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The Future of Investment Protection: Assessing the Fallout of BIT Renegotiations and Terminations in India and Sri Lanka

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ABSTRACT

This paper examines the changing paradigm of international investment governance in South Asia through the lens of the legal, economic and geopolitical consequences of Bilateral Investment Treaty (BIT) terminations and renegotiations in India and Sri Lanka. Both countries have turned sharply away from traditional investor-centric treaty frameworks to reclaim their domestic regulatory sovereignty, a shift catalysed by an unprecedented wave of high-stakes Investor-State Dispute Settlement (ISDS) claims, including the retrospective tax disputes in India and the unilateral cancellation of the Colombo East Container Terminal (CECT) agreement in Sri Lanka. This paper also examines the systemic reform initiated by India's mass treaty cancellations and the adoption of its highly defensive 2016 Model BIT, and considers the structural effects of shifting from asset-based to enterprise-based definitions of investment, removing the Most-Favoured-Nation (MFN) clause, and introducing strict Exhaustion of Local Remedies (ELR) requirements. It further explores how such postures intersect with Sri Lanka's ongoing economic restructuring and sovereign debt management. A critical analysis of the fifteen-year sunset or survival clause in the terminated 1997 India-Sri Lanka BIT exposes a fractured investment landscape in which legacy investments are protected for long periods while modern inflows during the crisis period are exposed to municipal law. The paper concludes with policy recommendations for a balanced BIT architecture, arguing that emerging economies can effectively protect foreign risk capital, without sacrificing their essential public policy flexibilities, by incorporating refined substantive standards, limiting arbitral discretion, and confining survival clauses to five years.

Keywords: *Bilateral Investment Treaty, Investor-State Dispute Settlement, Model BIT 2016, sunset clause, regulatory sovereignty, India-Sri Lanka relations.*

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I. INTRODUCTION

A. Historical context of investor protection

Bilateral investment treaties are intergovernmental agreements that enable countries to extend protection to foreign investors. They ensure that foreign investors are treated equitably as compared to domestic investors, that the assets of foreign investors are not nationalised without payment of just compensation, and that the profits of their investments may be repatriated to the home countries in which their headquarters reside.¹ Such protection is particularly important for developing countries like India and Sri Lanka, which have historically witnessed instances such as the nationalisation of banks in 1969 under the Indira Gandhi government, or the re-nationalisation of SriLankan Airlines in 2014 after it had initially been sold in 1998 to Emirates, a foreign investor from the Gulf region.

It is often observed that the BITs entered into during the investment boom following the globalisation of the 2000s mostly favoured capital-exporting nations, although some critics maintain that most treaties still contained clauses permitting states to guide and control capital flows during economic crises.² In India, for example, BITs cannot override the Foreign Exchange Management Act, 1999 (FEMA),³ a domestic law that imposes strict requirements on capital convertibility, that is, on the conversion of Indian rupees to foreign currencies such as the US dollar for making purchases or investments outside India.

During the period after independence, from 1947 onwards, the Indian government under the leadership of Pt. Jawaharlal Nehru harboured grounded suspicion about foreign investors owning real assets such as land and industries in India. This was understandable after centuries of colonial rule and the extreme poverty endured by the majority of Indians soon after independence. However, during the 1990s, when the International Monetary Fund (IMF) attached policy conditions to the Extended Fund Facility extended to counter the balance of payments crisis faced by India, it became imperative to attract foreign investors, which required the signing of numerous bilateral treaties giving their investments protection within India on the basis of the model treaty of 1993.

¹ S. R. Subramanian, *Evolution of Indian Bilateral Investment Treaties: Pre and Post Revision of Model BIT*, 14 PENN ST. J.L. & INT'L AFF. 6 (2026).

² N. Sharma, *An Analysis of the Impact of the Model Indian Bilateral Investment Treaty on Foreign Direct Investment in India* (2024) (on file with Dialnet, art. no. 9912373).

³ The Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999 (India).

After 2010, however, the Indian government faced several reversals in international arbitrations, such as the Vodafone, Cairn Energy and White Industries matters.⁴ It was thereby pressed to take the remarkable step of unilaterally cancelling many of the existing BITs it had concluded with other countries, and framed a Model BIT in 2016 that preserved the authority of the state to appropriate the assets of foreign investors or to take taxation and other actions against them.⁵ The sunset clause in most of the cancelled treaties with European countries nonetheless ensures that India may still be taken to arbitration should any Investor-State Dispute Settlement (ISDS) issue arise until 2031, that is, fifteen years from the date of cancellation.

In the Nehruvian period, although a deep suspicion of foreign investors of the colonial mindset prevailed, India as a newly independent country did not resort to forced expropriation of foreign assets or enterprises within the country. Where such assets were acquired by the government, adequate compensation under the domestic acquisition laws was paid to the investors. For instance, the Imperial Bank was reconstituted as the State Bank of India in 1955, life insurance companies were nationalised in 1956, and general insurance companies in 1972. The compensation paid to foreign investors in these cases strictly followed the public accounting standards then applied in India, a practice that differed from that followed in communist countries such as Cuba or the Soviet Union, where foreign assets were taken over forcibly from investors.

The ingrained suspicion of foreign investment now gave way to its acceptance, owing to the financial crisis India was facing and to the IMF fund facility being tied to conditions requiring an improved investment environment for privatisation. With the aim of attracting foreign investment to India, the provision of a robust ISDS mechanism became a key feature of the first Model BIT adopted by India in 1993.⁶ Alongside the dispute settlement mechanism, the model treaty also contained provisions extending favourable benefits to investors where such benefits were extended to third parties, known as the Most Favoured Nation (MFN) clause. Full Protection and Security of foreign assets in the country, and Fair and Equitable Treatment of foreign investors on par with domestic investors without discrimination, were likewise part of the 1993 model treaty.

⁴ See *Vodafone Int'l Holdings BV v. Republic of India*, PCA Case No. 2016-35, Award (Perm. Ct. Arb. Sept. 25, 2020); *Cairn Energy PLC v. Republic of India*, PCA Case No. 2016-7, Award (Perm. Ct. Arb. Dec. 21, 2020); *White Indus. Austl. Ltd. v. Republic of India*, Final Award (UNCITRAL Nov. 30, 2011).

⁵ P. Ranjan & P. Anand, *The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction*, 38 NW. J. INT'L L. & BUS. 1 (2017).

⁶ K. Singh & B. Ilge eds., *Rethinking Bilateral Investment Treaties: Critical Issues and Policy Choices* 1 (Madhyam, Both ENDS & SOMO 2016).

II. THE POST-2010 ARBITRAL BACKLASH AND STRUCTURAL SHIFTS IN INDIA'S MODEL BITS

Even after India entered into most of its BITS following 1991, there were no adverse arbitration rulings or financial setbacks that were immediately felt by the country. After 2011, however, once the foreign direct investment that followed those treaties became entrenched, it became evident that the government could not act arbitrarily against foreign investors or extract retrospective taxes from them as easily as it had conceived. It was then that the decision to unilaterally cancel the investment treaties with European and other countries was taken by the Indian government.

The highly investor-friendly language in these treaties would later operate strongly against the government when it sought to regulate foreign capital. For example, the meaning of 'investment' in these treaties was very wide, encompassing tangible and intangible assets such as goodwill, claims to money, contractual rights and portfolio shares. This breadth would later lead even short-term stock market capital flows to claim protection that had been intended for long-term investments.⁷ The wide interpretation of investment in the 1993 model treaty gave rise to many shell companies, mostly incorporated in Mauritius and other similar jurisdictions that had BITS and double taxation avoidance agreements with India, which claimed protection under these treaties even though they had no interest in the long-term development of India. The principal aim of such shell companies was to gain quick profits from movements of the stock exchange.

The definition of investment was thus asset-based, and it lacked what is known as the Salini criteria, the filters under which an investment qualifies for treaty protection only where it is long-term in nature, makes a distinct contribution to the recipient's economic development, and carries operational risk. This deficiency in the 1993 model treaty was rectified in the 2016 model treaty, which recognised an enterprise-based definition of investment incorporating the Salini filters.⁸ Hence, entirely speculative transactions, portfolio investments and hot money are now excluded from the protection given to foreign investors under India's 2016 Model BIT.

Although the 1993 model treaty gave significant protection to foreign investors against direct and indirect expropriation, it did not clearly distinguish such expropriation from constitutional regulatory action taken by the government against foreign investments where they damaged the environment, caused pollution or affected public health. This gap in the drafting conferred

⁷ M. R. Mendoza, *Review of Karl P. Sauvant & Federico Ortino, Improving the International Investment Law and Policy Regime: Options for the Future*, 14 WORLD TRADE REV. 164 (2015).

⁸ A. Grabowski, *The Definition of Investment Under the ICSID Convention: A Defense of Salini*, 15 CHI. J. INT'L L. 287 (2014).

sweeping powers on foreign arbitral tribunals to undermine domestic legal principles whenever the government took action against foreign investors. There was also an absence of general and national security exceptions, such as those provided in Article XX of the GATT or Article XIV of the GATS for public health, safety and environmental conservation, which similarly gave international arbitral tribunals room to narrow the scope of government action against foreign investors on these grounds.

The 1993 model treaty further lacked any restriction on the repatriation of profits and capital by foreign investors, even when India was facing a balance of payments crisis. The Indian government could thus not stem the outflow of foreign currency in order to stabilise the Indian rupee in such conditions. The ISDS mechanism in the early treaties entered into by India contained no provision requiring the exhaustion of domestic remedies, which meant that a foreign investor could take the government directly to an international arbitral tribunal over any action taken against it.⁹

With these loopholes built into India's earlier investment treaties, it was therefore inevitable that the government of India would face numerous challenges in the coming years from foreign investors who had put millions of dollars into setting up corporations and industrial infrastructure in India.¹⁰

III. GEOPOLITICAL REALITIES, INFRASTRUCTURE CONTROVERSIES AND FUTURE TREATY FRAMEWORKS IN SRI LANKA

India and Sri Lanka occupy strategic positions in South Asia along the Indian Ocean. Both countries have maintained long-standing and strategic ties based on geopolitical necessity and geographical advantage. Sri Lanka, positioned critically near the Indian Ocean, remains attractive to international investors seeking a trade route into East Asia. During the recent 2022 debt crisis, the Sri Lankan government received generous credit lines and deferments of loan repayments. India remains one of the dominant foreign direct investors in Sri Lanka, with cumulative investments exceeding USD 2 billion as of 2023.¹¹

After the 2023 crisis, when Sri Lanka amended its Electricity Act to permit the privatisation of the Ceylon Electricity Board, it attracted Adani Green Energy as a potential investor. Similarly,

⁹ M. Malik, *The Full Protection and Security Standard Comes of Age: Yet Another Challenge for States in Investment Treaty Arbitration?* 1 (IISD Best Practices Series 2011).

¹⁰ R. Radović, *Defending the Undefendable: Asia's Sovereignist Battles Against Easy Access to Investment Treaty Arbitration*, in *ASIAN PERSPECTIVES ON INTERNATIONAL INVESTMENT LAW* 54 (Junji Nakagawa ed., Routledge 2019).

¹¹ D. Pathirana, *An Overview of Sri Lanka's Bilateral Investment Treaties: Status Quo and Some Insights into Future Modifications*, 7 *ASIAN J. INT'L L.* 287 (2016).

Tata Sons showed interest in acquiring an ownership stake in SriLankan Airlines, among other instances. In 2021, Sri Lanka cancelled the Colombo East Container Terminal (CECT) project, under which the state-owned Sri Lanka Ports Authority (SLPA) would have retained a 51 per cent stake, while India (represented largely by the Adani Group) and Japan would have held a combined 49 per cent stake. The cancellation followed a wave of protests driven by nationalist fears that the Sri Lankan government was selling its prized assets to foreign countries, as in the case of the Hambantota Port, which had been given on a long-term lease to China in 2017.¹² India had shown interest in the CECT as a counterweight to China's growing presence in Sri Lanka, which included Hambantota and the adjacent Colombo International Container Terminal (CICT). To prevent any possible international arbitration over the exclusion of India and Japan from the CECT, Sri Lanka offered India the development of the West Container Terminal (WCT), with 70 per cent controlling rights. As that was an entirely undeveloped port, there were no protests over the sale of a profitable national asset such as had occurred in the case of the Colombo East Container Terminal.

After the cancellation of the 1997 BIT with Sri Lanka in 2016, all investments made prior to March 2017 still carry protection under the sunset clause, which means that if the Sri Lankan government moves to expropriate their assets, Indian investors may proceed directly to international arbitration without exhausting domestic remedies in Sri Lanka. Investments made after March 2017, however, remain unprotected and are governed by the domestic law of Sri Lanka.

Given its strategic position on the geopolitical map and its location on an important trade route, Sri Lanka must negotiate a new bilateral investment treaty with India so that it does not lose new developmental projects and the foreign direct investment arriving from Indian territory. Indian investors can no longer rely on the fifteen-year sunset clause protection, nor on the domestic laws of Sri Lanka after the fifteen-year period, to protect their investments in Sri Lanka.¹³

Any such fresh BIT must contain an enterprise-based definition of 'investment' so that the protection it affords is not misused by shell companies. The Fair and Equitable Treatment standard must be aligned with customary international law, and India must retain self-determining national security exceptions as well as general exceptions relating to public health,

¹² D. Pathirana, *The Paradox of Chinese Investments in Sri Lanka: Between Investment Treaty Protection and Commercial Diplomacy*, 10 ASIAN J. INT'L L. 375 (2020).

¹³ A. A. Escobar, *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka (ICSID Case No. ARB/00/2): Introductory Note*, 17 ICSID REV. 140 (2002).

environmental safety and currency stability during a balance of payments crisis.¹⁴ The sunset or survival clause must be restricted to five years by the mutual consent of India and Sri Lanka, so that a treaty, once revoked, does not continue to drag on over an exhausted legal terrain.

If the above safeguards are built into any new BIT between India and Sri Lanka, it will be able to strike a balance between protecting the interests of foreign investors and maintaining the state's regulatory authority to be exercised where needed. Any such bilateral investment treaty between India and Sri Lanka must be based on the reformed provisions of the 2016 model treaty, which have now replaced the time-worn rules of the 1993 model treaty.

Under the Constitution of India, the executive power over international treaties is governed by Article 73, read alongside Entry 14 of List I in the Seventh Schedule.¹⁵ A key constitutional limitation under Article 253 is that, while the executive can bind the nation internationally, any treaty provision that alters domestic laws or affects the existing rights of citizens requires the enactment of implementing legislation by Parliament.¹⁶

In early investment disputes such as *White Industries v. India*, foreign investors placed heavy reliance on the Most Favoured Nation (MFN) clause to invoke protections that the Indian government had advanced to third parties under a different treaty.¹⁷ The 2016 model treaty makes a remarkable change by removing the MFN clause, thereby giving the state greater room to regulate foreign direct investment in the country.

IV. CONCLUSION

A key feature of the development of bilateral investment treaties in the Indian and Sri Lankan cases is the transition from investor protection towards the maintenance of state regulatory autonomy. India actively dismantled its wide-ranging model treaty system of 1993 in the wake of adverse jurisprudence in prominent matters such as *Vodafone* and *Cairn Energy*. The 2016 Model BIT, by contrast, adds new and highly protective provisions, among them the enterprise-based approach that excludes highly speculative hot money and shell companies from protection by applying the Salini filters. In the shadow of the complicated geopolitical realities of the trade corridors of the Indian Ocean, the need for a balanced legal regime cannot be overlooked. The recent friction over infrastructure in Sri Lanka, including the Colombo port terminals controversy, highlights the vulnerabilities faced by uncovered post-2017 investments. Finally,

¹⁴ M. Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* 1 (Oxford Monographs in International Law 2013).

¹⁵ INDIA CONST. art. 73; INDIA CONST. sch. VII, List I, entry 14.

¹⁶ INDIA CONST. art. 253.

¹⁷ *White Indus. Austl. Ltd. v. Republic of India*, Final Award (UNCITRAL Nov. 30, 2011).

if another India-Sri Lanka BIT is to be negotiated, it should incorporate these new concepts. Both states can effectively defend foreign direct investment through provisions based on customary international law, explicit general exceptions for public health and economic stability, and a shortened survival clause of five years, while not compromising their constitutional sovereignty and regulatory competence.

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