

CRITICAL ANALYSIS OF BILATERAL INVESTMENT TREATIES IN PAKISTAN

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Abstract

Protection of alien's property has been the key issue among the sovereign trading nations of the world. The contesting considerations of capital exporting nations and least developing capital importing nations have played pivotal role for the development of international investment law. The failure to build multilateral consensus for the protection mechanism led to the emergence of bilateral investment treaties (BITs). Least developing countries (LDCs) owe obligations under the influence of incumbent external and internal factors. Last three decades have shown prolific increase of the instrument, which has established an insulated guarantee for the protection of foreign investment in host states. Bilateral investment treaties have promulgated substantive and procedural guarantees to protect the assets of foreign investors. This paper has analyzed that BITs acquired by successive government in Pakistan, which have created pro-investor obligations. Substantive and procedural framework of BITs in Pakistan has created vulnerability to regulate the national interests of the state. A skillfully negotiated and democratically devised policy for adoption of future BITs shall have tendency to engender a balanced approach for the foreign investors and the state.

Keywords: Bilateral, Treaties, Foreign Investment,

1. Introduction and Scope of BIT

The research paper discussed briefly nuances of protection of properties of foreigners in host state. The growth of trade and investment activities during the industrialization of nineteenth century stirred diplomatic interventions for the protection of assets of their citizens in host states. In twentieth century, certain newly independent states in post-colonial period pursued 'Calvo Doctrine' for the protection of foreign investments as their national policy. The consequent controversies move certain trading nations to adopt Friendship Commerce and Navigation treaties (FCN) for the protection of their trade and investments among contracting states. FCN treaties proved to be the founding stone for the emergence of Bilateral Investment Treaties (BITs). BITs became the predominant preference for the promotion and protection of foreign investment in post-Cold War era. The shared interest ensured global economic stability, but failure to build consensus for the multilateral agreement for the promotion and protection of foreign investment, which have been the impetus for the emergence of BITs.

Pakistan and Germany signed first ever bilateral investment treaty in 1959. Pakistan adopted a liberal approach in their respective treaties. Bilateral investment treaties have been providing substantive and procedural guarantees for the protection of investments of foreign investors from contracting state. Majority of BITs of Pakistan have offered dispute resolution guarantee by supranational adjudicative forum to ensure a credible protection of foreign investment in Pakistan.

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2. Background Analysis of Growth of Bilateral Investment Treaties

The political communities of the world had not been inclined to accept any rights and capacity of these aliens in their territories prior to middle ages. The customary international law of the time had no accepted standard system for the treatment of property of foreigners (Newcombe & Paradell, 2009, 3). In the middle ages the early Roman and The German tribes demonstrated hospitality to recognize the rights and capacity of these foreigners (Borchard, 1913). Some early writers of seventeenth century recognized the rights to travel, live, trade, and non-discriminatory treatment on entering a foreign territory in accordance with the law of the land. In 1758, *Emmerich de Vattel*, in his work, Law of Nations, opined that the mistreatment to the foreigner property was an injury to the home state for foreigner admitted to the territory. This view was eventually become the principle of international law (Vattel, 1858).

The industrialization era of nineteenth century engendered sensitivity among trading nations for the protection of foreigner's property under international law. The controversies arose for the recognition and enforcements of foreign investment protections. Edwin Borchard established treatise on the diplomatic protection of citizens abroad to explain the rights of foreign traders and investors in the foreign land. The treatise provided evolution and justification for recognizing legal capacity of foreign citizens while in foreign territories (Borchard, 1913). Prior to twentieth century, these foreign citizens, including investors, were treated by the customary international rules of diplomatic protection (Newcombe & Paradell, 2009, 2). In later developments, the rhetoric of protection of foreigner's property invoked diplomatic intervention by the home state. The intervention for the protection of foreign investment ranged from diplomatic efforts to Gunboat diplomacy in certain incidents (Okpe, 2014).

Decolonization era in the last decades of nineteenth century gave birth to number of sovereign states. Newly independent states asserted their sovereignty by adopting home states principle of 'no preferential treatment' for foreign traders and investors, but equal to locals. Number of Latin American states incorporated '*Calvo Doctrine*' in their constitutions, which provided to treat foreign property alike local investors and to be dealt with in accordance with the domestic laws. The doctrine asserted that in case of disputes with the foreign investor, the local remedies to be exhausted first before invoking any transnational forum of disputes resolution. On the other hand, USA supported the '*Hull Formula*', which insisted for the adequate, prompt, and effective compensation for expropriation of the property of foreign investors (Lowenfeld, 2008).

In post-World War II developments, the trading nations of the world signed the treaties of FCN for the protection of trade route and assets of foreign investors essential for durable peace. Treaties were signed bilaterally by UK, USA and Japan with the other states in the context of Post-World War reconstruction of Europe. The US entered into twenty-one FCN treaties during 1946 to 1966 and other trading nations of the world, including states of Latin American countries (Vandeveld, 1992, 19). After 1966 US never signed any FCN (Vandeveld, 2005, 162). In the backdrop of economic integration after WWII, FCN treaties contained all the essential ingredients of modern Bilateral Investment Treaties without using this nomenclature (Newcombe & Paradell, 2009, 23).

Pakistan was the first country which signed first ever BIT with Republic of Germany in 1959 for the promotion and protection of investments of contracting states (Newcombe & Paradell, 2009, 2). Sovereign states had shown least attraction to adopt it up till 1979. First twenty years gathered a stock of 100 BITs entered by the sovereign states. The decade of 1980s has reflected moderate trend of signing BITs when 385 BITs were finalized till 1990s for the promotion and protection of foreign investment. In last decade of twentieth century, adoption trend of BITs skyrocketed in the post-cold war time. In the year 1999, the world economies have signed 2392 BITs as compare to 385 in 1990. This pattern of international investment treaty was quickly followed by the other capital exporting countries. In a short span of time, BITs become the wide spread instrument in international law (Guzman, 1997, 651). With the increasing trends for BITs, this number reached to 2392 in 1999 as compare to 385 in 1990. This number has reached 2900 signed BITs of which 2342 enforce treaties till December, 2020. Wherein, 177 states have been the contracting parties of the instrument (investmentpolicy.unctad.org).

International investment law has pledged its origin from the protection of human rights and fair, non-discriminatory, and equitable treatment of aliens on foreign land (Ghouri & Mahmood, 2012). BIT features provides for an obligation to take steps for promotion of investment on the contracting states. As an instrument of investment

protection, BITs have standardized the national treatment of foreign investors and guarantee transfer of capital and its returns. The dispute settlement mechanism before supranational forums in case of expropriation of the assets of the foreign investors have introduced procedural guarantee of foreign investment protection (Newcombe & Paradell, 2009, 43). The contracting states are obliged to refrain from discriminating treatment against the activities of the investor from other states. The investors of contracting state shall enjoy the protection of their investment and in case of expropriation right of prompt and adequate compensation.

The USA began its BIT program in 1977 in consequence of lobbying of the US business community. Despite the opposition of labour organizations, the US administrations finalized 265 BITs until 1987 with over seventy other states. On the other hand, China signed its first BIT in 1982. The early Chinese BITs provided limitations of substantive and procedural nature regarding the admission and treatment toward foreign investments and its dispute settlement mechanism. This trend was changed in 1998 in *Barbados- China* BIT, which provided for dispute settlement trend like other capital exporting states. Now China is part of number of BITs with wide ranging procedural and substantive investment obligations. Latin American states remained opponent to such international instruments of obligation, which limited jurisdiction of national courts for investment disputes. The inclination of South American nations for the *Calvo* doctrine witnessed for more than thirty years after signing of first BIT. These states left its resistance to BITs in 1990s. Most of the African, Middle Eastern, and Asian countries started signing BITs in 1970s and early 1980s (Newcombe & Paradell, 2009, 43-57).

3. Factors Contributed for the Emergence of BITs

Post-world war politico-economic developments led considerable efforts for the integration of international economic. The shared interests of world community for the stable new economic order led its negotiations under the auspicious of international economic organizations. Therefore, inflexible conflicting approach of capital exporting and capital importing nations, for the protection of international trade and investment, failed to build consensus for the collective legal system. The failure of negotiations for multilateral investment treaty has been another factor, which led for alternative instrumentality (Ghouri, 2009). The leading organizations i.e. UNO, IMF, OECD, UNCTAD, and World Bank sponsored the struggle for integration of international economic. The new economic order under the auspicious of international organization has encouraged bilateral agreements for the protection of international trade and foreign investment (Poulsen, 2011).

The wealthy states encouraged BITs as a supranational institutional check for uncompensated expropriation under domestic laws of the host state. Developed countries shift their emphasis for signing of BITs with Less Develop Countries (LDCs) to avoid uncertainty and controversies surfaced by the application of *Hull Rule* to treat foreign investors. These capital exporting nations want ensured protection for their investors in the host states against the possible breach of contractual liabilities and expropriation than customary international law. These BITs provide effective dispute settlement mechanism and enforcement of their claims with ensured compliance of enforcement liabilities under an award (Guzman, 1997, 652).

On the other hand, the host state desirous to attract FDI and increasing the trade relations in business of the world (Tobin & Busch, 2010, 2). Treaty protagonists suggested that these BITs are major factor for the flow of foreign direct investment for capital importing countries (Newcombe & Paradell, 2009, 62). The capital importing developing countries started negotiation for FTA and BITs for the sake of job creation, technology, skill transfer, and to attract foreign capital (Ghouri, 2009). These international instruments are considered as helpful for increase of foreign direct investment for the states (Newcombe & Paradell, 2009, 48). This flow of foreign direct investment included lending finance from the international financial institutions.

In the backdrop of a campaign of attracting foreign capital by developing economies, the capital exporting developed countries lobbied for full, prompt, and adequate compensation in case of expropriation for foreign investors. A competitive pressure on capital importing states for providing enabling environment for foreign investment by international instruments led to another reason for the emergence of contemporary regime of bilateral investment treaties (Newcombe & Paradell, 2009, 63).

4. Framework of Bilateral Investment Treaties in Pakistan

Pakistan has been the first country to sign first ever bilateral investment treaty with Germany on November 25, 1959. Pakistan took a pause of nineteen years, till 1978, when she signed her second BIT with Romania. The BITs have been considered to be the impetus to the growth of international investment law for the capital importing nations in the era of 1990s. Prior to 1990s, Pakistan signed eight treaties with leading and developed economies of the world. The treaties with all those eight countries are still enforceable. In the last decade of 20th century, Pakistan signed 30 new BITs with thirty new economies of the world and one replacement of old version of the previously BITs (Pakistan-Romania BIT, 1995). Pakistan signed 53 BITs until December 2017 with 48 nations, including less-developing, developing, and developed economies of the world.

The BIT adopted by Pakistan and Germany in 1959, introduced no provision for the settlement of investment disputes between investor and the host state. The investor has no option to approach directly to any foreign adjudicative forum for the resolution of investment disputes. After 19 years of its first ever treaty, Pakistan-Romania 1978 was the first wherein jurisdiction of ICSID tribunal was recognized for investment dispute settlement. The jurisdiction was introduced with the condition that if the award of compensation by national arbitration tribunal remained unsatisfactory for the investor then ICSID forum can be approached. The next three BITs with France, Kuwait, Germany were executed in 1983 wherein Pakistan consented for the ICSID jurisdiction in the treaty where investment dispute could not be resolved amicably between disputing parties. The investor can approach the ICSID jurisdiction without any intervening procedures in the host country. According to the language adopted in treaties with Kuwait, France and Sweden, the investor needs not to prove the requirement of consent by the host state to invoke ICSID jurisdiction. An additional provision was also adopted which prohibit the exercise of diplomatic channel to resolve the investment dispute in Pak-Sweden BIT. In 1988, in the BIT of Pak-Netherlands, ICSID jurisdiction was agreed upon by the contracting parties without any intervening procedures by the investor. But in the next two BITs, Pakistan opted for different procedure, which has to be adopted for the resolution of the investment disputes. In 1988, the treaty which was finalized with Republic of Korea without involving any international dispute resolution mechanism for the settlement of investment disputes. The Pakistan-Korea BIT provides only compensation in case of expropriation of assets of a foreign investor and declares arbitration tribunal of the host state of a competent forum for the resolution of an investment disputes. The treaty requires an adequate compensation according to the market value of the assets by applying the laws of the host state (Pakistan -Korea BIT, 1988). The bilateral investment treaty between Pak-China, 1989 also provides that investor can only claim compensation in case of expropriation under the treaty. The options available for the investor under the treaty are: firstly, the investor can claim adequate compensation for expropriated assets. Secondly, investor can challenge the legality of expropriation. Thirdly, investor can file a review of the amount of compensation before the appellate tribunal of the host country. If the matter is not resolved within a period of one year, then the investor has the option to approach any international arbitral tribunal (Pakistan-China BIT, 1989). The investor can approach international tribunal where the amount of compensation is not adequate and the matter is not resolved after filing of complain with the competent authority.

In the last decade of 1990s, Pakistan signed 32 bilateral investment treaties. The majority of the BITs have referred supranational forum of dispute resolution. The treaties have recognized ICSID jurisdiction in fifteen of BITs where means of amicable settlement i.e. negotiation or consultation, in order to resolve the investment dispute. Foreign investors are given the freedom to invoke ICSID jurisdiction for the settlement of investment disputes. Four treaties of the decade have suggested a procedure of constituting an *ad hoc* tribunal. The *ad hoc* tribunals are constituted by appointing one member, each by the litigant parties, and third how would be Chairman of the tribunal is to be appointed by those two members. In case these two members failed to appoint the Chairman, then such Chairman to be appointed by an international authority. In case of Iran, the parties agreed that the appointing authority is Chairman of permanent court of international arbitration. The Chairman shall appoint the third member to complete the constitution of *ad hoc* tribunal where any of the party remain fail to appoint her member for the tribunal. In case of Pak-Oman BIT and Pak-Mauritius, the appointing authorities are president ICJ and Chairman of International arbitration institute of Stockholm of chamber of commerce. Whereas, the treaty Pak-Uzbekistan 1992, investor is entitled to approach an international institutional arbitration forum by following the arbitration rules of UNCITRAL.

Bilateral investment treaties have promulgated a credible protection for admitted foreign investment from political risks and domestic laws. Substantive and procedural guarantees have been incorporate in the instrument of international obligations to ensure non-discriminatory and equitable treatment. Bilateral investment treaties have brought pivotal change in the trend of foreign investment dispute settlement from state own adjudication to

transnational institutional settlement. The rule based adjudication system has been referred in majority of BITs in case of expropriation of the assets of the foreign investor (Douglas, Pauwelyn & Viñuales, (2014).

5. Evaluation Of Pakistani BITS

The developing states with their emerging economies are more inclined to sign a BIT as instrument for the protection of foreign investors (Poulsen, 2011, 112). It is unlikely that international economic organizations such as IMF, World Bank, IFC, and MIGA have no compelling contribution to encourage BITs among member states (Poulsen, 2011, 80-89). The unequal bargaining powers of developing states, to avoid diplomatic and economic reactions from capital exporting nations have been the reasons for signing of BITs. International financial institutions have been used to convince capital importing countries to choose such guarantees of protection of foreign investment (Poulsen, 2011, 112). A large portion of BITs were adopted in post-Cold War period in 1990s. The establishment of unipolar political and economic world created an opportunity to motivate LDCs to accept obligations for attraction of foreign investment and other related economic benefits. Pakistan adopted majority of BITs in post-Cold war era.

Pakistan adopted 44 BITs after 1990 out of the total Stock of 53 treaties till date. Nine treaties were finalized within thirty years of first signing of the instrument. The broad structures of the BITs in Pakistan include the title to show contracting parties, preamble to reflect a desire for mutual cooperation for the promotion of foreign investment. All Pakistani BITs referred their preamble for promoting favorable conditions for the reciprocal investments. A typical BIT includes provisions of interpretation clause, admission regulation, standard of treatment, transfer of capital, compensation for damage and dispute resolution mechanism (Ghouri & Mahmood, 2012). Bilateral investment treaties have affected legal, political, and economic prevalence in Pakistan.

The preamble contains provisions for economic cooperation and commitment of the governments for the protection of investments by foreign investors from contracting party of the BIT (Ghouri & Mahmood, 2012). Pakistan's BITs in their interpretation clauses define the term investment in broad terms to include every kind of assets. UK-Pak BIT of 1995 defined investment to include every kind of assets acquired by law. These assets include any kind of property, shares, contracts, intellectual property rights and other rights relating thereto. The definition of "investor" covers both natural on the basis of its nationality and legal persons on the basis of its incorporation if it has the nationality of the contracting party. The rights under a BIT can only be claimed by the investor (Ghouri & Mahmood, 2012).

The contracting states have no qualifications for invoking rights under the provisions of bilateral investment treaties. Foreign investors of the contracting states are the sole beneficiaries of the BITs even without privity to the treaties. These multinational corporations have been recognized as subject of international law at par with the sovereign states. These multinationals can invoke international adjudications against host state unilaterally without any interference or permission of the home state. The home state has no power to restrict these foreign investors to sue the host state. Therefore, host states are considered as permanent respondent for investor state dispute settlement mechanism.

BITs standards have been finalized by ignoring human rights issues, public welfare, and international environmental sustainability (Ghouri & Mahmood, 2012). The provisions of treaties relating to expropriation and standards of treatment have shown their tendency to resist 'shared global objectives' of international community. In the case of *Philip Morris vs Austeralia*, permanent court of Arbitration assume its jurisdiction in a multibillion dollars claim filed against host state for imposing restrictions on cigarette packaging under plain packaging Act (*Philip Morris v Australia*, PCA Case No 2012-12). In case of *Vattenfall Republic of Germany* received a claim of \$ 3.7 billion to regulate environmental hazards under Atomic energy Act, 2011 (*Vattenfall v. Germany*, ICSID Case No. ARB/12/12).

The diplomatic handicap of the contracting states has undermined the sovereign status to regulate national interests of the state. There are treaties of Pakistan which specifically mentioned stabilization clause. The clause has the effect of freezing up of domestic laws to affect the investment with an average of 15 to 20 years duration (Ghouri & Mahmood, 2012). The irrevocability status of these BITs has been difficult for the successive governments of the host states. These treaty obligations have the surrendering effect to exploit natural resources of the country. In the gold mine case against Pakistan, Tethyan Copper Company earned an award of more than five

billion US dollars on the plea of legitimate expectation to expand its lease agreement on the other mining area in *Rekodiq* Balochistan province (Tethyan v. Pakistan, ICSID Case No. ARB/12). The provisions of BITs in Pakistan has widened the scope of foreign investment and investors. The wide application of the scope of foreign investment and investment has created unpredictable results of ICSID ligations against Pakistan. The experience of *Impreglio S.p.A. v. Islamic Republic of Pakistan* and *Bayindir v. Pakistan* cases have highlighted that any measures to enforce contractual performance can invoke actionable claim against state. On the other hand, *Agility for Public Warehousing Company K.S.C. v. Islamic Republic of Pakistan* case an expired service performance contract of a foreign company became the cause of action the state. The expensively liberal interpretations the provisions of bilateral investment treaties have enhanced the chances to potential litigation with narrow scope of amicable settlements of investment disputes.

6. Conclusion and Suggestions for BITS in Pakistan

The sensitivity of protection of foreign property can be traced back in early world communities of nineteenth and twentieth century. The scholarly work of *De Vattel* in 1758 explained that mistreatment with property of foreign to be dealt as injury to the home state. This explanation eventually has been recognized as the principle of customary international law. *Edwin Boucher* extended it for diplomatic protection of state. The expanded narrations of foreign investment engendered controversies among trading nations. The decolonization of nineteenth century provoked nationalism among the political governments of newly independent states. Numbers of nation states choose to treat international investment alike their domestic standards. The investment disputes were dealt under the local remedial system of adjudication. The experiences of nationalization of foreign assets without effective compensation stimulated concerns about politicized and biased system of adjudication among the capital exporting nations. The capital exporting nations pleaded for transnational adjudication of foreign investment disputes. Number of trading nations finalized FCN treaties to save trade route and ensure credible protection for their citizens investing in contracting host states. FCN treaties proved to be preliminary model for BITs in post-World War II era of economic revival.

Pakistan and Germany in 1959 signed first ever bilateral investment treaty for the promotion and protection of foreign investments. This model of treaty showed a moderate trend of adoption and ratification in 1980s. Such trend skyrocketed in 1990s by attracting sweeping majority of world economies. All the major capital exporting nations have promoted such assurance under BITs. On one hand, the UNO and other international economic organizations played its leading role to promote and encourage BITs after failure to build multilateral consensus for multilateral investment treaty. On the other hand, the thirst of LDCs adopted international obligations to attract flow of foreign capital, skill, and technology. Till 1990s, Pakistan showed slow response of acquiring obligations under BITs. In the last decade of twentieth century, the successive governments in Pakistan acquired international obligations for foreign investment protection under BITs. The framework has acquired international obligations for treatment standards and expropriations. One of the major assurances incorporated to protect foreign investment has been in form of consent to supranational forums of adjudications in case of investment dispute. Majority of BITs provided procedure for the constitution of international tribunal in case of investment disputes with the foreign investors of contracting state. BITs obligations highlighted that foreign investor has privilege to invoke jurisdictions of international forum unilaterally without the permission of home state against contracting state.

The acquisition trends of bilateral investment treaties of Pakistan shows that Pakistan has adopted major portion of BITs in post-Cold War era. The establishment of unipolar world has motivated capital thirsty country to attract foreign capital from capital exporting nations and financial institutions by providing credible assurances. The increase in number of investment treaties enhanced the chances of litigations before supranational forums in the presence of liberal interpretations of treatment standards and provision of expropriation of foreign assets. The measures even taken to protect national interests or public welfare became actionable by supranational adjudicative forum without permission of contracting state.

The criticism on BITs suggests that these international investment agreements are form of global economic constitutionalism with neo-imperialistic approach to protect multinational capital even by subverting democratic decision making (Newcombe & Paradell, 2009, 64). The accumulative effects of Pakistan BITs regime have affected state sovereignty and its power of economic reforms and enhanced chances of multibillion dollar litigations against the state due to wide application of provisions of BITs. The Award of hefty damages in litigations against Pakistan

has generated economic vulnerability for Pakistan. The revisit of the adoption policies of bilateral investment treaty can reset equilibrium between interest of foreign investors and national interest of Pakistan. The proposed BITs should be discussed democratically before committee of foreign affairs and expert committee of the subjects. The expression of 'foreign investments' defined by specifically including and excluding list of activities covered under the expression. The citizenship clause of foreign investors' qualification narrowly defined interpretation clause of proposed treaty. The provisions on the pattern of corrupt practices laws of the USA should be introduced to check the corruption of foreign investors. The BITs should be negotiated by special committee of experts with other counterpart delegations. The foreign affair committee of the parliament should approve rectification of bilateral investment treaty. A rationale and democratically devised policy can best serve the interests of stakeholders.

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