Laws governing investment

1-6-05 Law & Jt. Dawn

By Syed Mohibullah Shah

RECENT developments indicate that the issues relating to law and practice of investment in Pakistan, especially the settlement of investment disputes, are acting as a disincentive for long-term investment in the country. Giving a background of the concerns of investors, press reports have quoted from the summary of the Promotion and Protection of Investment Bill stating that as a consequence of various recent judicial decisions, notably by the Supreme Court in the Hubco and Kapco cases, the confidence of foreign investors in Pakistan's legal/judicial processes have been markedly weakened.

Faced with this problem, the government has now had a review of the legal framework relating to investment. As a first step, it has taken away jurisdiction from the lower courts and given exclusive right of adjudication to the high courts over "all matters related to" the Foreign Private Investment Act of 1976. Other follow-up measures expected are the liberalization of the national law on arbitration (Act of 1940) and agreeing that henceforth English law will be applicable in cases involving rights and obligations of the parties to an investment agreement in Pakistan. These will be decided through international arbitration held at a neutral place.

Even since Justice Munir and his brother judges (with Justice Cornelius dissenting) allowed the law to be trumped by their 'necessity', and the Speaker (Moulvi Tamizuddin) lost his case against the governor-general (Ghulam Mohammad), the 'doctrine' has remained a dominant instrument of governance in Pakistan and in its many reincarnations has ruled the roost in the country's chequered history.

Consequently, instead of power being distributed through the traditional arms of government-executive, legislature and judiciary, it has largely come to be concentrated in the executive. The legislative and judicial branches of the government have neither been able to protect the legitimate position of their own institutions in governance nor provide effective protection to citizens from the excesses of an overbearing top executive. Over the years, this has turned the executive, from being one of the three arms of government, into the government itself.

'How to govern the governments' that are beyond restraint by their national laws and institutions? In a globalized world, this is not only a problem faced by governance of the country.

But any advice to temper governance with moderation and in consonance with international standards was like talking to the deaf, as individuals and institutions, all the way up to the Supreme Court of the country, were made to bear the brunt of his singular pursuit of absolute power over all instruments of governance. If his favourite 15th amendment had been passed, Pakistan would have re-entered the age of medieval autocracy.

While the 'natives' have no recourse to anything other than their national laws and institutions for redress of their grievances against an overbearing executive, the foreign investors have other avenues of relief and redress available to them. They rely increasingly on international treaties and conventions to guide and regulate the conduct of the governments of the host countries.

Pakistan's move towards becoming an attractive destination for investment flows suffered a severe blow under the Nawaz Sharif regime when the governance was turned into an instrument for settling scores with real and imaginary opponents. Investment flows in those days dropped to one-fourth of their previous levels — from over one billion dollars a year to less than three hundred millions. Repairing the damage has neither been easy nor without heavy penalties being paid by the country to compensate for the overbearing attitude of its top executive. Already tens of millions of dollars have been paid in penalties to the aggrieved foreign parties by way of settling investment disputes, and claims of another $850 million against Pakistan are still pending.

Investment disputes are unique in the sense that these are usually disputes between a private party and a sovereign state. And devising a balanced, impartial and independent system for settlement of investment disputes between a sovereign state (host country) and a private party (investor) has been a difficult proposition. A consensus was finally reached in 1967 in the Washington Convention for the settlement of investment disputes. Sponsored by the World flows into developing countries while protecting these against the vagaries of the host country's laws and institutions.

As long as the governance of the host country was guided by due process of law and its dispute settlement system was impartial, this compromise worked satisfactorily and there were no grounds to change this balance, although debates and discussions for 'delocalization' continued at various forums. But, the idea of lex mercatoria, which had lost ground for centuries after the Middle Ages, received a new lease of life from the increasing frequency of the actions of overbearing governments and the investor community redoubled their efforts to seek protection against an unpredictable and politicized system of decision-making.

In its modern reincarnation, lex mercatoria now calls for 'delocalization' of the substantive law to be applied by international arbitral tribunals. Although, amending and liberalizing our Arbitration Act of 1940 or the adoption of UNCITRAL Model Law on Arbitration would reduce the risk, the investors are counting on the new and modified version of Bilateral Investment Treaties (BIT) as the principal instrument for protection against vagaries of government policies and for putting dispute settlement effectively beyond the national legal system.

These BITs, which have rapidly increased during the last 8-10 years and numbered over 2000 by the end of 2004, are the heart and soul of the new levels of investment protection and settlement of investment disputes. These new BITs contain many provisions that enlarge the traditional definitions and scope of several critical concepts like investment, protection of investments, fair and equal treatment, corporate nationality, compensation, repatriation of profits and other such measures, and are creating a whole new system of international law on investment.

Traditionally, investment agreements (IA) between parties used to determine the choice of law by the consent of the parties — the principle of party autonomy — and in its absence, the national legislation determining the applicable law. But under the new investment law, in the event of the existence of an IA and a BIT, when it becomes a case of one contract and two dispute resolution mechanisms, the one agreed to under the BIT is more likely to determine the applicable law for the settlement of investment dispute.

Neither does the absence of a specific arbitration clause in an investment agreement any longer constitute a bar for either party to seek international arbitration of their dispute, exclusively on the basis of a BIT between their two countries. Nor would such arbitrations have to wait for the mediation, negotia-

> Some recent developments are now redefining the international law on investment through bilateral investment treaties. As Pakistan is now entering into negotiations for a bilateral investment treaty with the US, many other developed countries with whom Pakistan had earlier signed bilateral investment treaties, are also watching this process to see if a case could be made for reopening their old BITs under the 'level playing field' argument.

How to govern the governments' that
e beyond restraint by their national
ws and institutions? In a globalized
orld, this is not only a problem faced by
e citizens of many developing countries,
has also become our area of concern for
e international community over a wide
nge of issues — from human rights and
curity considerations to trade, invest-
ent, economic development and other
atters. In many cases, non-compliance
th international standards involves
avy penalties to be paid by the country.
Sitting across the table during their
lks in Islamabad in April 1997, the
eat Asian leader and a friend of
kistan, Prime Minister Mahathir
ohammed of Malaysia spent a great
al of time explaining to his Pakistani
unterpart how Malaysia had devel-
ed by making use of foreign invest-
ent and technology, asking Mr Nawaz
arif, then prime minister of Pakistan,
focus on harnessing resources for
veloping the economic potential,
her than as he told him to his face,
dopting revenge-seeking habits" in

proposition. A consensus was finally reached in 1967 in the Washington Convention for the settlement of investment disputes. Sponsored by the World Bank, it created a mechanism under the International Centre for Settlement of Investment Disputes (ICSID) that combines international arbitration of investment disputes with the enforcement of the awards — all under one roof.

The delicate balance between a sovereign state and a private party is arrived at when the investor (and the developed country) forgoes his diplomatic pursuit for protection of investment, and the host country forgoes a part of its sovereignty and agrees to be sued under the rules of international arbitration. While the developed countries had argued for international law to be applicable, the developing countries secured recognition that the law of the host country will be the applicable law, along with the principles of international law, in the absence of the party autonomy. This compromise was meant to strike a balance: encouraging foreign investment

arbitration of their dispute, exclusively on the basis of a BIT between their two countries. Nor would such arbitrations have to wait for the mediation, negotiations or other steps to be tried before recourse to it is taken by either party.

These and many other developments are now redefining the international law on investment through bilateral investment treaties. There are no uniform standards for such treaties and they vary in scope, contents, definitions and other critical aspects, including issues relating to settlement of investment disputes. It is a matter of negotiations between the parties that determines the final shape of a bilateral treaty. As Pakistan is now entering into negotiations for a bilateral investment treaty with the US, many other developed countries with whom Pakistan had earlier signed bilateral investment treaties, are also watching this process to see if a case could be made for reopening their old BITs under the 'level playing field' argument.

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