often delegated to executive authority, to maintain this control[11]. On the one hand, the legislation evidences a desire to attract foreign investment by offering incentives and guarantees against potential risks. On the other

[7] D.H. Brooks, *et al* (2003), *Foreign Direct Investment in Developing Asia: Trends, Effects, and Likely Issues for the Forthcoming WTO Negotiations*, Economics and Research Department Working Paper, Series No. 38, Asian Development Bank, Manila, p. 20

[8] Quillin S. S. (2003), The WTO and its protection of FDI: The Efficacy of the Agreement on TRIMs, *Oklahoma City University Law Review*, Vol. 28, No. 2&3, p. 889.

[9] *Supra* at 5, p. 4

[10] *ibid*, p.39

[11] R. Sachdev, (2006), "Comparing the Legal Foundations of FDI in India and China: Law and the Rule of Law in the Indian FDI Context," *Columbia Business Law Review*, Vol. 167, p. 197.

hand, legislation is used to regulate both the entry and the operation of the foreign investment in the host state.[12] The policy framework in India consists of rules and regulations governing entry as enumerated in the Policy 2010 and revised on April 1, 2011, FEMA Regulations, Companies Act 1956, IDRA 1951, etc. Complementing this core FDI policy are other policies such as trade policy and competition policy evinced through legislations such as the Competition Act, 2002. In addition, business facilitation measures including investment promotion incentives such as tax holidays, improvement in amenities are provided in the SEZ Act, 2005 and the EOU scheme[13] of the GOI. Measures that reduce the transaction costs for foreign businesses are being also promoted such as streamlining the process of approval by establishing a single window authority such as FIPB.

The fourth chapter evaluated the loss of regulatory space and the issues related to harmonization of norms between the international and domestic regulatory regimes. "The tussle between the right to regulate entry and establishment and complete liberalization of entry and establishment is a characteristic of conflict between different set of norms."[14] In their efforts to maintain control over foreign investment, host states enact legislation to carefully regulate the entry of multinational corporations and their subsequent operations. At the same time, the home states of these MNCs argue for a system of open entry and the liberalization of movement of MNCs on the basis of binding international minimum standards which create responsibility in the host state. Such minimum standards of treatment constrain the power of regulation of the host state.[15] For example, there is a recent movement for introduction of the right of pre-entry national treatment into investment treaties which would enable the MNCs to establish a business on the same terms as a national of the host state. In the course of building such international standards in international law the capital importing states have attracted considerable opposition[16].

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[12] *Supra at 5*, p.101

[13] M.B. Baker, (2004), "Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century," *Indiana International and Comparative Law Review*, Vol. 15, No. 3, p 402

[14] Supra at 5; p.45

[15] ibid, p.31

For, the interests that a state has to take into account are diverse. It protects its national economy by relying on an intense sovereignty centred notion. But at the same time it also has to protect the interests of MNCs[17] and does so by seeking to create internationally valid norms of foreign investment protection. This dichotomy applies to many states, including India though internal factors may for the present dictate that they resist international norms[18], they are silently but steadily incorporating them in domestic legislation and regulation. The states even if they are not entirely sure of whether these norms present in the IIAs such as BITs and DTTs lead to higher FDI flows continue to subject themselves to these norms in the belief that at least there will be no negative effect on such flows. These instruments may serve as indicators of the government's willingness to bind their national policy frameworks as the regulatory changes that favor FDI in international agreements cannot be changed unilaterally. Also, these treaties may be used by some governments to advance domestic policy reforms which otherwise may not be possible owing to local factors such as a lack of political consensus.[19]

However, states continue to exert substantial national control over entry, establishment and operation of foreign investments. The states have to take stances at three levels which may be at variance with each other. At the domestic level, states are inclined to enact legislation having their domestic goals in mind and in such a manner as to exploit fully the advantages of foreign investment and diminish the possible harmful effects. At the bilateral level, states make treaties, having particular objectives such as building strategic partnerships in mind and may accept binding commitments in the field of investment as a trade off for advantages in other areas of co-operation. These objectives maybe at variance with the stances they take at the multilateral level where developing states may have common goals to pursue in order to effect a global change in international law[20]. It

[16] ibid, p.167

[17] K.P. Sauvant, (2005), "New Sources of FDI: The BRICs- Outward FDI from Brazil,, Russia, India and China," *The Journal of World Investment and Trade*, Vol. 6, No. 5, pp. 670

[18] Supra at 5, p.167

[19] L.E.Sachs, and K.P. Sauvant (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*, Oxford University Press, Oxford., p. 27

[20] Supra at 5, p.31

may be argued by capital exporting states at such multilateral forums that domestic regulatory measures should confirm to the minimum standards and the violation of these standards amounts to an actionable wrong in international law.[21] Capital importing states, like India have been consenting to such norms in bilateral agreements while it contests them at multilateral forums leading to actual changes on the ground while still posturing in international sphere. These bilaterally accepted changes enable international law to remain significant for the process of foreign investment and results in the shrinkage of domestic regulatory space.

As regards , the harmonization of norms, it was argued that in the international competition to attract FDI, the effectiveness of a legal system provides absolute advantage to states over other states with ineffective legal systems in attracting FDI sensitive to legal systems. By contrast, a state with an ineffective legal system has no advantage whatsoever in attracting investors, whether sensitive or insensitive. [22] Therefore, the states tend to err on the side of caution by going for harmonization of norms to achieve an effective legal system. Developing countries like India, in order to attract FDI are allowing such harmonization. But this harmonization may not be termed complete. On the one hand, India is providing NT and MFN treatment, opening up maximum sectors to automatic route of entry, streamlining the approval process by establishing single window agencies, providing tax incentives , etc.

On the other hand, it is not including pre-entry establishment rights in its BITS or FTAs under negotiations, has screening authorities and legislation in order to exclude investments perceived as harmful to the economy. As there is a consensus on the positive effect of export performance requirements[23] in forcing FDI to generate more economic benefit to the host country, India continues to retain export performance requirements and uses them in consonance with tax incentives such as provided under the SEZ Act, 2005 and the EOU scheme to ensure maximum benefit from FDI. The effectiveness of

[21] ibid, p. 103

[22] A.Perry-Kessaris,(2003), "Finding and Facing Facts about Legal Systems and Foreign Direct Investment in South Asia," *Legal Studies*, Vol. 23, p. 651 and 698.

[23] S.P.Kumar, (2009), "Rethinking the Linkages between Foreign Direct Investment and Development: A Third World Perspective," *NALSAR Student Law Review, p. 53*

performance requirements in meeting their policy objectives depends on the clarity of objectives, the policy capability of the governments, market size, absorptive capacity in terms of skills of the work force and strength of domestic enterprises, and other location advantages and policies. India also prefers[24] Greenfield Investments over M&A in order to protect local entrepreneurs[25] as in visible in the guidelines provided to FIPB for the approval process and further the Competition Act, 2002 gives extraterritorial powers to the CCI for effective regulation of M&As having an appreciable adverse effect on the domestic markets.

However, it can still be safely stated that the liberalization sentiment is the dominant force in India [26] and there is a movement towards maximum harmonization. The Intellectual Property Laws have been fully harmonized to TRIPS standards, the entry barriers in the services sector have been unilaterally reduced to far more than the standards committed under GATS, more sectors are being opened up and the number of sectors under automatic route increased, the approval process at the central level streamlined; even sensitive sectors like agriculture and allied activities and multi brand retail[27] are under consideration for opening up to FDI. Therefore, as regards the third hypotheses this trend in India clearly shows that if the government is willing to harmonise the complexity of legal structures does not serve as an impediment. A red carpet is rolled out for foreign investors as evidenced in the high profile interest taken in the cases of POSCO, Vedanata, etc. Such a trend may or may not increase the inflow of FDI but is definitely detrimental to regulatory control.

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[24] S.K. Ghosh, and S. Bagchi (2002), "Capital Account Liberalisation in India: Implications for Infrastructure Financing and Economic Growth," *Economic and Political Weekly*, Vol. 37, No. 49, p. 4933.

[25] Supra at 5, p.304

[26] United States Government Accountability Office (USGAO) (2008), *Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries*, Report to the Committee on Banking, Housing, and Urban Affairs, US Senate, p. 76

[27] Footnote 4, Department of Industrial Policy and Promotion (DIPP) (2011), *Consolidated FDI Policy*, Ministry of Commerce and Industry, Government of India, New Delhi. p.76; E. Shabshelowitz, (2007), "Opening for Business in India: Retailer's Options," 31 *Suffolk Transnational Law Review*, 169.

2.RECOMMENDATIONS

"A mix of regulation and openness seems desirable"[28]. The heavy regulatory regimes, of the past have given way to new pragmatic regulatory regimes. The institution of administrative controls is seen as necessary to enhance the economic objectives of the state in deriving benefits from the foreign investment received. International law also needs to respond to these changes as a uniform view that all investments have to be protected through international minimum standards is not a feasible notion[29]. The externally imposed minimum standard insulates the MNCs without the creation of any corresponding duties. The requirement is clearly of a notion that extends protection to MNCs which act in accordance with the laws and policies of the host states in which they function. Compliance with internal laws should be made a precondition to access and the same should be afforded by international law.[30]

The government on its part needs to simplify the procedures relating to investment in order to ensure that the businesses do not get entangled in the web of policies. This could be done by making the policies clearer and self-explanatory, which will ensure a harmonious and homogeneous construction of policies both by the government authorities and the potential investor. This is the path followed by India with the introduction of the Policy 2010. While entry barriers need to be removed, this should be done in a systematic manner over a period of time and not in a rush. In removing barriers it is suggested that that the government should do its homework by accurately determining the supply and of demand of products and services in the relevant sectors and probe the existence and effect of competition. Industrial policies, should be harmonized with competition policies in order to strengthen competitiveness.[31]

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[28] Supra at 5, p.64

[29] ibid

[30] ibid, p. 65

[31] S. Chakravarthy, (2004). "India's New Competition Act 2002: A Work still in Progress," *Business Law International*, Vol. 5, No. 2, pp. 266

Within the GoI, the DIPP is responsible for foreign investment and the Foreign Investment Promotion Board (FIPB) is the nodal agency for FDI. There is a need to increase the effectiveness of FIPB in removing procedural bottlenecks and reducing bureaucratic red tape by granting it wider powers. The FIPB could also be empowered to give other Central Government level approvals, such as company incorporation, DGFT registration, central and excise registration, income tax registration etc. This would speed up the process of getting regulatory and administrative approvals, as is done in China[32] and will be more effective in promoting FDI. "A composite form containing such entry-level central approvals could be devised, with a time bound referral system to speed up company incorporation, DGFT registration, central and excise registration, income tax registration etc. within the FIPB clearance system."[33]

At the local level (sub-state) issues pertaining to land acquisition, land use change, power connection, building plan approval are sources of project implementation delay.[34] Therefore , the process at the level of states needs to be streamlined with the help of state governments. This could be done by having one common agency akin to FIPB in each state which handles all the approval procedures with regards to FDI. This agency can co-ordinate with the FIPB in specific investment proposals and ensure that a single window system is created throughout. This will also help in enhancement of the transparency situation as the details of the entire process can be made available online.

As regards, the possibility of a multilateral framework having broad competence over FDI under the auspices of the WTO, it needs to be remembered that the WTO essentially has a liberalising mission[35]. It is difficult to envisage an instrument under the WTO which will not have strong liberalizing provisions and therefore there will be a movement towards pre-entry national treatment. This movement will be stressed by developed states.

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[32] W. Shan,(2006). "Law and Foreign Investment in China: Effectiveness of the Chinese FDI Legal System," *Manchester Journal of International Economic Law*, Vol. 3, No. 1, pp. 53

[33] A. Virmani, (2004), *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, New Delhi, p 27

[34] ibid, p 24

[35]Supra at 5, p. 2

Its acceptability to the developing countries is questionable as it may mean an end to the screening procedures currently employed. In light of the divergent policy goals and the disparity in the development status of all the FDI-seeking states in the world it is rather improbable that there will be an agreement on a uniform and fully harmonized foreign investment regime in the near future. The process of multilateralisation can only occur through gradual changes made through bilateral and regional arrangements.

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