



# An Implication of Bilateral Investment Treaty in Protecting Foreign Direct Investment in Nepal

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## Abstract

*Foreign Direct Investment and Bilateral Investment Treaty are very much closely related with each other. The Modern world is much concerned about the promotion and protection of foreign direct investment so do the BIT as well. Foreign Direct Investment or FDI is a kind of investment that makes profit or interest in enterprises which works outside of the domestic territory of the investor. It is known that FDI is beneficial to both the investors and the Investment seeking Nations. Not only developing nations like Nepal, but also developed nations like USA, France, UK, Japan etc., have formulated different policies to entice Foreign Direct Investment from the nations. Foreign Direct Investment brings money, skill and technology with it. Some nations like India, China, Russia, USA are using foreign direct investment as a tool to initiate their international relations with other nations and use them in international when needed. BIT is important tool for foreign investment. Fair and Equitable Treatment, Full Protection and Security, Most Favored Nation, National Treatment, Expropriation, Compensation for Losses and Settlement of Investment Disputes are the major structure and contents of BIT which fosters and protects the foreign direct investment in least developing countries like Nepal.*

**Key Words:** *Foreign Direct Investment, Bilateral Treaties, FITTA, BIPPA, ICSID, UNCITRAL, ICJ, Fair and Equitable Treatment, Most Favored Nation, Repatriation, Expropriation, Dispute Settlements.*

## 1 Introduction

Foreign Direct Investment (FDI) is an integral part of international economic system. It is a major indicator of development. <sup>204</sup>FDI has become the one of the sources of economic growth and development, modernization and employment for developing countries. Countries

<sup>204</sup> Aryal, Dornath et al., *Diplomatic Dealings*. Apex Education Consultancy 2010.

have liberalized their FDI regimes and pursued other policies to attract investment. Foreign Direct Investment is the investment made by a person or entity on the province of another State. It is generally referred to any investment to other country which is carried out by private individuals and companies as opposed to government aid. Foreign Investment is considered as a means of obtaining capital, technology, scarce management and skill, and improved marketing “know-how” and outlets for non-traditional exports of manufactures, processed commodities and traded services. Foreign investment may also create employment opportunities and raise the levels of domestic wages.<sup>205</sup>

With the increasing number of Bilateral Investment Treaties protection on the one hand and the rising of BITs claim on the other have demanded the quest for the policy space in foreign investment regime. Numerous instances have proved that, due to the lack of enough regulatory space within BITs, host State governments are left in vacuum in protecting its very legitimate public interests. As such recent efforts have been made in many jurisdictions to revisit their international investment regime amending and terminating existing BITs with the object of balancing it. Nepal, as a highly potential country in receiving foreign investments occasionally governed by four BITs in force (out of six signed BITs) and numerous domestic laws: FITTA being a parent Act.

Nepalese BITs resemble that of first-generation BITs and states how each provision of BITs have addressed the interests of foreign investors with the minimal recognition of rights of Nepal as a host State Government. Nepalese BITs ensure wide protection of investment and access to Investor-State Dispute Settlement (ISDS), Fair and Equitable Treatment (FET), Most-Favored-Nation (MFN) and National Treatment (NT), Monetary Transfer Provision, Protection against Expropriation, Full Protection and Security and Non-Precluding Measures (NPMs). Moreover, Treaty Act of Nepal has kept BITs of Nepal on a higher space compared to that of domestic laws thereby further questioning the need to incorporate the claim of policy space of host State Government.

The second generation of these treaties are Bilateral Investment Treaties (BITs), which set forth actionable standards of conduct that applied to governments in their treatment of investors from other nations, including:

- Fair and equitable treatment (often meaning national treatment or most favored nation treatment);
- Protection from expropriation;
- Free transfer of means and full protection and security.

The important feature of many BITs is that it allows for an alternative dispute resolution mechanism, whereby an investor whose rights under the BIT have been violated could have address to international arbitration, often under the goodness of the ICSID (International Center for the Settlement of Investment Disputes), rather than suing the host State in its own courts.<sup>206</sup> It is estimated that there are more than 2,500 BITs active in the world today.

<sup>205</sup> Sunam, Rodap, “Foreign Direct Investment on Hydroelectricity Development in *Nepal*”, *Thesis* TU, 2075 B.S.

<sup>206</sup> *Bilateral Investment Treaty*, <https://www.law.cornell.edu>.

## 2 Foreign Direct Investment and Bilateral Investment Treaty

### 2.1. Foreign Direct Investment (FDI)

Foreign direct investment generally refers to the investment made by foreigners. It is the combination of two words foreign and investment resembles to the act of investing property for the purpose of generating wealth and profit. Foreign investment came through the foreign person who may be natural and legal. It differs from donation, budget or grant assistance to the government. Therefore, the foreign investment is the transformation of property from the one state to another state for the purpose of business activities. Country from where the property is invested is called home country. Another country which exports capital or the country where the capital is invested is called the host country or capital importing country.

Black Law Dictionary states the meaning of investment as “expenditure to acquire property or assets to generate revenue, a capital outlay”.

In Nepal, Foreign Investment and Technology Transfer Act (FITTA) 1992 has defined the term “Foreign Investment and Technology Transfer” separately. Foreign investment is related with tangible property. Foreign Investment and Technology Transfer Act, 1992, foreign investment means the following investment made by a foreign investor in any industry: Investment in Share (equity)’, Reinvestment of the earning obtained from the investment, Investment created in the form of or loan facilities.

FITTA has specified the definition of FDI to the industry defined in section 3 of Industrial Enterprises Act, 1992<sup>207</sup>. FITTA has defined technology transfer as any transfer to technology to be made under the agreement between an industry and a foreign investor on the following matters:<sup>208</sup>

- Use of any technological right, specialization, formula, process, patent, or technical-know-how of foreign origin,
- Use of any trademark of foreign ownership,
- Acquiring any foreign technical, consultancy, management and marketing service.

Hence, the FITTA has recognized the technology transfer as foreign investment in different term. According to our legal provisions, foreign investors are categorized into four types: Foreign citizens, foreign entities, foreign citizens of Nepalese origin, and Non-residential citizens

These four kinds of investors are seemed as foreign investors because Non-Residential Nepalese Act, 2007 has recognized to Non-Residential Nepalese as a foreign investor and has permitted to repatriate the benefits from investment and the capital of investment. Before the NRN Act, 2007, there was no recognition to NRN as foreign investors.<sup>209</sup>

### 2.2 Bilateralism and Bilateral Investment Treaty

It is thought that the evolution of bilateral investment treaties began from the year 1959 which very important. There were almost ninety-seven nations participated in the signature of at

<sup>207</sup> *The Foreign Investment And Technology Transfer Act, 1992, Sec.2(b).*

<sup>208</sup> Government Of Nepal Department of Industries, *Procedural Manual for Foreign Investment in Nepal*, (2007) 16.

<sup>209</sup> *The Non-Residential Nepalese Act, 200, Sec.2.*

least one treaty. The total number of treaties rose to 2,099 from 1941 the previous year among the 158 BITs signed in 2001. The most crucial figure concerns the increasing number of BITs signed among developing countries: up from 36 in 2000, to 66 in 2001 (42 percent of all BITs)<sup>210</sup>. Bilateral Investment Treaties refer to treaties between nations intended to protect the investment made by both nations' investors. These treaties encompass various conditions such as:

- Giving fair treatment to overseas investors and investment;
- Permitting repatriation of profits-this implies sending off money to the investor's country;
- Giving legal measures such as dispute resolution, regulatory measures, and compensation.

The distinctive feature of most BITs is that they permit for an optional dispute resolution mechanism, whereby an investor whose right has been contravened could have recourse to international arbitration, often under the backing of ICSID (International Centre for settlement of Investment Disputes), instead of suing the host State in its courts. This process is known as Investor-State Dispute Settlement.

The first BIT was conducted between Pakistan and Germany on November 25, 1959. At present, there are more than 2500+ BITs in action, comprising most countries in the world. Environmental norms have also become an essential of these types of agreements.<sup>211</sup> Currently, India and the European Unions are collectively working on concluding new bilateral investment treaties. Bilateral Investment Treaty agreements are often envisaged as historical or academic interests. But, for most nations, these agreements help investors in understanding legal mechanisms & dispute resolution.

Bilateral Investment Treaties especially designed for investment have a double aim: the protection and the promotion of investment. In spite of differences in emphasis and drafting style, the majority of BITs subscribe to a common structure. They provide four types of dispositions: the establishment of investment, its treatment following the establishment, its protection and guarantee, and the settlement of disputes between States as well as between the host state and Investors. To this end, there is a series of issues that BITs generally consider: admission of investments, standard of treatment of investments, transfer of the proceeds, expropriation, and settlement of disputes.

## 2.3 Expropriation

There are three issues to take into consideration in a discussion comprising an expropriation: conditions, measures of compensation, and transfer of compensation. Public interest seems as a needed condition for embarking on any measure of expropriation in 90 per cent of the BITs. The majority of them also need to be "non-discriminatory" and some also that it be not breach of any particular commitment not to expropriate.<sup>212</sup>

## 2.4 Settlement of Investment Disputes

Both the international Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL) are involved in

<sup>210</sup> Rafael Leal-Arcas, *International Trade and Investment Law*, (Paperback edition 2011) 205.

<sup>211</sup> *Bilateral Investment Treaty*, <https://en.wikipedia.org>.

<sup>212</sup> *Ibid*, p. 208.

arbitration and since the overwhelming majority of investment arbitration cases are conducted under either the ICSID rules or the UNCITRAL rules. Private parties have great possibility of bringing a State in front of an international tribunal. There are more institutions which deal with arbitration (whether commercial or investment arbitration) such as the International Court of Justice, International Chamber of Commerce, the London Court of International Arbitration, the Stockholm Chamber of Commerce, and the Permanent Court of Arbitration inter alia are not taken into the consideration for the study purpose.<sup>213</sup>

#### **2.4.1 ICSID Arbitration**

The International Centre for Settlement of Investment Disputes (ICSID) is an institution of the World Bank group based in Washington, D.C., and was founded in 1966 pursuant to the Convention on the Settlement of Investment Disputes between Nations and Nationals of Other Nations (commonly known as the ICSID Convention or Washington Convention). Approximately, 156 countries had signed the ICSID Convention as of 2009.

#### **2.4.2 UNCITRAL Arbitration Rules**

The United Nations Commission on International Trade Law (UNCITRAL) is an organ of member and observer States under the auspices of the United Nations. It is drafted and later adopted the UNCITRAL Model Law on International Commercial Arbitration in June 1985. The agreements which mention the UNCITRAL Arbitration Rules might be forced to this type of dispute resolution.<sup>214</sup> In BITs, the *CME/Lauder v. the Czech Republic* arbitration is taken to be the “first publicly known investment dispute comprising bilateral investment treaties to be decided under UNCITRAL Rules in place of ICSID. Another example of a BIT requiring that the arbitral tribunal apply the UNCITRAL Rules is *Saluka Investment BV (The Netherlands) v. The Czech Republic*.

#### **2.4.3 The International Court of Justice (ICJ)**

The role of the International Court of Justice (ICJ) in the sector of investment disputes has been quite restricted so far. Though there have been three cases involving claims of expropriation of origin investment before the International Court of Justice, i.e., the *Anglo-Iranian Case*, the *Barcelona Traction Case*, and the *ELSI Case*. In all three cases, the claim was dismissed, but the International Court of Justice has stopped a pronouncement on the underlying question of the obligation of the host Nation to foreign investors.<sup>215</sup>

### **2.5 Bilateral Agreements with Nepal**

Nepal has entered into Bilateral Investment Promotion and Protection Agreement (BIPPA) with India, Finland, Mauritius, United Kingdom and Northern Ireland, Germany and France. The history of signed agreements with these countries are tabulated as follows<sup>216</sup>:

<sup>213</sup> *Ibid*, P. 209.

<sup>214</sup> *Ibid*, P. 211.

<sup>215</sup> *Ibid*, P. 213.

<sup>216</sup> <http://www.investmentpolicyhub.unctad.org>

No.	Agreement	Partners	Status	Date of Signature	Date of Entry of Force
1	Agreement on Reciprocal Promotion and Protection Investments	France	In force	02/05/1983	13/06/1983
2	Agreement of the Reciprocal Promotion and Protection of Investments	Germany	In Force	20/10/1986	07/07/1988
3	Agreement for the promotion and protection of Agreements	UK	In Force	02/03/1993	02/03/1993
4	Agreement for the Reciprocal Promotion and Protection of Investments.	Mauritius	Signed but not in Force	03/08/1999	
5	Agreement on Promotion and Protection of Investments.	Finland	In Force	03/02/2009	28/01/2011
6	Agreement for the promotion and Protection of Investments.	India	Signed but not in Force	21/10/2011	

### Nepal-India BIPPA in Controversy

BIPPA which was signed on October 21, 2011, between Nepal and India. While some political leaders have censured the government on grounds of it being “anti-national”, others have shied away from appreciating the signing of the agreement by this administration despite supporting the idea of BIPPA itself. With BIPPA getting so much of political attention it was finally challenged before the Supreme Court by petitioner Bal Krishna Neupane in *Bal Krishna Neupane v. Office of the Prime Minister*<sup>217</sup> on the grounds that it was signed breaching the provisions of the Interim Constitution and Treaty Act.

## 3. Legal Aspects of FDI and BIT

### 3.1 Foreign Investment and existing policies and laws

Foreign investment and One Window Policy 1992 and industrial policy are the most important policies to attract foreign investment. Policies are one type of foreign investment management rules; legal instruments are the other.<sup>218</sup> Basically, foreign investment in Nepal is regulated and governed by Foreign Investment and Technology Transfer Act (FITTA), 2019 and Industrial Enterprises Act, 2020. Labor act 1992, the Patent, Design and Trademark act 1965, Company Act 2006, Water Resources 1992, Public Private Partnership Act 1992, Non-residential Nepali Act 2007 etc. are also important to address foreign investment.

<sup>217</sup> *Bal Krishna Neupane v. Office of the Prime Minister*

<sup>218</sup> Russel B. Sunshine, *Managing Foreign Investment: Lessons from Laos*, Honolulu East West Center 1995 123.

### 3.2 Constitution of Nepal, 2072 B.S.

The part four of the Constitution of Nepal comprises obligation, directive principles and policies which mentioned about the foreign investment<sup>219</sup>.

### 3.3 Foreign Investment and Technology Transfer Act (FITTA) 2019

The foreign investment & Technology Transfer Act (FITTA), 2019 is enacted after president's approval on 27<sup>th</sup> March, 2019 and replaced the traditional Foreign Investment and Technology Transfer Act, 1992. The FITTA intends to increase the industrialization and foreign investment of the long term and sustainable growth in national economy by utilizing the available resources and also by reforming the existing legal framework of foreign investment in Nepal to attract more foreign investments. The new act has included other forms of foreign investment; in addition to the earlier provision of investment and re-investment in shares and Technology Transfer; such as incorporating a Branch Office, Lease Financing, Investment in secondary stock market, investment in equity through Venture Capital Fund and investment by issue of securities in foreign stock markets.

Chapter 2 of this Act has the provision on Settlement of Disputes through Arbitration. In any circumstances if any agreement provides for the settlement of disputes through arbitration, the disputes related to the agreement or issues coming under the agreement must be settled through arbitration.<sup>220</sup> And Sec. 34 of this Arbitration Act has provision on Implementation of award taken in a foreign State. Any entity which is willing to implement an award made in foreign State in Nepal may submit an application to the Appellate Court of Nepal.<sup>221</sup>

### 3.4 Repatriation Facility:

A foreign investor making investment in foreign currency is entitled to repatriated the prescribed amount outside in Nepal.<sup>222</sup>

### 3.5 Dispute Settlement Provision

An Arbitration is chosen in case of dispute settlement and it is notably popular in industrial and commercial sector. Nepal has complied to the New York Convention on recognition and enforcement of foreign arbitral awards and it is obligatory to give effect to provision of the convention in our domestic law. General assembly of the United Nations has recommenced the use of UNCITRAL conciliation Rules, 1980<sup>223</sup> in case where the disputes arise in context of international commercial relation and parties seek for good-natured settlement of their dispute by recourse to reconciliation. In this regard Arbitration Act, 1981<sup>224</sup> could not meet those provisions. Therefore, Arbitration Act 1999 came into force. This Act followed the rule of UNCITRAL Model law if the agreement concluded between the parties in accordance with the no settlement of disputes, such a dispute shall be settled by arbitration as per with the arbitration law of Nepal. In case of *Krishna Jha on behalf of agricultural input incorporations v. East India transportation*

<sup>219</sup> *The Constitution of Nepal-2072.*

<sup>220</sup> *Arbitration Act 1999, Sec.2.*

<sup>221</sup> *Arbitration Act, 1999, sec. 34.*

<sup>222</sup> *FITTA 2019, sec.20.*

<sup>223</sup> *Uncitral Conciliation Rules, 1980.*

<sup>224</sup> *Arbitration Act, 1981.*



*et.al*<sup>225</sup>. of the Supreme Court either in the writ jurisdiction on appellate jurisdiction. Full bench of Supreme Court, having the writ jurisdiction against the endorsement to the award of tribunal of the appellate court sustain and send back to division bench to decide on merit.

In the case of *Krishna Chandra Jha on behalf of agricultural input corporation v. Dinesh Bhakti Sheathe on behalf of Milimili Enterprises et.al*<sup>226</sup>. the Supreme Court held the above-mentioned view.

The Government of Nepal may bring into foreign investment by concluding a Multilateral or Bilateral Investment Agreement with any foreign friendly nation or international institution for the promotion of foreign investment.<sup>227</sup>

### 3.6 Foreign Investment Plans and Policies

In order to get speedy execution of said plan within the period, the government has adopted additional policies, such as National Labor policy 2000, Industrial policy 2010, Labor Regulation, Land use policy 2015, National agriculture policy 2004, information technology policy 2010, Telecommunication policy 2015 and hydropower development policy 2002 and so on. Foreign Investment Policy, 2071 (FIP, 2017), the policy has taken a liberal stand on sectors under FIP, 2071 there are five foreign investment areas considered as priority sectors; hydropower, transport, infrastructure, agriculture (those related to food processing and medicinal herbs processing), tourism and mining. For example, allowing foreign investors to invest in projects with fixed capital of more.<sup>228</sup>

### 3.7 Judicial Case Relating to Foreign Investment in Nepal

*Axiata and Ncell v. Nepal 2019*. This is the case of Nepal-UK BIT. The Supreme court verdict was that Ncell, a private sector telecom company can pay only Rs 21.10 billion in capital gains tax against the Rs 39.06 billion determined by the tax authorities under section 120(a) of the Income Tax Act, 2002<sup>229</sup>.

## 4. Conclusion

The international instruments like the BITs are an important tool for foreign investment. BITs are crucial and can send a positive message about our nation's commitment to promote and protect foreign investment in a non-discriminatory manner. To increase investment, Nepal needs to address constraints such as inadequate supply of infrastructures, policy inconsistencies and high interest on credit to key sectors. The political leaders politicizing the issue of signing of Nepal-India BIPPA was unjustified. It only leads to portraying Nepal as a bad investment destination. Any outstanding process that remains to be settled in connections to bringing Nepal-India BIPPA in force should be completed at the earliest so that Indian investors can win the confidence of investment in Nepal. Nepalese BITs has given been given excessive emphasis

<sup>225</sup> *Krishna Jha on behalf of agricultural input incorporations v. East India transportation et.al*

<sup>226</sup> *Krishna Chandra Jha on behalf of agricultural input corporation v. Dinesh Bhakti Sheathe on behalf of Milimili Enterprises et.al*

<sup>227</sup> FITTA 2019, sec. 38.

<sup>228</sup> *Foreign Investment Policy, 2015*.

<sup>229</sup> *Dwarikanath Dhungel v. Tax Office* (NKP 2076, SC 10163).



for the protection of foreign investors rather than the ensuring policy quest of the host government. Thus, the effective examination of current international investment regime is necessary so that Nepal, being a host country, may not be left in a vacuum in addressing the demands of legitimate public interest and its right to regulate while protecting investments.

Thus, Nepal being a capital importing country is always prone to provide maximum protection to its foreign investors thereby curtailing its minimal regulatory power. Most of the BITs have been much priority to the foreign investors. Nepal has decided to review its domestic laws and intends to sign more BITs as such it is high time for Nepal to re-consider its treaty-making practice. Moreover, instead of end up in paying high amount of compensation and price of awards, Nepal should review its existing BITs. Nepal should revise its BIT model. It should move to New Model where much priorities are given to Capital importing and domestic regulation for the foreign investment.

Though the structure and contents of BIT are good and effective but due to political instability, raising of corruption, disturbances in Human Rights, less concerning to environmental protection, weak labor status, ignorance of Rule of Law, paying less attention to Sustainable Development Goals etc., Nepal is not achieving its developmental goal regarding foreign direct investments. Therefore, Nepal should pay much attention to Rule of Law, Anti-Corruption, Respecting Human rights, Respect international laws, give much attention to environmental protection and sustainable developmental issues. Then only existing BITs will be secured and more BITs will come and obviously increase in foreign investment which ultimately leads to the development of Nation. Thus, BITs certainly help to promote and protect foreign investments in Nepal.

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