

# Real Estate Investment in India: Canada-India Investment Treaty as a Conduit for US Investors

By Cliff Sosnow and Prakash Narayanan

*Cliff Sosnow is a partner practicing in the International Trade, Procurement, International Dispute Resolution, India Working Group and China Practice Groups of Blake, Cassels & Gonyon, LLP. Mr. Sosnow advises corporations, industry associations, and governments on all Canada-US and global cross-border issues, including bilateral investment treaty arbitration, anti-dumping and countervailing duty and unfair subsidy claims, technical barriers to trade, export/import licenses, customs, procurement, compliance with international agreements (NAFTA, WTO), and compliance with anti-bribery legislation. Prakash Narayanan is an associate practicing in the firm's Business and International Trade Group. Prakash has been called to the bar in Ontario and in India and is a member of the firm's India Working Group. The authors can be reached at cliff.sosnow@blakes.com and prakash.narayanan@blakes.com, respectively.*

Annual GDP growth averaging over seven percent for the last decade has resulted in explosive growth in another sector in India—real estate. Some forecast that the Indian real estate market will grow from \$12 billion in 2005 to \$90 billion by 2015. Increasing incomes and a growing middle-class that is over 300 million strong propel demand for residential homes. Rapidly growing businesses, particularly in the IT sector, are fueling demand for high-quality commercial office space across a number of cities. Add to this the large number of western-style malls being built across the country, a relatively new concept in India, and the potential entry of large retailers such as Wal-Mart and Carrefour, and it becomes clear why real estate in India is a prime investment destination.

The recent lifting of restrictions by the Indian government on foreign direct investment in construction projects has triggered foreign investment in Indian real estate. It is estimated that there are a number of foreign funds that have raised money for investment in Indian realty, including the Blackstone Group, Goldman Sachs, Citigroup Property Investors and Morgan Stanley. For instance, in mid-2007, Morgan Stanley entered into a deal with India's Oberoi Constructions to invest about \$150 million. CALPERS invested \$100 million in a real estate fund promoted by India's IL&FS. The Nakheel Group of Dubai entered

into a \$10 billion deal with India's DLF for residential projects. Most recently, Canada's Caisse de depot et placement du Quebec announced that it may invest up to \$1.7 billion in India's real estate market.

The real estate sector in India is growing fast, and is poised for even larger growth. The Indian government is reportedly considering the introduction of Real Estate Investment Trusts (REITs), which would provide further impetus to the real estate market in India. There are significant opportunities for foreign investors as well as businesses involved in real estate development. Investment decisions of course, always have to be made with care, especially when dealing with a still-developing economy that may have legal, business and cultural differences with the North American or European economies that a US company may otherwise be familiar with.

This article briefly describes an investment treaty being concluded between Canada and India that, as explained below, can be used as a conduit for the protection of US investments, including investments in the real estate sector, in India, given that the US and India have no such similar treaty protection.

## THE ROLE OF A BIT

Decisions regarding investments in foreign countries, particularly for mid-size entities, are easier to make when the protection of a bilateral investment treaty (BIT) is available to

the investor. A BIT is an agreement entered into between two countries that obligates each country to obey certain rules respecting investors from the other country and their investments. The protections offered by a BIT generally include anti-discrimination rules, including "national treatment" and "most-favoured nation" treatment. National treatment prohibits a country from treating investors from the other country and their investments less favourably than its own investors and investments. "Most-favoured nation" treatment requires a country to treat investors of the other country and their investments, as well as it treats those of any other third country. In addition to anti-discrimination rules, BITs also often impose rules concerning direct and indirect expropriation that ensures that even if such expropriation occurs, it would be in accordance with due process of law and ensure adequate and appropriate compensation. In addition, BITs may protect investors against the imposition of measures such as performance requirements such as local content requirements, minimum export level requirements, obligatory technology transfers, etc.

A number of countries have entered into BITs. For instance, the US has entered into BITs with Argentina, Egypt, Morocco, and more recently with Uruguay. Similarly, Canada has entered into BITs with Costa Rica, Lebanon, Philippines, the Ukraine and most recently with Peru. Indeed, with the outcome of the most recent round of the World Trade Organization negotiations remaining uncertain, countries are increasingly focusing on bilateral treaties to expand the range of protection for cross-border trade and investment.

The US, however, does not have a BIT with India. Meanwhile, Canada has recently announced that it is in the final stages of concluding a BIT with India. This Canada-India Foreign Investment Promotion and Protection Agreement (Canada-India FIPA) is expected to increase the trade and investment between Canadian and Indian companies manifold. US companies that have a subsidiary or other operations in Canada will also be able to take advantage of the Canada-India FIPA by routing their investment in India through their Canadian entity.

While the text of the Canada-India FIPA is not yet publicly available, publicly available information on the Canada-India FIPA and the model FIPA that the Canadian government uses in negotiating BITs with developing countries point to the nature of the protections likely to be available to investors under the Canada-India FIPA.

## OVERVIEW OF THE CANADA-INDIA FIPA

On June 16, 2007, the Minister of International Trade for Canada, Mr. David Emerson, along with his counterpart in India, Minister of Commerce and Industry Mr. Kamal Nath, announced the conclusion of the negotiations for the forthcoming Canada-India FIPA. While the text of the Canada-India FIPA is not yet publicly available, like all new FIPAs entered into by Canada, the Canada-India FIPA is expected to be based on Canada's model FIPA. The Canadian model FIPA is derived from the investment chapter (Chapter 11) of the North American Free Trade Agreement (NAFTA). Therefore, the protections available under the Canada-India FIPA will be familiar to US entities with investments in Canada or Mexico. Like the NAFTA, the Canada-India FIPA is likely to offer comprehensive investment protection including non-discriminatory treatment with the customary international law minimum standard of treatment, protection in relation to expropriation, limited allowances for relaxation of health, safety or environmental laws and access to international arbitration in the face of an investor-state dispute.

### Scope of Coverage

While the actual wording of the text of Canada-India FIPA would have to be examined when it becomes available, based on publicly available information, including Canada's model FIPA, the scope of the Canada-India FIPA is likely to be broad and cover all kinds of investment without restrictions to any major industry sector. For instance, investments in the real estate sector, investments in intellectual property, infrastructure, natural resources, etc., whether by equity participation or otherwise, are all to be covered by the Canada-India FIPA. At the same time, just as in the NAFTA, investments relating to certain sectors, such as cultural industries, which has been an area of particular concern for Canada, will likely be excluded from coverage.

In particular, investments in the real estate sector, when acquired for economic or business purposes whether through equity participation or by entering into a joint venture or by other means, are likely to be covered by the Canada-India FIPA, unless the finalized text of the Canada-India FIPA, which is not as yet public, maintains certain limitations on investments in the real-estate sector.

Further, while the text of the Canada-India FIPA is not yet available to confirm how an "investor" would be

defined, based on the text of previous FIPAs entered into by Canada, it is likely that an "investor" will be broadly defined to include any entity that is constituted or organized under the laws of the applicable country (India or Canada, as the case may be). This means that the Canadian affiliate of a US entity would be considered an investor if the investment in India is flowing through the Canadian entity. This would allow the US parent entity to obtain the advantages of the Canada-India FIPA by routing its investment through a Canadian affiliate.

### **Anti-Discrimination Provisions**

With regards to the substantive provisions affording protection of investors and their investment, the Canada-India FIPA will contain a provision for "national treatment" under which Canada and India will be required to accord investors and investments from each other treatment no less favourable than it accords, in like circumstances, to its own investors and investments. The "national treatment" provision in the Canada-India FIPA is likely to be applicable only post-establishment, for example the "national treatment" provision would only apply to investments that are actually made in the country and not potential or planned investments (pre-establishment).

The Canada-India FIPA will also contain a most-favoured nation treatment provision which dictates that the investors and investments of one country be treated no less favourably than investors and investments of a third country. Thus, the best treatment that is available to investors of any other country will necessarily be extended by India to investors from Canada and their investments in India.

These anti-discrimination provisions are also likely to extend to investment loss due to armed conflict, civil strife or natural disaster. Based on the provisions of the NAFTA investment chapter and Canada's model FIPA, sectors that will likely not be afforded the protection of the anti-discrimination provisions include the social services sector, health sector, environmental protection, safety and public education.

### **Protection against Expropriation**

Of particular interest to holders of real estate, a provision that will likely also be included in the Canada-India FIPA is a provision relating to protection against expropriation. In Canada's model FIPA, expropriation protection specifically includes the words "having an effect equivalent to" nationalization or expropriation. These words are however,

different than the NAFTA text, which uses the words "amount to expropriation." While the Canada-India FIPA will almost certainly include protections against expropriation of real estate, such as compensation for the appropriation of the investment, it remains to be seen what the extent of such protection will be and whether the NAFTA approach or the model FIPA approach is adopted so as to put to rest any uncertainty with regard to the scope of the protection.

### **Other Protections**

Another obligation likely to be present in the Canada-India FIPA is the right to temporarily admit any person who possesses managerial, executive or specialized knowledge into the country, so that the investor can benefit from their relative expertise. Other standard protections offered in the Canada-India FIPA would include a provision that neither party is entitled to necessitate performance requirements in the form of minimum levels of exports of certain goods or require minimum levels of domestic content. Monopolies and state enterprises are likely to be allowed under the agreement so long as the regulatory control or administrative supervision does not conflict with any other provision in the Canada-India FIPA.

As for the transfer of funds, as per Canada's model FIPA, investors will be capable of transferring any contributions to capital, profits, dividends, interest, capital gains, royalty payments and other amounts derived from investment subject to each party's bankruptcy and insolvency securities, and criminal laws or any adjudicatory proceedings. With regard to the specifics of the Canada-India FIPA, given India's concerns as a developing country and perhaps cognizant of the Asian crisis in the late 1990s, in relation to speculative capital there are likely to be some carve-outs in relation to the transfer of such capital into and out of India.

### **General Exceptions**

Much like other investment treaties and free trade agreements, the Canada-India FIPA will contain provisions setting out any substantive reservations and exceptions. Given that these provisions are specific to the concerns of Canada and India, the precise scope and nature of the exceptions may not be clear until the text of the Canada-India FIPA becomes publicly available. Nonetheless, in addition to the likely exemptions discussed above, one can expect to see the usual general exceptions relating to ensuring the preservation of the environment, human, animal and plant health,

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as well as natural resources. Under the specific provision of the health, safety, and environmental measures, the Canada-India FIPA likely will prohibit each country from lowering health, safety, or environmental laws in order to attract foreign investment. In addition, procurement by government entities is likely to be exempted from most obligations in the Canada-India FIPA.

### **Dispute Settlement**

The dispute settlement provisions of a BIT are one of the most important parts of the agreement since they provide for a mechanism that is independent of the domestic legal system. In the case of India, given the slow pace of the judicial system, access to international arbitration is an important component of the Canada-India FIPA. Based on the provisions of Canada's model FIPA, the Canada-India FIPA is likely to contain two different provisions pertaining to dispute settlement. One that deals with disputes arising between investors and the host country, and another that deals with disputes arising between the two countries. Recourse under either kind of dispute is likely to be through international arbitration in accordance with one of the accepted international arbitration rules.

In this context, it is noteworthy that while Canada has recently moved ahead with steps to bring into effect the International Convention on Settlement of Investment Disputes (ICSID Convention), India is not a signatory to the ICSID Convention. This means that the use of ICSID as a venue for arbitration is only possible if India specifically

agrees to do so in a particular situation. On the other hand, both Canada and India are signatories to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards which provides for the enforcement of arbitral awards made in foreign countries. As a result, while arbitrations are less likely to be held under the aegis of the ICSID, if they are held under the aegis of one the numerous other arbitration bodies, such as the United Nations Commission on International Trade (UNCITRAL) or London Court of International Arbitration (LCIA), both Canada and India have a mechanism in place to have such arbitration awards enforced in their respective domestic legal system.

The provisions relating to dispute resolution should therefore provide considerable comfort to real estate investors taking advantage of the Canada-India FIPA.

### **THE CANADA-INDIA FIPA AS A CONDUIT**

The forthcoming Canada-India FIPA will permit Canadian entities to take advantage of the rapidly expanding Indian real estate sector while being assured of a minimal degree of protection for their investment. US companies that are contemplating taking advantage of the booming Indian marketplace, and in particular the real estate sector, would be well advised to consider routing their investments in India through Canada, for instance through their existing Canadian affiliates or by establishing a Canadian affiliate, and taking advantage of the protections available under the soon to be finalized Canada-India FIPA.