Investment Protection Under Bilateral Investment Treaties of Pakistan

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ABSTRACT

This research is carried out to explore the BITs of Pakistan and its effects on bringing much needed foreign investment in Pakistan, which is considered a backbone for the economic development for any country. The research reveals that the BITs entered by Pakistan remained a ceremonial gesture to improve the economic relations of Pakistan with other countries without even analyzing the contents of these treaties. Due to this unawareness at the government level, BITs are becoming more nuisance as they give rise to the international investment disputes at international forums, where Pakistan is exposed to investment claims and the cost of international arbitration. Keeping in view of these aims, this research article highlights the pros and cons of the BITs regime of Pakistan with a hope that in future, a careful analysis may be undertaken before entering into such type of treaties.

KEYWORDS

Bilateral Investment Treaties, Investment Protection, Pakistan, Qualitative, Trade

INTRODUCTION

Definition of BIT

Bilateral investment treaty is an investment facilitation agreement between two countries whereby foreign investment from each other is regulated. UNCTAD defines BIT to be “an agreement between two countries for reciprocal encouragement, promotion, and protection of investment in each other’s territories by companies based in either country”1. As two countries are sovereign states and without compromising their sovereignty, both countries desire to exchange the arrangement to grow economically and to improve the lives of their subjects. As per the definition of International Monetary Fund’s Balance of Payments, foreign investment is defined to be as “an investment that is made to acquire the lasting interest in a firm or an enterprise operating in the county other than investor, thereby, the investors have effective voice in management of firm/enterprise.”

The countries commit themselves through internationally binding instrument to respect and honor the investment of each other nationals in their own country. Under the international investment regime, country from where investment is made is referred as the origin or home country, whereas the country where the investment is destined is referred as the host country.

Bilateral investment treaty also covers rights and liabilities in respect of investment. There are also set patterns of international investment law, which have to be abided by both the countries. The history of modern BIT dates back to 19592, where Germany after the devastation of Second World War first time felt the need of safeguarding and protecting their investment interests in another country,
as their investment in other countries were ruined, ransacked, destroyed, and forcibly expropriated by allied countries and their forces. Therefore, it entered into an international agreement with Pakistan, which was then called the Bilateral Investment Treaty. Since then, the sharp rise in these sorts of agreement were witnessed. By now, it is estimated that there are 2500 Bilateral Investment Treaties and other international agreements globally on the subject [3][4]. In 19th Century, countries used to execute ‘Friendship, Commerce and Navigator Treaty’ (FCN)5.

A BIT begins with a preamble containing the purpose and information about the respective treaty. It normally has information about the promotion and protection of investment. The other provisions, like the definition of investment, clauses relating to investor are also incorporated in it. Thereafter, the main body of BIT contains the clauses of treatment and admission of investment, protection clauses (i.e., Standards of Treatment, Minimum Standards of Treatment, Fair and Equitable Treatment, Full Protection and Security, National Treatment, and Most Favoured Nation Treatment).

The exchange of investment proceeds and expropriation clause are also provided in modern BITs. The BIT also contains compensation clause in wake of expropriation of investment. The right to foreign investor is also provided in BITs to get his investment dispute resolved through ‘investor-state settlement’ mechanism6. The BIT has a life expectancy as to when it is terminated or extended7. Under the international investment law, the words as used in the treaty are given preference for interpretation of the treaty8. In practice, BIT is divided into three portions:

1. The scope of the agreement.
2. Substantive protections and treatment standards,
3. Alternative dispute resolution.

OVERVIEW OF PAKISTANI BITS

The first Bilateral Investment Treaty was executed by Pakistan with Germany in 1959. Since then, so far 48 Bilateral Investment Agreements have been executed by Pakistan with different countries of the world9, out of which 26 are in force10. The purpose of Pak-Germany Treaty was the promotion of economic relations between two countries by giving access to the investment made by their nationals or corporations into the boundaries of other country. It has fourteen clauses, and this agreement was first of its kind to be executed by two economies in the post-World War II scenario. This treaty was later on superseded by another BIT in 2009, referred as the, ‘Agreement of the Encouragement and Reciprocal Protection of investment’.

Being an agriculture-based country, Pakistan is most of the time dependent upon foreign investment, while signing these BITs, the government officials being unaware of international investment law ignored its implications on the economy. However, Pakistan is to some extent benefitting from these BITs, but it has also exposed it to the unnecessary investment claims and their settlement at international institutions given the fact that local remedies cannot be resorted, which in result take out a handsome amount from the foreign exchange for contesting these claims.

In the current investment environment, Pakistan has to swallow the bitter pill by relying on BITs to attract investment11. Without analysing the implications, around 15 more BITs are under card with no empirical evidence that previously 50 executed BITs have justified their existence. To shift the BITs on modern lines, the government official even have turned to new policy trends by introducing new BIT template with more emphasis on arbitration clauses through Investment Policy, 2013. This new template proposes a specific period for the resolution of investment dispute prior going to the international arbitration12.

The impracticalities of Pakistani BITs can be understood from the fact that in 1996, the Pakistan government officials cancelled the contract executed by Pakistan with Societe General de Surveillance (SGS) on the charges of not being transparent and even the element of bribe was detected. The said allegations were refused by SGS, and thereafter different legal proceedings in Pakistan and Switzerland
began, but all failed. After passing of five years, Pakistan government officials received a letter from ICSID for the payment of US$110 million as a compensation on the basis of Pak-Switzerland BIT in spite of the fact that domestic litigations failed. At that time, government officials realized the severity of the matter as due to vagueness of treaty clauses, SGS got away with the settlement of its dispute with the Pakistan government outside the Pakistani legal system.

These vague and faulty treaties have caused a claim of one billion US dollar. Mostly, these BITs were executed in 1990. The analysis of executed BITs revealed that these have been signed by the government officials, representatives of Ministry and Department Officers, which suggests that there is no central control over the procedure and process of these BITs. Rather, it appears that the execution of these BITs signifies ceremonial gestures accompanied by unsophisticated negotiations and unawareness of such implications.

Though, the Pakistani BITs have broad protections cover to global investments of other treaty country, but it lacks benefits for Pakistan. As a host state, the reciprocity of obligations in BITs have been emphasized, which is prerequisite for attracting investments. While comparing the BITs of Pakistan with its national law, i.e., Foreign Private Investment (Promotion and Protection) Act, 1976, it can be concluded that the investment protection under BITs regime are far broader than this statute.

To appreciate such investment protection, two BITs i.e., Pakistan-UK and Pakistan-Germany should be followed as an example. The BITs are normally restricted to foreign investors instead of local investors. The foreign person has to fulfil the criterion of investor set out in the respective BITs, which includes national or legal/lawful corporation of that state. In some of the cases, mere registration suffices to fulfill the criteria of investor’s definition. But some of the BITs necessarily requires the existence of substantial business operations. This has led to a new practice as most of nationals of either country establishes hollow companies in another state to acquire most of the benefits from BITs, this concept is called “treaty shopping”.

Under the Pakistan BITs, the much broader and extensive definition of investment has been provided, which is also apart from the traditional definition of investment. The said definition is also broader than the national legislation. For instance, the Article 2 of Foreign Private Investment (Promotion and Protection) Act, 1976 defines investment as under:

*Foreign Private Investment means an industry, undertaking, or establishment engaged in the production, distribution or processing of any goods, the providing of services specified in this behalf by Federal Government or the development and extraction of such mineral resources and products as may be specified in this behalf by the federal Government.*

Whereas, according to most of the Pakistan BITs, ‘investment’ is defined to be every type of assets except the following:

1. “Movable and immovable property as well as any other rights in rem, such as mortgages, liens, and pledges.”
2. “Shares of companies and other kinds of interest in companies.”
3. “Claims to money which have been used to create an economic value or claims or any performance having economic value.”
5. “Business concession under public law, including concession to search for, extract, and exploit natural resources.”

The investment as per Pakistani-BIT includes a variety of assets including but not limited to ‘commercial transaction’, ‘contract’ and ‘intellectual properties rights’, but enforcement of rights arising from the intellectual properties are weaker in Pakistan as there is no effective or forceful
mechanism in the field over these rights. There is also a definition of ‘investment’ provided under the ICSID Convention, which also defines the qualification for investment and investor had to fulfil such criteria of investment to maintain his claim against home state at ICSID23.

Under the ICSID Convention, there is no specific definition of investment given, rather it is left to the wisdom of the arbitration tribunals to define investment from case to case. This collection wisdom has produced a wide range of economic transaction to be included in the definition of an investment. Following are some of the assets found to be falling under the definition of ‘investment’24:

1. “Acceptance of promissory notes where a State issues them as an acknowledgement of its debt to a company but fails to make repayments (Fedax NV v. Republic of Venezuela).”
2. “The construction and operation of hotels where a State fails to provide promised financing or seizes control of the enterprise (Holiday inns SA v. Morocco & Amco Asia Corporation v. Republic of Indonesia).”
3. “The cultivation of crops and the construction of a textile factory where a State fails to pay for materials (Adriano Gardella SpA v. Cote d’Ivoire).”
4. “The construction and management of a fertilizer factory where a State has, in breach of contract, failed to pay construction costs (Klockner Industire-Anlagen GmbH v. United Republic of Cameroon).”
5. “The mining of bauxite where a State raises a production levy in breach of a ‘no further tax’ agreement (Alcoa Minerals of Jamaica Inc. v. Jamaica).”
6. “An oil distribution venture where a State fails to comply with the terms of a share purchase agreement (Agip SpA v. The People/s Republic of Congo).”
7. “A bottle manufacturing and mineral water production venture where a State fails to meet its obligation to contribute share capital and subsequently expropriates the investors’ property (SARL Benvenuti and Bonfant v. The People’s Republic of Congo).”

In the case of SGS v. Pakistan, the tribunal considered ‘pre-inspection customs services agreement’ as an investment in terms of Pak-Swiss BIT. The tribunal further broadened the definition by including “every kind of asset”, “claims to money or any performance having economic value” and “all other rights given by law, by contract, or by decisions of the authority in accordance with the law”.

The main consideration for the tribunal about such definition was that, SGS bore the expenses in meeting its obligation, therefore, element of expenses made services as investment. As per the International Law Commission (ILC), the acts of any nationalized agency are binding upon the national government. ILC while deliberating on “responsibility of state” has given the following statement25:

“The conduct of an organ of an entity which is not part of formal structure of the State or of a territorial governmental entity, but which is empowered by the internal law of that State to exercise elements of governmental authority, shall also be considered as an act of the state under international law, provided that organ was acting in that capacity in the case in question.”

The tribunal also considered the above statement in the case of (Compana de Aguas v. Argentine Republic 40, ILM (2001), 457) in the following words:

“Under international law, and for the purposes of jurisdiction of this Tribunal, it is well established that actions of a political subdivisions of a federal state, such as the Province of Tucuman in the federal state of the Argentine Republic, are attributable to the central government. It is equally clear that the internal constitutional structure of a country cannot alter these obligations.”26
Under the International investment regime, commonly every BIT has some guarantee over certain rights. Most common protection found in most of BITs are:

1. Protection against breach of the investment contract.
2. Full protection and security for the investment.
3. Fair and Equitable Treatment.
4. Most Favoured Nation Treatment for the Investment.
5. National Treatment for the Investment.
6. Compensation for losses due to war or riot.
7. Protection against expropriation or nationalization.
8. Rights to repatriate investment and returns.
9. Right to international arbitration for violation of the treaty provisions.

The above rights have given a sense of discrimination as it mostly favors investors than national investors as BIT gives protection cover to foreign investment only, thus neglecting the national investors. The enforcement of rights by foreigner over national investor is also quicker and smoother under BIT. For instance, the Act of 1976 in Pakistan restricts the rights of foreigner in respect to repatriation of funds, which is to be regulated under the Pakistani Foreign Exchange Regulation Act, 1947. In case of dispute, such foreigner can have access to the national courts as like the domestic investors, but right to the international tribunal is not available for the domestic investors.

Most of the Pakistan-BITs contains a special guarantee clause resembling with similar clauses of many modern BITs of countries. It is known as ‘Fair and Equitable Treatment’ clause. The purpose of this clause is to regulate acts of national governments or their functionaries. This clause has been interpreted in the way that it has completely changed and even overstretched than the standards set under the International Law of ‘standard of treatment for aliens’. This clause is a clog against the host state from taking any adverse action against the foreign investment. It also forces the host state to make a cordial legal framework for the investment. This clause includes both executive and non-executive actions including legal action. In Pakistan, the violation to this standard is often witnessed.

Another important factor of Pak-BIT is that they have a ‘protection and security guarantee’ standard. This clause is triggered where there is malafide action/actions on the part of a government agency, as it is causing damage to the property of investor and the state has not taken any action to safeguard it. This clause is normally invoked whereas host state fails to provide any legitimate protective measures to avoid damage to the respective investment. The language of this clause is vague and is not explained expressly in BITs of Pakistan, leaving the field open for the tribunal to interpret it in the light of their judicial precedents as per their wisdom.

The clause of compensation for loss owing to war, riot, or various internal disturbance of host country is also found in many Pakistan-BITs. It says that the investors would be compensated where loss to his investment is caused due to internal exigencies, state of emergency, revolution, military takeover, coup, or any other conflicts. This clause further says that in case of army action for requisition or destroying the investment, the investor would be given full compensation and it is also immaterial as to how local or third state investors are treated.

Breach of BIT is seriously viewed under the International Investment Law. Every country is bound to abide by any obligations made with foreign investors by virtue of any BITs. The opponents of this theory often argue against it as it puts extra pressure on the weakened economies of BIT i.e., which are mostly the third world countries. This clause is called ‘Umbrella’ clause and its violation by the host state or its government department is viewed as a violation of BIT.

Likewise, Equal Treatment clause treating the investment of investor at par with the treatment provided to national of home state is also available in many BITs of Pakistan. The treatment against discrimination is also taken care of in modern BITs regime. This treatment is provided in Most Favoured Nation (MFN) standard. It says that the investment of foreign investors would be given
similar treatment as it has been given to the national of any third states under some other BITs between that state and the host state.

There are two more important clauses found in modern BIT regime. The first one is the ‘expropriation’ clause, which provides for the compensation in case the foreign investment is nationalized or expropriated in the territories of host state. The expropriation and ‘measures tantamount to expropriation’ would only take place, where it is deemed appropriate for public benefits and against compensation. The expropriation is permissible under investment subject to the certain conditions i.e.,

1. “Acquired for a public purpose of host state.”
2. “It is Non-discriminatory.”
3. “Acquisition is in accordance with due process.”
4. “It is accompanied by prompt, adequate and effective compensation.”

The second clause is the dispute resolution clause. Unlike domestic arbitral dispute and litigations, all BITs of Pakistan consist of investment dispute resolution clauses. These BITS give the investor to choose either ICSID or UNCITRAL arbitration forum for resolution of their claim. This right by the investor can be resorted to if amicable resolution of dispute and local remedies are failed. Such recourse is always dependent on wording to wording of the BITs.

**BIT MODEL OF PAKISTAN**

This first BIT of Pakistan was signed with Germany in 1959. Since then, Pakistan is following the BIT template of other countries from time to time and has no specific BIT model of its own. Due to the cumbersome and vague provisions, by the passage of time, Pakistan face difficulties in following these BITs. The said BITs regime led to various arbitral proceedings, which shows that the BITs enforced needs revision and updation as they on one hand have caused the very depletion of natural resources and on the other hand Pakistan had to churn out huge sum of money in defending these cases. It would not be wrong to say that these BITs are not doing any good for the economy of Pakistan.

Keeping in view above defects and hurdles in the BIT regime, Pakistani authorities decided to prepare its own model of BITs that would replace older BITs and would be implemented as an alternative way to already enforced BITs. The future investment negotiations would be done on this model BIT30. Statutorily, BoI of Pakistan has been assigned the task to do the needful. The deliberation on the model of BIT is going on keeping in view of special emphasis on the protecting the interests of Pakistan. In the new BIT, no private investment dispute would be enforced against government and provisions regarding Alternate Dispute Resolution (ADR) are compulsory, which would be mutually decided in advance prior to going to litigation. For settlement of investment dispute, the local courts are given preference than international arbitration.

The BIT model was prepared in 200631. US is also negotiating BIT with Pakistan due to the existing investment relationship. Pakistan is cautiously looking on this BIT as US had introduced a new draft BIT suggesting strict clauses with far reaching implications32. There are some blanket provisions in the existing International Investment Treaty Model that only protect the rights of investors instead of focusing on the rights of host countries33. Many enforced Pakistani BIT clearly depicts that they were not concluded through sophisticated negotiations.

These BITs have more suitable provisions ensuring protections with strict clauses to foreign investment than the people of Pakistan34. Due to these negative effects, the modern BIT model of Pakistan looks a way forward to streamline its BITs regime with the modern investment law and its best practices. BoI in terms of national law of Board of Investment Ordinance, 2001 is negotiating and finalizing the agreements with other countries in line with a new model of BIT35.
According to the new model, all investment contracts would be vetted by Law and Justice Ministry. In case of any delay in implementation of agreement on the part of government officials, BoI would intervene, which would appoint a panel of arbitration lawyers to look out for domestic solution. BoI has renegotiated Pak-Germany BIT of 1959 in November-2009, Pak-Kuwait BIT in Feb-2010, and Pak-Turkey BIT in April-2012. Revisions of BITs are also adopted by many countries (i.e., Venezuela, South Africa, Brazil, Argentina, Ecuador, as well as Indonesia) around the world as their economies have received a tremendous financial blow owing to costs of arbitration and their awards.

This latest development of new template and renegotiation on BITs are encouraging development in foreign investment laws of Pakistan. The new BIT is viewed as a new milestone and would contribute significantly towards the investment climate of Pakistan.

CONCLUSION

Bilateral investment Treaties are a major source of Pakistani foreign investment laws as they regulate the rights and liabilities of investor-state relations. BITs are international agreement executed by two countries for protection and promotion of investment with each other. When investment is made by nationals of firms of one state with another state is called Foreign Direct Investment (FDI). Prior to BIT, in 19th century, there was ‘Friendship, Commerce and Navigator Treaty’ (FCN). The most common features of BITs are that they contain clauses of “fair and equitable treatment”, “protection from expropriation”, “free transfer of funds” as well as “full protection and security”. They also have provisions of alternative dispute resolution, whereby jurisdiction of ICSID is accessed in case of dispute between the investor and state. The first BIT was executed between Pakistan and Germany in 1959 and at present there are 2500 BITs in force between countries, and between the investor and countries.

Pakistan so far have executed 48 BITs with different states of the world, out of which 26 are in force. But, despite the execution of long list of BITs, Pakistan still lags behind in attracting foreign investment as against other South Asian countries like, China and India, therefore, government officials started deliberation on new Pakistan model BIT from 2006 and future investment negotiations would be undertaken on the basis of such model. Under the new model BIT, more emphasis is given on arbitration clauses, which infers that the resolution of investment related dispute would be decided through local courts than international arbitration.

There are some blanket provisions in the existing International Investment Treaty Model that only protect the rights of investors instead of focusing on the rights of host countries. These BITs have more suitable provisions ensuring the protections with strict clauses to foreign investment than the people of Pakistan. Due to these negative effects, the modern BIT model of Pakistan looks a way forward to streamline its BITs regime with modern investment law and its best practices. BoI in terms of national law of Board of Investment Ordinance, 2001 is negotiating and finalizing agreements with other countries keeping in view, the interests of Pakistan.
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5. (Reisman et al, 2004)
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8. Article 31(1), Vienna Convention on the law of Treaties, which says that the terms of any treaty shall be construed in accordance with their ordinary meaning.
11. (Mustafa, 2015)
12. (Khan, 2013)
14. “SGS Societe Generale de Surveillance S.A. v Islamic Republic of Pakistan ICSID Case No.ARB/01/13, decision on Jurisdiction, 06-08-2003, para.63”
17. Protections of investments offered by Pakistan contain almost 32 BITs of Pakistan signed with different countries. These include Germany, Sweden, Kuwait, Korea, Netherlands, China, Turkmenistan, UK, Singapore, Turkey, Romania, Kyrgyzstan, Azerbaijan, Indonesia, Tunisia, Syrian Arab, Denmark, Portugal, Belarus, Mauritius, Italy, Oman, Sri Lanka, Australia, Japan, Belgium, Philippines, Yemen, Egypt, Lebanon, and Morocco.
19. Mahnaz. International Law Protections for Foreign Investment in Pakistan, 32
20. For example, Swiss-Pak BIT, has a clause that needs real economic presence in home country of registered corporation.
21. Mahnaz, International Law Protections for Foreign Investment in Pakistan, 33
22. Mahnaz, International Law Protections for Foreign Investment in Pakistan, 34
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