Looking Beyond the Dabhol Debacle: Examining its Causes and Understanding its Lessons

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ABSTRACT

This Note analyzes foreign direct investment in India, looking into the investment troubles surrounding the Dabhol power project, India's largest foreign investment project to date. After providing an introduction to the mechanics of project finance and a backdrop to the Dabhol power project, the Note considers whether the Indian government's actions, specifically the use of the Indian legal system, constituted "total expropriation" and violations of international law. Additionally, this Note considers what systemic changes India can make in order to create a more investment-friendly environment in the post-Dabhol context.

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I. INTRODUCTION

Dabhol, India’s largest foreign investment project to date, continues to be surrounded by litigation and controversy over fifteen years after its inception. Following India’s solicitation of foreign investment to strengthen its electrical power capacity in the early nineties, a group of foreign investors formed an Indian company to develop, construct, and operate a two-phase, project-financed power plant and related facilities.\(^1\) Indian financial institutions, overseas lenders, and export credit agencies contributed approximately $2 billion in secured loans.\(^2\) Unfortunately, an alleged series of actions by Indian national and state officials and agencies hindered the project, causing multibillion-dollar losses to investors and project lenders.\(^3\)

The Overseas Private Investment Corporation (OPIC), a U.S. government agency created to promote U.S. private investment in developing countries and areas, subsequently paid out over $110 million on political-risk insurance policies covering the Bank of America, Bechtel, Enron, and General Electric (GE) against the risk of expropriation.\(^4\) Pursuant to an investment guaranty agreement between India and the United States, the U.S. consequently initiated arbitration of OPIC’s claims for approximately $110 million plus compound interest against the Indian government.\(^5\) While India and the United States recently reached a successful settlement regarding these claims,\(^6\) the domestic resolution of Dabhol continues to remain a contentious issue within India.

After providing an introduction to the mechanics of project finance and a backdrop to the Dabhol power project, this Note considers whether the Indian government’s actions, specifically the use of the Indian legal system, actually constituted “total expropriation” and violations of international law. Understanding the parameters of expropriation is especially useful given the continued increase in foreign investment in the context of potentially unstable host country economies. Additionally, this Note considers what systemic changes India can make in order to create a more investment-friendly environment in the post-Dabhol context.

2. Id.
3. Id.
5. Id.
6. See infra notes 196–98 and accompanying text.
II. THE MECHANICS OF PROJECT FINANCE

Infrastructure development is a priority for many emerging economies as they attempt to compete in the international economic system. Traditionally, the state has assumed the responsibility of funding infrastructure projects through taxpayer financing, especially in the areas of telecommunications services, public electricity, and transportation systems. The role of private sector participation has been limited not only because these projects have been perceived as public works projects, but also because the costs of participation have been relatively high due to large initial capital outlay requirements, slow expected rates of return, and high risks of unprofitability. However, governments have been forced to seek alternative means of funding for these projects in the face of large financial deficits and poor economic conditions.

A wave of privatization and deregulation in the 1980s and 1990s coincided with a strengthening of capital markets and a sudden availability of commercial lending for larger-scale projects in the category of hundreds of millions of dollars. Accordingly, there has been a marked increase in the funding of infrastructure development projects through private sources of capital in the past several decades. Specifically, project financing has become the most significant legal and financial means by which this shift to private participation in infrastructure development has occurred. Financing is especially important in the context of developing countries attempting to accelerate their industrialization processes and foreign developers seeking to invest in emerging economies with high profit potential.

Project finance is a debt finance technique where the repayment of borrowed funds is primarily dependent upon the revenue generated by the project itself:

It is the financing of a particular economic unit in which the lender is satisfied to look initially to the cash flows and earnings of that

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9. Nassar, supra note 7, at 60.
10. Id. at 61.
12. Banani, supra note 8, at 358.
13. Stelwagon, supra note 11, at 49.
economic unit as the source of funds from which a loan will be repaid and to the assets of the economic unit as a collateral for the loan.\textsuperscript{15}

Additionally, the financing generally consists of two portions: equity and debt capital.\textsuperscript{16} The sponsors or developers of the project are usually a group of large investors, both domestic and foreign, that make equity contributions to the project in the range of 20\% to 25\%.\textsuperscript{17} The lenders are generally large international commercial banks and multilateral lending agencies.\textsuperscript{18} Because of the large amount of funding required for infrastructure projects, debt is usually obtained in the form of syndicated loans with the participation of more than one bank.\textsuperscript{19} Given the increased risks associated with this type of financing structure, project lenders are able to charge higher interest rates.\textsuperscript{20}

The process of setting up a project financing usually begins with the sponsors forming a project company for the purposes of constructing, owning, and operating the project facility.\textsuperscript{21} The sponsors own and manage the project company, which is established as a corporation.\textsuperscript{22} Significantly, the project company, rather than the sponsors themselves, borrows funds from the lenders for the benefit of the project; accordingly, the transactions have no direct impact on the sponsors' balance sheets or general creditworthiness.\textsuperscript{23} Under this arrangement, the lenders look to the assets and cash flow of the project as the security interest for the loans.\textsuperscript{24} By protecting against potential threats, contractual agreements play an important role in helping lenders achieve both their expectations of continuous operation of the project and constant cash flow.\textsuperscript{25} Similarly, the sponsors seek guarantees from the host government on maintaining smooth operation of the project.\textsuperscript{26}

Project finance is a very attractive investment technique for developers for two primary reasons. First, if the project is unsuccessful in meeting its loan obligations, the lenders' only recourse is obtaining the assets of the project corporation itself.\textsuperscript{27} Second, despite investing in a long-term project that borrows millions

\begin{itemize}
  \item \textsuperscript{15} Id.
  \item \textsuperscript{16} Id.
  \item \textsuperscript{17} See id.
  \item \textsuperscript{18} Nassar, supra note 7, at 62–63.
  \item \textsuperscript{19} Id. at 63.
  \item \textsuperscript{21} Banani, supra note 8, at 358.
  \item \textsuperscript{22} Id.
  \item \textsuperscript{23} Id.
  \item \textsuperscript{24} Id.
  \item \textsuperscript{25} Id.
  \item \textsuperscript{26} Id. at 359.
  \item \textsuperscript{27} Id.
\end{itemize}
of dollars in frequently unstable developing countries, the parent corporation's credit rating is unaffected because the project corporation acts as the borrower. 28 However, there are also significant risks associated with project finance for both sponsors and lenders, often in the form of currency-related issues, risks of government default on payment guarantees, and possibilities of political and legal instability in the host nation. 29 Accordingly, project sponsors and lenders attempt to mitigate these risks by involving international agencies that provide credit enhancement programs such as political risk insurance in addition to the obtained host-government guarantees. 30 An appreciation of the mechanics of project finance, as well as the risks associated with this type of finance technique, provides the necessary background for understanding the Dabhol power project. The following Part discusses the economic climate in India leading up to the development of the project.

III. INDIAN ECONOMIC REFORMS

Following decades of unsuccessful socialist-oriented policies aimed at achieving self-sustainability in all sectors of the economy, India embarked upon an economic liberalization plan in the early 1990s that moved the economy away from its traditionally protectionist policies and toward policies that actively encouraged foreign direct investment. 31 Specifically, the Indian government adopted a variety of structural reforms, including the de-licensing of industry, the adoption of full currency convertibility, the reduction of trade barriers, and the welcoming of foreign investors and multinationals, in order to alleviate a balance of payment crisis and spur much needed economic growth. 32 One of the key economic reforms pursued by the government involved opening infrastructure sectors to private companies, which included power, telecommunications, air transport, and roads sectors. 33

Recognizing that India's industrial growth depended substantially on the availability of reliable electric power, the government focused on bringing additional power capacity on line

28. Id.
29. Id.
31. ANDREW INKPEN, ENRON AND THE DABHOL POWER COMPANY 2 (Am. Graduate Sch. of Int'l Mgmt. 2002) [hereinafter THUNDERBIRD CASE STUDY].
33. Id.
throughout the 1990s as a central component of the country’s overall growth plan.\textsuperscript{34} It was estimated that many of India’s industries could operate at only half their capacity because of a lack of electric power, with analysts projecting that India urgently needed to double its capacity to maintain growth.\textsuperscript{35} Virtually all of India’s power was generated and managed by state-owned electricity boards (SEBs) that suffered from chronic managerial, financial, and operational problems.\textsuperscript{36} Not only did government-run power plants typically operate at about 50% capacity, in comparison to private power plants operating at about 85% capacity, but estimates also indicated that approximately 30% of power was stolen by individuals, primarily factory owners, who realized it was cheaper to pay off the SEB than to pay for electricity.\textsuperscript{37} Moreover, an inefficient pricing policy that granted heavy subsidies to rural consumers contributed to huge financial losses.\textsuperscript{38} In this context, the government made two amendments to the Indian Electricity Act in the early 1990s in order to allow more private participation in the power sector.\textsuperscript{39}

Unfortunately, the private sector did not respond positively to such government measures because it remained skeptical of the Central Government’s commitment to reform, and it was doubtful of the SEBs’ ability to pay for privately generated power.\textsuperscript{40} Accordingly, the Central Government actively began seeking foreign investment in the power sector.\textsuperscript{41} Following a May 1992 visit to the United States and the United Kingdom, where a delegation of Indian officials made a pitch for foreign investment in the power sector, many independent power producers (IPPs) immediately sent executives to India.\textsuperscript{42}

IV. BASIC OVERVIEW OF THE DABHOL POWER PROJECT

In turning to private investment for power plant development, the Indian Government gave the first few private sector projects the status of pioneer projects, or “fast-track” projects.\textsuperscript{43} For these fast-track projects, eight of which were eventually signed, the standard public tendering process was not followed because the Indian Government was sensitive to its weak negotiating position.\textsuperscript{44}

\begin{itemize}
\item \textsuperscript{34} Id.
\item \textsuperscript{35} THUNDERBIRD CASE STUDY, supra note 31, at 3.
\item \textsuperscript{36} Id.
\item \textsuperscript{37} Id.
\item \textsuperscript{38} HARVARD CASE STUDY, supra note 32, at 6–7.
\item \textsuperscript{39} THUNDERBIRD CASE STUDY, supra note 31, at 3.
\item \textsuperscript{40} Id.
\item \textsuperscript{41} HARVARD CASE STUDY, supra note 32, at 7.
\item \textsuperscript{42} THUNDERBIRD CASE STUDY, supra note 31, at 3.
\item \textsuperscript{43} Id. at 4.
\item \textsuperscript{44} Id.
\end{itemize}
Instead, the Central Government negotiated with IPPs for individual projects in order to entice them to invest in India by taking measures to reduce their financial risk.\textsuperscript{45} For example, the projects included twelve-year counter-guarantees that obligated the national government to pay the IPP if the state government defaulted on its energy agreement.\textsuperscript{46} These types of guarantees are crucial to investors because state-owned utilities do not have credit ratings from banks or international financial institutions, which makes it difficult for investors to calculate the risk involved in contracting solely with Indian states.\textsuperscript{47}

In the early 1990s, Houston-based Enron Corporation\textsuperscript{48} was a diversified provider of services in the natural gas industry with nearly $9 billion in revenues and $453 million in net income.\textsuperscript{49} Chairman and CEO Kenneth Lay's vision was "to become the world's leading energy company—creating innovative and efficient energy solutions for growing economies and a better environment worldwide."\textsuperscript{50} Toward that end, he had created a holding company that oversaw five major subsidiaries with varied capabilities, spanning every aspect of the natural gas industry.\textsuperscript{51} One of the five subsidiaries, Enron Development Corporation (EDC), was structured to satisfy infrastructure and energy needs in emerging economies by developing power plants and providing electricity.\textsuperscript{52} Following the Indian Government's campaign to attract foreign investment in the power sector, Enron representatives visited India in June 1992 to investigate power plant development opportunities.\textsuperscript{53} Within days, Enron had identified a potential site for a gas-fired power plant in Dabhol, a port town in the Indian state of Maharashtra.\textsuperscript{54}

According to EDC President and CEO Rebecca Mark, Enron first decided to enter India on the basis of "the attractiveness of the market, its Western-style legal code and contracts, the widespread use of English, and the strength of its democracy."\textsuperscript{55} Within the country, "the primary criterion for locating a plant was based on ensuring a 'credible buyer' amongst the many electricity boards."\textsuperscript{56} The Maharashtra State Electricity Board (MSEB) emerged as a front-
runner in preliminary discussions because of its relative success within the country and its long-standing desire to build a gas-fired plant to reduce its dependence on coal and oil.\textsuperscript{57} Dabhol was selected because it was the only deep-water port in the region that would not require significant dredging.\textsuperscript{58} Acting on the Government's assurances that there would not be any tendering on the first few fast-track projects, Enron was the first IPP to formally submit a proposal.\textsuperscript{59} Enron's proposal outlined plans to build a 2,015 mega-watt (mW) gas-fired power plant in Dabhol, and to import the liquefied natural gas (LNG) necessary to fuel the power plant from a LNG plant Enron would build in Qatar.\textsuperscript{60} Moreover, the development of a modern port facility capable of unloading large tankers for equipment and LNG, as well as the development of a re-gassification facility to vaporize the LNG prior to it being used in the gas turbines, would accompany construction of the Dabhol plant.\textsuperscript{61} "The proposed project would be the largest plant Enron had ever built, the largest of its kind in the world, and, at $2.8 billion, the largest foreign investment in India."\textsuperscript{62}

The project was subsequently broken into two phases.\textsuperscript{63} Phase I would involve the construction of a 695-mW plant using distillate fuel rather than natural gas.\textsuperscript{64} The shift from LNG supplies to distillate occurred because distillate could be sourced from local refineries, helping deflect the growing criticism that gas imports would be a persistent drain on India's foreign exchange.\textsuperscript{65} Moreover, using distillate instead of gas eliminated the need to build a port facility for Phase I.\textsuperscript{66} Phase II would introduce an additional 1,320 mW and would involve building the remainder of the plant and re-gassification facility, converting Phase I to LNG, and raising the additional capital.\textsuperscript{67} According to Mark, the splitting of the project "was meant to get us started, test India's credit, and convince suppliers of the project."\textsuperscript{68}

Enron signed a Memorandum of Understanding (MOU) with the MSEB in June 1992, resulting in the formation of a new project company called Dabhol Power Company (DPC).\textsuperscript{69} The equity in DPC

\textsuperscript{57} Id.; THUNDERBIRD CASE STUDY, supra note 31, at 4.
\textsuperscript{58} HARVARD CASE STUDY, supra note 32, at 8.
\textsuperscript{59} THUNDERBIRD CASE STUDY, supra note 31, at 4.
\textsuperscript{60} Id.
\textsuperscript{61} HARVARD CASE STUDY, supra note 32, at 8.
\textsuperscript{62} THUNDERBIRD CASE STUDY, supra note 31, at 4.
\textsuperscript{63} HARVARD CASE STUDY, supra note 32, at 9.
\textsuperscript{64} Id.; THUNDERBIRD CASE STUDY, supra note 31, at 5.
\textsuperscript{65} THUNDERBIRD CASE STUDY, supra note 31, at 6.
\textsuperscript{66} Id.
\textsuperscript{67} HARVARD CASE STUDY, supra note 32, at 9.
\textsuperscript{68} Id.
\textsuperscript{69} THUNDERBIRD CASE STUDY, supra note 31, at 4.
was divided among Enron and its two partners, General Electric Capital Corporation and Bechtel Enterprises; Enron held 80% equity in the project company and each of its partners held a 10% equity interest. Under the relevant agreements, General Electric was responsible for supplying the gas turbines and Bechtel would serve as the general contractor. Following the signing of the MOU and establishment of the project company, Enron began a complicated negotiation process with the appropriate government entities for approval of its proposal.

V. RELEVANT PROJECT DOCUMENTS

With the necessary government approvals in place by March 1993, Enron was in a position to negotiate the financial structure of the deal. The Power Purchasing Agreement (PPA) between Enron and the MSEB was the most critical element of this financial structuring because the PPA was the contract under which Enron, as the owner of the power plant, would supply power to the MSEB electric grid. Under the PPA, dated December 8, 1993, the MSEB was responsible for making capacity and energy payments to DPC. If the PPA were to be terminated and the Dabhol project transferred by DPC to MSEB in accordance with the terms of the agreement, the MSEB would then be required to pay for the facilities by making a lump-sum payment to the DPC.

The Government of Maharashtra (GOM) subsequently issued a guaranty, dated February 10, 1994, pursuant to which it guaranteed MSEB’s payment obligations under the PPA. The GOM and the DPC also entered into State Support Agreements whereby the GOM promised, among other things, to promote and support the Dabhol project, including using its power over other governmental entities to facilitate the permitting process. Moreover, the Government of India (GOI) issued a counter-guaranty to the DPC (dated September 2003).

70. Id.
71. Id.
72. Id.
73. Id. at 5.
74. Id.
76. Id.
77. Id.
78. Id. The original State Support Agreement was entered into on June 24, 1994, and was subsequently amended by a Supplemental State Support Agreement dated July 27, 1996. Id.
15, 1994), agreeing to pay “any sum of money validly due” under the PPA that had not been paid by MSEB or the GOM.\textsuperscript{79} However, the GOI Guaranty was subject to various exposure limits, whereas the GOM Guaranty covered all amounts that came due under the PPA.\textsuperscript{80}

With respect to the financing of Phase II, DPC also entered into an Escrow Agreement with the MSEB and a GOI-owned bank called Canara Bank (dated September 19, 1998, and amended March 27, 1999).\textsuperscript{81} Under the Agreement, the MSEB would establish escrow accounts for the collection of receivables from MSEB’s electricity sales as a form of security for the fulfillment of its obligations under the PPA.\textsuperscript{82} Additionally, based on a requirement by the offshore lenders, Canara Bank issued DPC a letter of credit for up to $1.36 billion rupees on July 17, 1999; DPC then assigned the letter of credit to the onshore trustee as collateral.\textsuperscript{83} DPC (or Lenders) could draw on the letter of credit in the event MSEB failed to make timely payments.\textsuperscript{84}

In order to further protect their respective investments and loans, GE, Bechtel, Enron, and the Bank of America asked OPIC to support the Dabhol project as “a lender, investment insurer and U.S. Government development agency.”\textsuperscript{85} Accordingly, OPIC provided $160 million in funding to DPC for Phases I and II of the project; OPIC also entered into political risk insurance contracts with each of the parties, to provide coverage for their equity stakes and loans against political violence, incontrovertibility, and expropriation.\textsuperscript{86}

\section*{VI. DIFFICULTIES Emerge IN 1995}

After several years of negotiating, raising capital, and executing project agreements, construction of Phase I of the project began on March 1, 1995.\textsuperscript{87} Simultaneously, the Dabhol power project had become a major campaign issue in the 1995 Maharashtra state election.\textsuperscript{88} The incumbent Congress Party, which had been in power in Maharashtra for nearly fifty years, was challenged by a coalition between the Bharatiya Janata Party (BJP) and the Shiv Sena.\textsuperscript{89} Both

\begin{itemize}
  \item \textsuperscript{79} \textit{Id. at 4.}
  \item \textsuperscript{80} \textit{Id.}
  \item \textsuperscript{81} \textit{Id.}
  \item \textsuperscript{82} \textit{Id.}
  \item \textsuperscript{83} \textit{Id.}
  \item \textsuperscript{84} \textit{Id.}
  \item \textsuperscript{86} \textit{Id.}
  \item \textsuperscript{87} \textit{Id.}
  \item \textsuperscript{88} \textit{THUNDERBIRD CASE STUDY, supra note 31, at 8.}
  \item \textsuperscript{89} \textit{Id.}  
\end{itemize}
the BJP and the Shiv Sena have traditionally been suspicious of foreign investment and have espoused ideals of economic nationalism and sovereignty.\textsuperscript{90} Fueled by negative public reaction to the Dabhol Project, the BJP/Shiv Sena coalition won the Maharashtra state election “on a platform of throwing Enron into the Arabian Sea.”\textsuperscript{91} The negative public opinion initially associated with the Dabhol project can largely be explained by questions surrounding the process and content of the original agreement, including accusations of corruption in awarding the contract, the project’s effects on local communities, and the cost of the power when the project would ultimately come on-line.\textsuperscript{92}

Promptly after coming to power, the new government appointed a group of ministers, known as the Munde Committee, to review the Dabhol project.\textsuperscript{93} Assisted by five state government departments, including energy, finance, industries, planning, and law, the committee held more than a dozen meetings and visited the site of the power plant.\textsuperscript{94} The final Committee Report critiqued both the process by which the project had been developed and the terms of the contract. Specifically, the Munde Committee found that the “initial memorandum of understanding was rushed and ‘one-sided,’ condemned the absence of competitive bids and lack of transparency in the process, critiqued subsequent changes to the project design as addressing ‘only the concerns of Enron,’ and found that Enron was given undue favors and concessions.”\textsuperscript{95} Furthermore, the report found that the capital costs of the project were inflated, that the rates for the power would be much higher than justified, in part because the contract was based on U.S. dollars (placing the risk of currency fluctuations on the state), that there were outstanding environmental questions, and that the project would adversely affect the state of Maharashtra.\textsuperscript{96}

Based on the Munde Committee’s evaluations and on behalf of the state government, the MSEB directed DPC to cease construction and abandon the project in August 1995.\textsuperscript{97} DPC immediately exercised its right to international arbitration and commenced an arbitration proceeding in London against the GOM for breach of its contractual commitments, at which point the state government

\textsuperscript{90} Id.
\textsuperscript{91} MINORITY STAFF OF H. COMM. ON GOV'T REFORM, 107TH CONG., FACT SHEET: BACKGROUND ON ENRON'S DABHOL POWER PROJECT 9 (Comm. Print 2002) [hereinafter HOUSE COMMITTEE FACT SHEET].
\textsuperscript{92} Id. at 8.
\textsuperscript{93} Id. at 9.
\textsuperscript{94} THUNDERBIRD CASE STUDY, supra note 31, at 9.
\textsuperscript{95} HOUSE COMMITTEE FACT SHEET, supra note 91, at 9.
\textsuperscript{96} Id.
\textsuperscript{97} Arbitration Request, supra note 85, at 10.
challenged the jurisdiction of the arbitral tribunal. Moreover, the MSEB filed suit in the Bombay High Court to void the PPA, alleging fraud and misrepresentation. However, as early as September, Enron officials were publicly seeking a negotiation settlement. Prior to the arbitral tribunal issuing an interim award ruling that it had exclusive authority to decide DPC's dispute with the GOM, the state government announced that it would accept a revised agreement. The terms of the revised agreement were finalized on February 23, 1996. Subsequently, MSEB dropped its suit in the Bombay High Court and DPC withdrew the arbitration complaint. The GOM also entered into a Supplemental State Support Agreement and a consent judgment in the London Arbitration. By entering into the consent judgment, the GOM accepted, without reservation, the validity and enforceability of the PPA, including its mandatory arbitration commitment.

The revised PPA committed the GOM to both an expanded version of Phase I of the project and to the additional 1,320 mW Phase II portion of the project, which was not previously included in the initial agreement. Moreover, since the MSEB was still committed to buying 90% of the plant's output and covering the risk of currency fluctuations, the revised agreement actually increased the state's financial exposure. Additionally, contrary to state proclamations, reductions in the capital costs of the project may have largely been the product of external factors rather than accommodations by Enron. Consequently, critics of the revised PPA argued that instead of fixing the project's problems, the changes to the initial agreement served to exacerbate those problems. Regardless, by May 1999, Phase I was completed and entered into commercial service.

98. Id.
99. HOUSE COMMITTEE FACT SHEET, supra note 91, at 10.
100. THUNDERBIRD CASE STUDY, supra note 31, at 12.
102. HOUSE COMMITTEE FACT SHEET, supra note 91, at 10.
103. Id.
105. HOUSE COMMITTEE FACT SHEET, supra note 91, at 10.
106. Id. at 11.
107. Id.
108. Id. at 10.
109. THUNDERBIRD CASE STUDY, supra note 31, at 12.
After approximately eighteen months of successful operations, financial problems began to emerge given that the price of power from Dabhol was far beyond what consumers in the area could afford to pay and because demand for electricity in the state had not grown as estimated.\footnote{HOUSE COMMITTEE FACT SHEET, supra note 91, at 13; THUNDERBIRD CASE STUDY, supra note 31, at 13.} Unsurprisingly, the MSEB failed to make the October 2000 capacity payment to DPC and partially defaulted on four capacity payments between October 2000 and January 2001, which totaled approximately $49 billion.\footnote{OPIC MEMORANDUM OF DETERMINATIONS, supra note 75, at 5.} At around the same time, the MSEB agreed in November 2000 to sell half of its 30% stake in the DPC (acquired following the 1996 renegotiations) to Enron, reducing MSEB's overall stake in DPC to 15% as a result of huge financial losses.\footnote{THUNDERBIRD CASE STUDY, supra note 31, at 13.}

In October 2000, the GOM formed an Energy Review Committee, known as the Godbole Committee, to review the power situation in Maharashtra generally and to suggest the future course of action for reforms in the state energy sector.\footnote{OPIC MEMORANDUM OF DETERMINATIONS, supra note 75, at 5.} More specifically, the Committee was asked to evaluate the Dabhol power project, offer a careful assessment of the PPA, and suggest appropriate measures to facilitate purchase of the power produced by the DPC by other agencies/parties (including the GOI).\footnote{Id. at 5–6.} The final Committee Report concluded that

the MSEB was financially incapable of meeting its payment obligation under the PPA and proposed another renegotiation of the project and financing documents, seeking, among other things, [1] a restructuring of the tariff (de-linking it from the dollar/rupee exchange rate), [2] separating the LNG facility and selling LNG on the spot market, [3] canceling the planned escrow arrangements, [4] an increase in the term of the project debt, and [5] enhanced financial support from the GOM and the GOI.\footnote{Id. at 6–7.}

On January 25, 2001, the DPC exercised the GOM Guaranty and demanded payment for amounts due from the MSEB under the PPA.\footnote{Id. at 7.} While the GOM compensated DPC for the October and November 2000 payments, it did not pay the owed amounts for December 2000 and January 2001.\footnote{Id.} Moreover, the following month, the MSEB charged DPC with misdeclaring the amount of available

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\begin{itemize}
  \item \footnote{BEDTOWN CASE STUDY, supra note 91, at 13.}
  \item \footnote{THUNDERBIRD CASE STUDY, supra note 31, at 13.}
  \item \footnote{OPIC MEMORANDUM OF DETERMINATIONS, supra note 75, at 5.}
  \item \footnote{Id. at 5–6.}
  \item \footnote{Id. at 6–7.}
  \item \footnote{Id. at 7.}
  \item \footnote{Id.}
capacity for a one-hour period earlier that year. The MSEB further alleged that capacity shortfalls had occurred on at least two other occasions due to a "cold start" of the Dabhol project or where the plant had been shut down for over twelve hours. Additionally, the MSEB contended that these shortfalls were equivalent to a breach of the PPA and allowed for valid rescission of the contract.

DPC subsequently invoked the GOI Guaranty on March 7, 2001, demanding payment from the GOI for the invoices outstanding under the PPA. The GOI refused to make the requested payments, however, because the GOM had informed it that, under the circumstances, "the invocation of the GOI Guaranty may be rejected by the GOI." Furthermore, the central government stated that the GOI Guaranty was not unconditional and that "there has been no determination by any court or tribunal that the sum of money payable to DPC by MSEB under the PPA is validly due." Additionally, the GOI claimed that "the condition precedent to the invocation of the GOI Guaranty has not been fulfilled and consequently the GOI is not obligated to pay any sum under the GOI Guaranty as demanded by the DPC."

Ultimately, the MSEB paid the February and March 2001 invoices "under protest," and it made the April 2001 payment with a stipulated condition that the payment was "subject to resolution of the pending disputes." The DPC accepted the February and March payments, but returned the April payment due to the stipulation. When the DPC subsequently sought reissuance of the April payment, the MSEB refused. Eventually, in April 2001, the DPC served arbitration notices against MSEB pursuant to the arbitration provisions of the PPA; against the GOM under the GOM Guaranty and the State Support Agreements; and against the GOI under the GOI Guaranty.

On May 23, 2001, the MSEB declared its rescission of the PPA via letter to DPC, alleging that the DPC had engaged in misrepresentations and other wrongful actions. Two days later, the MSEB petitioned the Maharashtra Electricity Regulatory Commission (MERC) (1) to declare that MSEB had validly rescinded the PPA, (2) to enjoin DPC from pursuing international arbitration

118. Id.
119. Id.
120. Id.
121. Id.
122. Id. (internal quotations omitted).
123. Id. (internal quotations omitted).
124. Id. at 7–8.
125. Id. at 8.
126. Id.
127. Id.
128. Id.
against MSEB, (3) to prevent DPC from exercising any remedies outlined in the Escrow Agreement, and (4) to set the price for power produced by the Dabhol Project by regulatory decree.\(^\text{129}\) The GOM had established MERC in 1999, pursuant to the 1998 Electricity Regulatory Commission Act (ERCA) passed by the GOI.\(^\text{130}\) ERCA provided states with authorization to create Electricity Regulatory Commissions (ERCs) to regulate their power sectors.\(^\text{131}\) However, ERCA did not explicitly authorize ERCs to adjudicate disputes regarding power supply contracts that had been entered into prior to its enactment.\(^\text{132}\)

Additionally, on May 29, 2001, MSEB informed DPC that it would permanently cease to purchase power from the Dabhol project.\(^\text{133}\) Furthermore, when the onshore collateral trustee attempted to draw on the Canara Bank Letter of Credit in early September 2001, MSEB applied to the Bombay High Court for an injunction against payment.\(^\text{134}\) While the injunction was nominally for ten days, the injunction remained in place until the settlement of claims several years later.\(^\text{135}\)

Following MSEB's petition, MERC issued an interim order dated May 29, 2001, declaring its authorization to adjudicate the dispute between MSEB and DPC.\(^\text{136}\) It also granted MSEB's petition to enjoin DPC from continuing, in any manner, the arbitration it had initiated against MSEB.\(^\text{137}\) Based on a review of ERCA, MERC determined that "the provisions relating to arbitration in the PPA are inconsistent with § 22(2)(n) of ERCA. Therefore, the relevant PPA provisions cannot have any force whatsoever."\(^\text{138}\) MERC also ruled that

\[
\text{the only Indian law governing the subject of disputes and differences between the electricity utilities in existence today, when these disputes have actually arisen, is ERCA. . . . Therefore[,] . . . MERC has sole and exclusive jurisdiction to adjudicate upon the disputes and differences between the MSEB and the DPC.}\]

However, the MERC Order did not address DPC's rights to pursue arbitrations against the GOM and the GOI under the respective guarantees.\(^\text{140}\) Lastly, the MERC Order enjoined the DPC from

\(^{129}\) Id.
\(^{130}\) Id.
\(^{131}\) Id.
\(^{132}\) Id.
\(^{133}\) Id. at 16.
\(^{134}\) Id. at 18.
\(^{135}\) OPIC MEMORANDUM OF DETERMINATIONS, supra note 75, at 9.
\(^{136}\) Id.
\(^{137}\) Id.
\(^{138}\) Id.
\(^{139}\) Id.
\(^{140}\) Id.
attempting to recover funds owed by MSEB through the Escrow Agreement. Consequently, Canara Bank refused to reactivate the collection arrangements under the Escrow Agreement.

VIII. INDIAN JUDICIAL ACTIONS

Seeking to reverse the MERC Order, DPC sued MERC and the GOM in the Bombay High Court on June 6, 2001. However, the Bombay High Court found that MERC had authority to determine its own jurisdiction and denied the request. DPC promptly appealed to the Supreme Court of India, which reversed the lower court's decision, holding that the Bombay High Court could determine whether MERC had properly asserted its jurisdiction. The Supreme Court remanded the case to the Bombay High Court for resolution, upholding the effectiveness of the MERC Order in the interim. Subsequently, on March 5, 2002, the Bombay High Court issued an oral ruling that "MERC had exclusive jurisdiction over the disputes with the MSEB and that DPC would have to resolve all disputes there." In April 2003, the Indian Supreme Court agreed to hear DPC's appeal notwithstanding the lack of a written decision. Soon afterward, the Bombay High Court issued a written decision confirming the earlier oral ruling. The matter remained pending before the Indian Supreme Court at the time a resolution was reached between the relevant parties.

Similarly, in early September 2001, the MSEB applied to the Bombay High Court for an injunction to prevent payment of the Canara Bank Letter of Credit. The Bombay High Court immediately granted the injunction, and on September 17, 2001, DPC asked the Indian Supreme Court to lift the injunction. The Indian Supreme Court affirmed the lower court, and the injunction continued to remain in effect until an independent settlement was reached. Furthermore, the Bombay High Court subsequently granted an injunction against DPC pursuing arbitration against the GOM under the GOM Guaranty, and the Delhi High Court granted an injunction against DPC pursuing arbitration against the GOI

141. Id.
142. Id.
143. Id. at 10.
144. Id.
145. Id.
146. Id.
147. Id.
148. Id.
149. Id. at 11.
150. Id.
151. Id.
under the GOI Guaranty.\textsuperscript{152} Part IX considers whether these judicial actions constituted "total expropriation" and violations of international law.

IX. EXPROPRIATION ANALYSIS

Once the DPC had effectively been blocked from exercising its arbitration rights under the PPA, equity owners such as Bechtel and GE attempted to recoup at least part of their investments through other sources.\textsuperscript{153} As is common practice in project finance transactions, these investors had insured their investment in DPC against political risks, including expropriation, by purchasing insurance contracts from OPIC.\textsuperscript{154} When it became clear that OPIC had no intention of paying the relevant insurance claims, Bechtel and GE (Claimants) brought arbitration against OPIC under the provisions of their insurance policies in front of the American Arbitration Association.\textsuperscript{155} At OPIC's request, Bechtel and GE eventually consolidated their claims.\textsuperscript{156}

While the appropriate framework for determining OPIC's liability to such claimants is clearly based on terms of its insurance contracts, it is important to recognize that there is also an established body of customary international law on expropriation. Though expropriation by a host state traditionally required "prompt, adequate and effective compensation" under what is known as the "Hull Rule," international law has tended to move away from this full compensation standard in favor of respecting host state autonomy.\textsuperscript{157} Interestingly, however, as customary international law has shifted toward less protection for investors, there has been an increase in the number of Bilateral Investment Treaties negotiated between developed and developing countries, generally providing foreign investors with even greater protection than the Hull Rule once did.\textsuperscript{158}

Nonetheless, under OPIC's insurance coverage, "a breach or abrogation of the Project Agreements by [any agency or instrumentality of the Indian government] could result in a compensable claim if the foreign enterprise were denied its lawful recourse pursuant to the agreements and if the terms of OPIC's

\begin{itemize}
  \item \textsuperscript{152} Id.
  \item \textsuperscript{153} Bechtel Arbitration, supra note 101, at 21.
  \item \textsuperscript{154} Id. at 3.
  \item \textsuperscript{155} Id. at 22–23.
  \item \textsuperscript{156} Id. at 23.
  \item \textsuperscript{158} Id.
\end{itemize}
expropriation coverage were also satisfied."¹⁵⁹ Accordingly, in order to trigger applicability of the insurance contract, an insured would have to demonstrate both a denial of lawful recourse and a total expropriation as defined by OPIC. OPIC's official handbook describes its expropriation coverage as protection "against the nationalization, confiscation or expropriation of an enterprise, including 'creeping' expropriation—unlawful government actions that deprive the investor of fundamental rights in a project."¹⁶⁰ Nonetheless, "no compensation [would] be payable under expropriation coverage unless DPC [had] exhausted its available remedies under the project agreements. . . ."¹⁶¹ Available remedies encompass arbitration between DPC and the relevant Indian parties.

Under Article IV of the Bechtel and GE insurance contracts, four elements must exist for an act or series of acts to constitute a total expropriation.¹⁶² First, the relevant acts must be "attributable to a foreign governing authority which is in de facto control of the part of the country in which the project is located."¹⁶³ In this case, the Arbitral Panel found that the relevant acts were undertaken by the GOI, GOM, MSEB, MERC, and the judiciary, which are all either Indian state or national governmental authorities, agencies of the Indian government, or owned and controlled by the GOI or GOM.¹⁶⁴

Second, the acts must be "violations of international law without regard to the availability of local remedies or material breaches of local law."¹⁶⁵ This second requirement is the most controversial with respect to the instant facts. According to the Arbitral Panel, "[t]he evidence makes clear that MSEB, the GOM, and the GOI violated each of (a) the PPA, (b) the GOM and GOI guarantees and (c) the State Support Agreements, for political reasons and without any legal justification."¹⁶⁶ However, such an analysis presumes the validity of these agreements. For example, it can be argued that the MSEB, the GOM, and the GOI simply exercised their right to assess the validity of the relevant agreements (at least MSEB's rescission of the PPA) through a domestic judicial mechanism.

Additionally, the Panel found that MERC, MSEB, and the Indian courts "have enjoined and otherwise taken away Claimants' international arbitration remedies under the PPA, all in violation of established principles of international law, in disregard of India's commitments under the U.N. Convention as well as the Indian

¹⁶⁰. Id. at 9.
¹⁶¹. Id. at 11–12.
¹⁶². Id. at 24.
¹⁶³. Id.
¹⁶⁴. Id.
¹⁶⁵. Id.
¹⁶⁶. Id.
Again, it can be argued that MERC and the Indian judiciary were first concerned with assessing the validity of the relevant agreements, including rescission of the PPA, and then considering the availability of arbitration as a secondary issue. For example, if the PPA was found to be valid (the issue was still pending in the Indian Supreme Court at the time of these claims), it would follow that arbitration would be an available remedy. On the other hand, if the PPA was considered invalid and arbitration was consequently denied, the investors would seem to have a valid expropriation claim at that time. The broader question of whether simply using a host country’s domestic judicial system is a violation of international law and amounts to expropriation is subsequently addressed in this Part.

Third, the acts must deprive the investor of fundamental rights in the insured investment; rights are “fundamental” if “without them the [i]nvestor is substantially deprived of the benefits of the investment.” In finding that investors’ fundamental rights had been deprived, the Arbitral Panel pointed to the following: (1) the MSEB discontinued payment to DPC for the electricity generated by the Dabhol plant and attempted to “rescind” the PPA; (2) the GOM and GOI failed to honor their respective guarantees; (3) the MSEB, MERC, and the Indian courts enjoined investors from terminating the PPA in accordance with procedures that would have made MSEB responsible for a transfer amount; and (4) investors could not recoup their investment in the project because of a denial of arbitral remedies. These collective actions did, at least temporarily, substantially deprive investors of the benefits of the project.

Fourth, the violations of law are not remedied, with the expropriatory effect continuing for six months. According to the Arbitral Panel, “the expropriatory acts by the GOI and its related agencies began in December 2000 when MSEB breached its payment obligations under the PPA, culminating in the appointment of a receiver for the assets and accounts of DPC, which have never been remedied, and have continued for over six months.”

Finding that each of the necessary elements had been satisfied, the Arbitral Panel held that a “total expropriation within the meaning of Section 4.01 of the OPIC policies has taken place.” Waiving the requirement of exhaustion of remedies because “the reason for noncompliance was the unforeseen action of a party beyond the control of either claimants or OPIC, namely MERC and the

167. Id. at 24–25.
168. Id. at 25.
169. Id.
170. Id.
171. Id.
172. Id. at 24.
Indian Courts,” the Arbitral Panel consequently required OPIC to compensate the parties.\textsuperscript{173} Furthermore, on the basis of the discussed Arbitral award, OPIC decided to settle a similar claim with Enron as well as a related claim with Bank of America regarding an unpaid loan to DPC.\textsuperscript{174}

However, OPIC’s subsequent Memorandum of Determinations regarding an expropriation claim by Bank of America reflects the difficulty of equating the relevant Indian actions as expropriatory and as violations of international law. OPIC’s analysis begins with the recognition that the insurance contract “expressly excludes from coverage any expropriatory action taken by a foreign governing authority in its capacity or through its powers as, among other things, a purchaser from DPC or as a guarantor of any payment obligation to DPC, absent satisfaction of certain additional requirements that all parties agree have not been met.”\textsuperscript{175} While the Arbitral Panel construed this express exclusion to implicate the motivation of the parties, OPIC correctly notes that even if the motivation in defaulting in payments and in rescinding the PPA was governmental rather than commercial, the exclusion does not depend on the motivation behind the actions.\textsuperscript{176} In fact, “the exclusion is of actions taken by governmental actors through certain specifically cited relationships with the Project. The [alternative] interpretation would have the phrase ‘in its capacity’ read to mean, ‘motivated by.’”\textsuperscript{177}

Accordingly, OPIC considered only the government’s interference with arbitration rights and the obstruction of the lenders’ security arrangements as potentially expropriatory within the insurance contracts.\textsuperscript{178} Given that so many of the alleged breaches fit within the 4.02(b) exclusion, the relevant question is “whether the remaining acts, standing alone, constitute creeping expropriation.”\textsuperscript{179} Significantly, the remaining acts boil down to the government’s use of the domestic legal system, and the question becomes whether such actions constitute an improper taking of a right held by an investor.\textsuperscript{180} An affirmative answer to that question hinges on whether the government’s actions were violative of international law.\textsuperscript{181}

According to OPIC, “the actions of the GOM and the GOI in supporting MSEB’s efforts to avoid international arbitration as the

\begin{itemize}
\item \textsuperscript{173} Id. at 29–30.
\item \textsuperscript{174} See OPIC MEMORANDUM OF DETERMINATIONS, supra note 75.
\item \textsuperscript{175} Id. at 15.
\item \textsuperscript{176} Id.
\item \textsuperscript{177} Id.
\item \textsuperscript{178} Id. at 18–19.
\item \textsuperscript{179} Id. at 19.
\item \textsuperscript{180} Id. at 20.
\item \textsuperscript{181} Id. at 19.
\end{itemize}
forum for resolving PPA disputes with DPC, both directly and indirectly through actions of MERC and of the Indian courts, constitute a denial of justice in violation of international law." It is important to keep in mind, however, that the referenced "denial of justice in violation of international law" is more accurately described as a temporary blocking of access to certain contract rights through injunctions, lawsuits, and assertions of contrary legal positions. The temporary nature of the blocked access stems from the fact that the DPC was granted formal appeals rights. While recognizing that the disputed claims had not gone through the entire process of litigation, OPIC held that the appeals rights had been "rendered ineffective by delays in the Indian courts." Arguably, however, the Indian Supreme Court attempted to accelerate the judicial process (it agreed to hear an appeal regarding MERC's jurisdiction before the lower court had issued a written decision). Regardless, it remains unclear that a backlogged judicial system constitutes a violation of international law or expropriation. In fact, it is not even clear that corrupt judicial decisions constitute expropriation. Indeed, "[t]he chance that unstable or corrupt judiciaries in emerging markets may make judgments or deny access to courts is a major concern for investors. While international law tentatively recognizes that judicial decisions by national judiciaries can be tantamount to expropriation, companies often have difficulty recovering in such situations."

As evidence for the conclusion that India's actions violated international law, OPIC appealed to the "basic principle of international law that a state may not rely on domestic law as a defense to a breach of its international law obligations." Arguably, however, India had not technically breached its international law obligations since its actions were directed at determining the validity of the PPA as a first order issue. In contrast, once (1) the Indian Supreme Court had determined that the PPA was invalid and that arbitration was foreclosed or (2) the Indian Supreme Court had determined that the PPA was valid but the government refused to submit to arbitration, India would likely be in breach of its international law obligations. Furthermore, it can be argued that because questioning foreign judicial processes and decisions necessarily implicates issues of national sovereignty, there should be

182. Id. at 20.
183. See id. at 21.
184. Id.
185. Id.
186. See supra Part VIII.
187. DeLeonardo, supra note 4, at 784.
188. Id.
189. OPIC MEMORANDUM OF DETERMINATIONS, supra note 75, at 21.
reluctance in categorically equating use of a host country judicial system as expropriatory or violative of international law.\textsuperscript{190}

As further evidence in support of its position, OPIC appealed to the Restatement of Foreign Relations Third: "[A] state may be responsible for a denial of justice under international law if . . . [,] having committed itself to a special forum for dispute settlement, such as arbitration, it fails to honor such commitment."\textsuperscript{191} Again, because DPC refused to exhaust all local remedies, there can be no final determination that India refused to honor its commitments. At a practical level, however, it must be recognized that "the cumulative effect of the government's actions is that DPC has been blocked from prosecuting international arbitrations against MSEB, the GOM or the GOI in a fashion sufficiently timely to avoid collapse of the Project and substantial loss of the related investments."\textsuperscript{192}

Moreover, it is relevant that there appear to be elements of bad faith with respect to the government actions: "the GOI's enactment of the legislation pursuant to which the GOM was empowered to establish MERC, the GOM's subsequent establishment of MERC, and the GOM's issuance of a notification under ERCA conferring on MERC the exclusive jurisdiction to adjudicate disputes under the PPA" all seem to be conveniently timed to avoid the international arbitration of disputes.\textsuperscript{193} In this case, Judge Lauterpacht's observations become especially applicable:

\begin{quote}
[i]t is not enough for a State to bring a matter under the protective umbrella of its legislation, possibly of predatory character, in order to shelter it effectively from any control by international law. There may be little difference between a Government breaking unlawfully a contract with an alien and a Government causing legislation to be enacted which makes it impossible for it to comply with the contract.\textsuperscript{194}
\end{quote}

In this case, the relevant Indian actions seem to constitute at least de facto expropriation given both the practical impact of the actions and the strong evidence of bad faith.

As the preceding analysis demonstrates, however, whether the use of host country judicial systems to avoid contract obligations constitutes expropriation or a violation of international law is not a settled legal issue. In most cases, the inquiry will depend on whether the government actions have constituted a denial of justice. A traditional denial of justice claim encompasses the inability or unwillingness of courts to appropriately address a preexisting wrong

\begin{footnotes}
\item 190. DeLeonardo, \textit{supra} note 4, at 784.
\item 191. OPIC \textit{MEMORANDUM OF DETERMINATIONS}, \textit{supra} note 75, at 22.
\item 192. \textit{Id.} at 21.
\item 193. \textit{Id.} at 18.
\item 194. \textit{Id.} at 21 n.71 (internal quotations omitted).
\end{footnotes}
that occurred outside the judicial system. However, a modern definition of denial of justice also includes claims where the "wrong occurs as an unjust decision of the judicial system itself." Indeed,

[although the traditional notion of 'denial of justice' has centered on deficiencies in a state's system of justice and the state's failure to accord due process, there is also significant authority for the proposition that a refusal by a state . . . to arbitrate constitutes a denial of justice and engages the state's international responsibility. Specifically, "where [an] agreement provides for arbitration, an investor can claim denial of justice . . . if the state acts to frustrate the arbitration or refuses to honor the award." As a practical matter, it does not make sense to distinguish between a court's failure to remedy a wrong from outside the judicial system and a wrong initiated within the court system since both, equally, infringe on investors' rights and both are, equally, denials of justice.

Interestingly, while OPIC will typically cover frustration of the arbitration process under its insurance contracts, the Multilateral Investment Guarantee Agency of the World Bank Group has been reluctant to do so. Arguably, however, insurers such as OPIC are in the best position to assume such risk because they can reduce the final cost of an expropriation claim by obtaining reimbursement from the host country government after the expropriation occurs. Specifically, "the muscle, authority, and leverage of the U.S. government combine[] to make OPIC a formidable negotiator when the agency face[s] out-of-pocket losses." In this case, for example, the United States initiated arbitration of OPIC's claims against the GOI for approximately $110 million plus compound interest under a 1998 US-India Investment Guaranty Agreement. This was the

196. Id. at 1108.
199. Given the complicated nature of the inquiry, however, it may be helpful to borrow from the bilateral investment treaty context and consider the following three factors in determining whether an indirect expropriation has occurred: "1) an assessment of the adverse economic impact of the government action, 2) the extent of government interference with reasonable investment-backed expectations, and 3) the character of the government action." Benjamin H. Sheppard, Jr. et al., International Commercial Dispute Resolution, 39 INT'L L. 235, 245 (2005). Based on this standard, there would be an indirect expropriation in this case.
201. DeLeonardo, supra note 4, at 744.
202. Id.
203. AMJIL Brief, supra note 1, at 271.
first time arbitration was initiated against a host country under the bilateral agreements pursuant to which OPIC operates its political risk insurance program, presumably because settlements are generally reached at an earlier stage in the process.\textsuperscript{204} Even in this case, however, OPIC and the GOI were able to independently settle their claims.\textsuperscript{205}

X. LOOKING AHEAD

By July 2005, the GOI had finalized settlement terms with all of the international parties to the Dabhol power project, and for the first time, the project was fully owned and controlled by GOI interests.\textsuperscript{206} Rechristened as Ratnagiri Gas & Power Pvt Ltd (RGPPL), the Dabhol power plant finally resumed normal operations in September 2007 and is expected to be fully operational by spring 2008.\textsuperscript{207} Nonetheless, the failures associated with Dabhol have almost certainly contributed to negative impacts on the Indian economy. Despite the difficulties in assessing the foreign investment-related impacts of Dabhol because of the inelastic demand for investment in India or the general attractiveness of the Indian market, there is a consensus that "foreign investors—with memories of failed projects in the 1990s still fresh in their minds—continue to be wary of investing in India."\textsuperscript{208} Indeed, several international power developers disengaged from the Indian power sector in the late 1990s.\textsuperscript{209} As Nelivigi, Peel, and Krishnamoorthy explain, "the collapse of the Dabhol project, which had received financing from a number of international banks that were also the most likely sources of international financing for the other projects in India, essentially closed the doors for international lenders and raised questions about the reliability of central government counter-guarantees."\textsuperscript{210} Moreover, whether related to Dabhol or not, the total volume of project financing in India is still relatively small compared to


\textsuperscript{205} Id.

\textsuperscript{206} Id. at 4.

\textsuperscript{207} \textit{The Dabhol Saga: The Next Chapter Is as Uncertain}, FIN. EXPRESS (New Delhi, India), Jan. 11, 2008. However, several domestic hurdles with respect to successful operation of the plant continue to exist. Id.

\textsuperscript{208} Nandan Nelivigi et al., \textit{Infrastructure Project Finance in India: Recent Developments}, 1587 PRAC. L. INST. 133, 135 (2007).

\textsuperscript{209} Id. at 135–36.

\textsuperscript{210} Id.
international standards. While it is unlikely that there will be a second “Dabhol,” it is very possible that smaller-scale difficulties of a similar nature will arise in the future. In this context, it is important to consider the types of systemic changes the Indian government can make to minimize difficulties in international project finance transactions and to make the country more conducive to foreign investment. After highlighting some of the primary issues with Dabhol, this Note considers relevant reforms by the Indian Government and offers suggestions on additional measures India can take to provide an improved environment for future transactions.

One of the major criticisms of the Dabhol project has been the political rhetoric surrounding the project at all stages of the process. Indeed, the BJP/Shiv Sena coalition won the 1995 Maharashtra state election “on a platform of throwing Enron into the Arabian Sea.”

Moreover, as discussed earlier, state and national government entities did not follow through on several of their contractual commitments. According to Jonathan Rodden and Susan Rose-Ackerman, the Dabhol experience exemplifies the observation that “once an investor’s sunk costs reach a certain threshold, its exit threats are no longer credible, and local political leaders can renege on earlier agreements and attempt to extract extra concessions.” They reason that “[w]hile this kind of behavior will damage the reputation of the state and potentially hinder future investment, state leaders in highly competitive political environments may not have the luxury of long time horizons.”

Certainly, the disconnect between short-term political considerations and long-term investment strategies can create incentives for unproductive behavior, but it is also important to recognize the underlying conditions that allow for political mobilization along these bases. For example, with respect to Dabhol, political leaders were encouraged to seek extra concessions from Enron largely because of the strong public perception that the original terms of the agreement were unfavorable to India. While a general anti-foreign investment bias may have contributed to negative public opinion, objective sources were also critical of the agreement terms.

Thus, it is helpful to analyze the factors that contributed to negative political opinion about the project in the first place. This type of analysis is important because politicization of the project was largely dependent on the existence of these underlying factors;

211. Id. at 140.
212. HOUSE COMMITTEE FACT SHEET, supra note 91, at 9.
213. See supra Parts VI–VII.
215. Id. at 1542–43.
216. See infra note 218 and accompanying text.
precisely because "criticism of Enron in India was so great . . . the opposition Bharatiya Janata Party (BJP) made cancellation of the Dabhol project a central tenet of its election campaign."217 The following factors likely contributed to negative perceptions of the Dabhol power project: a rushed and incomplete deal-making process, an absence of competitive bidding, a lack of transparency, and the appearance of corruption.218 Indeed, the Dabhol project was controversial from the beginning: as an initial matter, the Maharashtra state government was criticized for entering into a MOU with Enron within a three-day period.219 Even though the MOU was not a legally binding document, the public was disappointed with the swiftness of the process given that an inexperienced government was negotiating a multibillion-dollar project.220 Unsurprisingly, both the World Bank and the Indian Central Electricity Authority subsequently found many irregularities in the agreement and determined that it was one-sided in favor of Enron.221 Furthermore, especially because of the lack of competitive bidding, the negotiating process was conducted exclusively between Enron and the Government of Maharashtra and was treated as highly confidential.222 The lack of competition and transparency generated severe criticism and encouraged speculation of corruption. For example, there were allegations that India's Commerce Minister P. Chidambaram had "strongly supported Enron's Dabhol power project in public forums in India and abroad without disclosing the fact that he had given a paid legal opinion to Enron," and that "Enron had paid Mr. Chidambaram a 'substantial fee' when he was practicing law in between holding two Cabinet posts."223 Similarly, Enron spent $20 million on "education gifts" for the Indian government, which payments were allegedly made as bribes to clear the project.224

In addition to these issues of politicization, corruption, and lack of transparency, the Dabhol episode also highlighted problems associated with SEBs, such as the MSEB. Most significantly, in the past, SEBs have not been creditworthy and have been the only

218. These factors can broadly be considered corruption/lack of transparency issues.
220. Id.
221. Id.
222. HOUSE COMMITTEE FACT SHEET, supra note 91, at 8.
223. Id. at 8 n.37.
customers to whom independent power producers could sell their power. In the late 1990s, many SEBs experienced serious financial difficulties as a result of systemic problems, such as inefficient retail pricing systems, insufficient collections, and widespread transmission and distribution losses. Accordingly, even if an escrow arrangement existed to mitigate investor risk, as in the case of Dabhol, SEBs were often unable or unwilling to transfer the escrowed tariffs. With respect to Dabhol, the MSEB ultimately made use of the Indian judicial system to contravene its contractual commitments.

Learning from the Dabhol experience, the Indian government has subsequently adopted key reforms to improve India's ailing power sector. The Indian Electricity Act of 2003, which consolidates all previous electricity laws in India, is one such reform. Among other things, the Act allows independent power producers and captive power generators to sell power directly to any consumer or licensee, subject to the payment of certain charges. The Act also establishes the Appellate Tribunal for Electricity to hear appeals from decisions from the Central Electricity Regulatory Commission (CERC) and State Electricity Regulatory Commissions (SERCs). Additionally, the Act provides for the corporatizing and unbundling of SEBs. In effect, "the new Electricity Act is intended to enable a move away from a system in which state utilities enjoy a monopoly to one in which competition thrives and independent power producers are no longer captive suppliers to a single SEB."

Furthermore, the Indian Government unveiled a new Electric Policy in early 2005 in an attempt to encourage greater investment in the power sector. The new Electric Policy establishes rules covering the purchase of electricity by power suppliers through medium and long-term contracts or power purchase agreements lasting for one year and beyond. Essentially, the policy requires power purchase agreements to be secured through open bidding processes.

While these reforms are a step in the positive direction, additional measures can be taken to improve the general investment
climate. For example, while several states have enacted electricity reform acts which restructure their SEBs from branches of the state government into independent corporate entities, the Central Government needs to apply pressure on the remaining states to do so because such restructuring would improve the creditworthiness of SEBs and mitigate the potential politicization of projects. Moreover, a disparity in SEB restructuring across the country could lead to an increased concentration of investment and infrastructure development in states with the most comprehensive reforms. Accordingly, the Indian government should conduct an outreach strategy on the benefits of restructuring SEBs and should provide technical assistance to states that do not have the requisite resources to engage in such a process. Additionally, in an attempt to ensure the independence of SERCs and SEBs, there should be a mechanism for internal and external audits to ensure a competitive bidding process and maximum transparency in the power sector.

With respect to the longstanding problem of corruption, there must be greater enforcement of anti-corruption laws, which could include the establishment of an independent agency on combating corruption. Moreover, an integral component of combating corruption in India should involve the adoption of a whistle-blower protection law to protect those who report instances of corruption within their respective organizations. In conjunction with such broad-based measures, there should be an effort to minimize the possibility of corruption at the level of individual transactions by streamlining negotiations and reducing the number of actors involved.

Additionally, while the increase in specialized courts, such as the Appellate Tribunal for Electricity, is generally a positive development because it mitigates the weaknesses of the Indian court system, attention cannot be diverted from the need to restructure the judicial system. For investors that could potentially be introduced to Indian courts, the guarantee of fair and efficient proceedings is essential. To that end, measures must be taken to reduce the judicial backlog and to provide more expedient justice. Once these broader changes of restructuring SEBs, enforcing anti-corruption laws, and restructuring the judicial system take form, the more sector-specific reforms adopted by the Indian Government will produce their greatest effect.

236. Nelivigi et al., supra note 208, at 137.
237. While the Supreme Court has previously recommended the passage of such legislation, the central government has not been successful to this end.
XI. Conclusion

As one of India's first and largest foreign investment projects, Dabhol was anticipated as a major step in improving the country's ailing power sector in the early 1990s. Similarly, project sponsors were excited about the opportunity of investing in India in hopes of gaining large returns. Unfortunately, however, the project has been wrought by crises and has resulted in multibillion-dollar losses to investors and project lenders because of a poorly conducted negotiation process that allowed Indian national and state officials to take a series of opportunistic actions.

Consequently, OPIC, a U.S. government agency created to promote U.S. private investment in developing countries and areas, subsequently paid out over $110 million on political-risk insurance policies covering the Bank of America, Bechtel, Enron, and GE against the risk of expropriation.\textsuperscript{238} While the parameters of creeping expropriation are not settled as a matter of international law, it seems that the Indian government's actions—specifically, the use of the Indian legal system to contravene contractual requirements—effectively satisfied OPIC's definition of total expropriation. Eventually, the United States initiated arbitration of OPIC's claims for approximately $110 million plus compound interest against the Government of India pursuant to an investment guaranty agreement between the two countries.\textsuperscript{239} While India and the United States have successfully reached a settlement regarding these claims, the domestic resolution of Dabhol continues to remain a contentious issue within India. More importantly, in order to counteract the negative impacts of Dabhol and to provide greater economic stability, India must adopt a series of socio-political changes that will allow it to achieve its full potential in attracting and retaining foreign investment.

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\textsuperscript{238} AMJIL Brief, supra note 1, at 271–72.
\textsuperscript{239} Id. at 271.

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