International Journal of Social Science Archives

ISSN: 2707-8892

Available at www.ijssa.com

International Journal of Social Science Archives, September, 2023, 6(2), 478-485.

Investor State Dispute Settlement and Pakistan: Balancing Sovereignty, Investment Protection, and UNCITRAL Reform

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***Abstract*:** Investor state dispute settlement has put Pakistan at the forefront of elaborate and often expensive international arbitrations involving foreign investors against state actions, pursuant to bilateral and multilateral investment treaties. High profile cases like Reko Diq and Karkey have generated billions of dollars in awards and settlement obligations which have led locals, politicians, and commentators to question their country's sovereignty, regulatory autonomy and the legitimacy of the ISDs system. Meanwhile, Pakistan has need of its own to invest in infrastructure and boost economy growth, and investors have expectations of effective legal safeguards, such as arbitration. This article locates the experience of Pakistan in the wider context of the ongoing reform efforts in the UNCITRAL Working Group III, examines how the state has historically engaged with treaty regimes in Pakistan, and seeks answers to the question of whether a 'mediation-first arbitration-last' model may be able to balance sovereign policy space with effective investment protection. It ends with a group of policy suggestions and priority areas for further empirical and doctrinal research.

Keywords: Investor state dispute settlement, ISDS, Pakistan, UNCITRAL Working Group III, Reko Diq, sovereignty, investment protection, mediation

Introduction

Investor state dispute settlement has been a highly voluminous and contentious issue with regard to Pakistan. Pakistan has entered into extensive bilateral investment treaties and other investment related agreements since the early 1990s, which tried to guarantee fair treatment of investors (including foreign investors) and grant them guarantee from expropriation without compensation and international arbitration. These commitments have taken place in the context of worldwide consensus of the need for high level investor protection in order to attract capital flows, including to developing and transition economies. For many years, this ISDS system largely existed out of public discussion and it was largely known to experts and parties directly participating in cases (UNCTAD, 2015).

This obscurity was soon broken as big awards against States gave the scheme publicity. Domestic concerns about risks that ISDS can pose on financial and policy grounds were sharpened by the Reko Diq arbitration which was done by Pakistani investment company.However, an ICSID Tribunal had initially issued an award of over five billion US dollars, for which a negotiated settlement was reached between the parties. Critics noted that the system provided foreign investors with a means of challenging the public interest regulation and ability to butcher a disproportionate compensation, thus limiting the democratic decision making. Backers responded that ISDS offers neutral venues to safeguard investors from arbitrary state trips, and issues faced by Pakistan were due to poorly designed projects and mismanagement rather than inherent flaws with ISDS (Aziz, 2020).

In this context, Pakistan is restating its investment treaty policy as the international community debates ISD reform in general, via the UNCITRAL Working Group III. Pakistan has terminated some of the bilateral investment treaties and has also expressed interest in a new model of investment treaty providing more balanced terms and conditions, as well as an interest in alternative dispute settlement methods, such as mediation to traditional ISDS. The central question this article poses is how can Pakistan reframe its investor protection mechanism to maintain a balance between adequate investor protection and maintaining an appropriate regulatory environment to be an attractive investment destination for the responsible investors.

This article is followed by an additional six sections. Section 2 provides a background to ISDS and key criticisms it has faced. The trends of Pakistan's treaty commitments and case history are explored in Section 3. In Section 4, the UNCITRAL Working Group III ongoing reform proposals are analysed and the relevance of these proposals for Pakistan. Section 5 is devoted to making the case for a "mediation first, arbitration last" strategy. Section 6 provides comprehensive recommendations on the Pakistani experience in the field of treaty practice as well as domestic institutions. A conclusion is provided in Section 7, along with priority areas for future research, in Section 8.

The Architecture and Critique of ISDS

The classic ISDS model provides that if an investor is eligible, then he may file a complaint directly to an international arbitral forum, typically ICSID, UNCITRAL or an institutional forum like the ICC or the SCC. This is because jurisdiction is based upon consent on the part of the state, manifested in a treaty or a statute, and on the part of the investor, manifested in its notice of arbitration. General substantive provisions include those on fair and equitable treatment, full protection and security, national and most favoured nation treatment and lawful expropriation/compensation. Tribunals are able to make monetary awards and in some cases are able to provide the declaratory or restitutionary relief (Dolzer and Schreuer, 2012).

There are several issues which have been the objects of criticism on this architecture. First, there have been fears about uniformity and certainty as tribunals set up under different treaties, with varying arbitrators, have not always interpreted the same parts of the treaties in exactly the same way. Second, opponents claim that the system is geared more toward foreign investors than local investors, and that the system will enable foreign investors to backlash against any regulation having an impact on their interest. Third, doubts have been raised about the independence of arbitrators and the existence of conflict of interests within the system, as a few arbitrators consistently arbitrate and counsel. Fourth, litigation can be expensive and can take a long time, which is a cost to both claimant(s) and respondent states (UNCTAD, 2015).

Consequently, states and international organisations have come with their menu of reform options. These are often measures of clarifying and restricting treaty standards, establishing filters for frivolous claims, improving transparency in proceedings, creating alternative bodies or institutions to guarantee consistency (i.e. appellate bodies or standing courts) and encouraging mediation and other forms of alternative dispute resolution as a means of resolving disputes in the initial stages or as an alternative to arbitration. But because ISDS in its current sense is in need of profound changes, UNCITRAL working group III is now the key forum to discuss systemic changes in a multilateral context (UNCITRAL, 2020).

In Pakistan, it is hardly an academic discussion on the reform debates. These criticisms of ISDS mirror and align with concerns raised about sovereignty, fiscal exposure and policy autonomy at home. Meanwhile Pakistan has an interest in maintaining credible dispute resolution processes to give comfort to investors in sectors like energy, telecoms and infrastructure that the state would not be taking arbitrary actions on their investment. The challenge is to bring a balance in it based on the emerging concepts of reforms in the international world as well as Pakistan's own experience.

One argument against ISDS is that it's asymmetric. Investors can sue states but—not through counterclaims—states cannot sue investors. This imbalance, critics say, is against the best interests of all the states and could prevent them from properly legislating in the interests of their citizens for fear of arbitration. The answer to this is that States still have regulatory room to manoeuvre and that their measures can be justifiable in view of public interest exceptions, necessity and proportionality and rights of the parties; and careful drafting of treaties can minimise the likelihood of undue constraint. The tension between the perspectives are at the core of what is being done in terms of reform (UNCTAD, 2020).

Pakistan's Treaty Network and Case History

In 1959, Pakistan reached its first bilateral investment treaty (BIT) with Germany, one of the earliest BITs in the world, and thereafter entered into over 50 BITs with participants from all over Europe, Asia, Middle East and North America. Many of these treaties adopted the same model as the many European treaties which include broad standards that are much more investor friendly, and access to investor state arbitration. Until the 2000s there were few ISDS cases brought against Pakistan, but the UN country suffered a large number of cases in energy, mining and infrastructure, increasing in both number and value. It is only a matter of understanding that cases like SGS v Pakistan, Bayindir v Pakistan, Karkey v Pakistan and Tethyan Copper v Pakistan (Reko Diq) pointed out the problems that may lead to claims ranging from contractual performance issues to regulatory changes, allegations of corruption (Aziz, 2020).

The Tethyan Copper Company (TCC) case against Afghanistan under the Pakistan Australia BIT and ICSID Convention drew a lot of attention in domestic debates due to the magnitude of the arbitration award and the natural resource issues. The tribunal held that Pakistan was in violation of its treaty obligations for refusal of a mining license under such circumstances that such refusal constituted expropriation and violated the investor's legitimate expectations. The case ended with a complicated restructuring of the project, including a partially payment by other investors, and a release from the financial burden, but it was a reminder of the significant exposure of national budgets to ISDS cases (World Bank, 2021).

In response to these experiences, Pakistan has started a process of reviewing and some even terminating the BITs it has concluded in the past. In 2021, the government announced plans to end and renegotiate some of its existing treaties and for a new model BIT, with more balanced provisions regarding public interest lawmaking and how it defines investment and investor. Other indications of interest in regional solutions are, for instance, the investment chapters in Pakistan's trade agreements with members of the Gulf Cooperation Council (ISDS design could mirror learnings from cases), and the ISDS involved in the China-Pakistan Economic Corridor (CPEC) (Government of Pakistan, 2021).

Considering the case history of different projects in Pakistan, it can be appreciated that contract management was weak, and coordination between various agencies was lacking. International arbitrations arising from disputes could have been avoided or managed more effectively had they been designed more carefully, negotiated in time and improved by using an early domestic dispute resolution process. This indicates that on the one hand revising the language of the treaty could be crucial, but also strengthening Pakistan's institutional ability to negotiate, monitor and adapt investment contracts could make a difference in reducing ISDS risk. The reform debates are now impacting the treaty practice in Pakistan. Of the new draft proposal of a new model BIT that has been floating around some of the policy circles are definitions of investment that are more likely to exclude the short-term and more speculative flows, and presents clauses that acknowledge states' the right to exercise regulation in important spheres like public health, environment and financial stability. Some ideas put forward for introducing 'filters' before ISDs would require 'exhaustion of local remedies' or at least resort to domestic courts to be a condition precedent; others are in favour of softer filters. How Pakistan is able to implement these will determine its liability to future claims and investor's confidence in protections (Government of Pakistan, 2021).

UNCITRAL Working Group III Reform Options

UNCITRAL Working Group III has come up with three general categories of concerns related to ISDs: consistency and coherence of decisions, independence and impartiality of adjudicators and cost and time of proceedings. States, in turn, have offered a variety of potential reform options, some of which involve making marginal changes, and others that more radically restructure the system. Incrementally, suggestions involve much stricter rules in appointing arbitrators, codes of conduct, greater disclosure requirements, and procedural changes, including: dismissal of manifestly unfounded claims. Broadly speaking, there are more systemic proposals, such as the proposal of a multilateral investment court with fixed judges and an appeals mechanism put forward by the EU (UNCITRAL, 2020).

There is a strong focus on mediation and other alternative dispute resolution methods, for cost saving and relationship building, in the Working Group's discussion. The Working Group has discussed model clauses for mediation, suggested guidelines for States on the setting up of mediation units, as well as the relationship between ISDS and the Singapore Convention on Mediation. Some states have voiced concerns about the need to insist a party engage in mediation, and some of the states have supported specific provisions encouraging parties to try and resolve disputes amicably before referring the matter for arbitration. As Pakistan is interested in ADR in general and has experienced complex investment disputes (UNCITRAL, 2021), it may have an opportunity to contribute into such discussions.

Specific reform options are either more or less appealing to Pakistan depending upon how much these would affect regulatory space, access to justice and administrative feasibility. In theory, a multilateral investment court may offer more consistency, and transparency, but also amount to a transfer of adjudicative powers to a new international court. Enhanced mediation and ADR (by comparison), can be done within existing treaty and institutional models, with significantly fewer changes, and litigating processes with the promise of cost savings and flexible solutions. So, on the reform side, the position of Pakistan is expected to accord with good elements of ADR and some amendment of a substantive measure in the form of clarifications and not with an overall shift towards court types of arbitration.

In the Working Group III of UNCITRAL, Pakistan joins those member states which are trying to attract reform in a meaningful but realistic fashion as opposed to complete ISDS and its replacement with other methods. It has pointed to the need of capacity development, technical assistance and financial assistance for developing states from complex cases, and had an interest in mechanisms to reinforce the early dispute resolution and settlement. This puts Pakistan in a better position to pursue incremental innovations such as setting up advisory centres, mediation services, and codes of conduct, without rushing into institutional changes of greater magnitude, such as a multilateral investment court (UNCITRAL, 2020), at this point in time.

Toward a Mediation First, Arbitration Last Model

A mediation first arbitisation later approach could involve drafting future investment treaties and contracts in Pakistan to either mandate mediation, or strongly encourage the parties to try mediation, before they engage in arbitration, retaining arbitration as a 'last resort'. It is a step in line with the general trend of commercial dispute resolution and with the domestic ADR policy of Pakistan and it also embodies Islamic and cultural approach of Pakistan towards reconciliation if it can be achieved. Important design considerations relate to how much to compel the parties to engage in mediation, how to incentivize adherence to mediation requirements and how to safeguard the rights of the parties during mediation (IMAC, 2021).

For instance, treaties might stipulate that before arbitration clauses a mechanism of good faith consultations is provided and in case of failure of consultations (after a specific time period), mediation is to be made available under a set of appropriate mediation rules (such as ICSID or UNCITRAL). Tribunals may consider penalties for failure to engage in mediation in good faith as the basis for determining costs. Meanwhile treaties should specify that the process of mediation does not force parties to agree to any specific resolution and that after an agreed upon mediation period these parties can still choose to go to arbitration. This is to have a balance between the encouragement of ADR and consent and access to adjudication (ICSID, 2022).

For the effectiveness of mediation in investment context, Pakistan should make efforts towards maintaining an institutional home for the side coordination of the State. Issues raised could be handled by a central investment management consultation and mediation unit which can be established either in the Attorney General's office or in the Ministry of Law and Justice, so as to provide for the involvement of relevant ministries and positions uniformity in the various pieces. Such a unit has been recommended by an intergovernmental organisation, UNCITRAL and World Bank and would also enhance Pakistan's ability to conduct arbitrations if it does choose to do so (World Bank, 2021).

The first step towards mediation doesn't have to be the only step. Where positions are far enough apart, political constraints are too significant or legal issues are too important to be compromised, there will continue to be conflicts. So, at least in those instances, some forum is going to be necessary for authoritative determination, and arbitration will be that forum. The role of a mediation first model is to limit the number of conflicts that make it to mediation and not to get rid of arbitration.

Similarly, mediation first models also have an extent of synergy with domestic legal and cultural context in Pakistan. Amicable settlement and reconciliation, based on Islamic legal terms such as sulh and islah, as discussed in the previous articles, exist as a principle in many ways, including the preservation of rights. Nationally referring to investment mediation as an international continuation of these well-known concepts might be helpful in domestically legitimising these settlements otherwise depicted as capitulation. Meanwhile, transparency and accountability need to be a focus to ensure that outcomes of mediation in high-profile conflicts are widely understood, and that the results are accepted by key domestic stakeholders (Rahman, 2022).

Recommendations of Policy for Pakistan

Based on this analysis, some policy recommendations can be made pertaining to Pakistan. To begin with, the new draft BIT for Pakistan should have a well-worded multi tier dispute resolution mechanism with consultations first, followed by mediation and then by arbitration. Limitation periods/confidentiality should be addressed and the time periods listed in the clause should be reasonable and there should be reference to mediation rules. It should also make it clear that mediation does not jeopardise either party's arguments in subsequent arbitration in keeping with the practice relating to settlement privilege (UNCTAD 2015).

Second, a standing inter ministerial committee/unit for the prevention and management of investment disputes should be set up in Pakistan. This body should keep an up-to-date database of investment treaties and investment contracts, track possible conflict parameters and even manage the early entering of investors into the mediation and arbitration and coordinate the state's involvement in arbitrations and mediations. There is a need for clear internal guidance to be set as a directive to provide roles among the line ministries, Attorney-General office and external counsels to limit the risks of split and confusing positions.

Third, in the case of participation of the Pakistan in the UNCITRAL WG III, it should be enhanced from a reactive to a more active role. Pakistan will be able to share its experience, help in support for reform options which would be based out in the Pakistani interest, and have some prowess so that coalitions could be formed with the other states facing similar problems in that region. In particular, Pakistan could advocate for the elaborations of workable guidance on investment mediation, capacity measures for governments and for incorporating mediation in potential multilateral reform instruments.

Finally, Pakistan requires building up a pool of investment dispute mediators and should consult mediators with investment dispute experience. This might include tailored in-house training initiatives, involvement in global mediations clinics and points of contact with organisations like ICSID, the Permanent Court of Arbitration as well as prominent mediation centres. Since this is an investment mediation that Pakistan can use its local ADR infrastructure for over time, Pakistan could also start setting up mediation institutions for the same purpose. Lastly, openness and dissemination of information need to be considered. As cases under ISD have drawn wide attention in the public, Pakistan should prepare a communication plan that doesn't talk down to people about why treaties, arbitration and mediation are necessary and that equips people with information about important cases and the compromises reached under the scope of confidentiality requirements. This can assist in fostering intelligent public discussion and minimising an opportunity for misconceptions on capitulation or losing sovereignty to be put into existence when differences are resolved.

Further, there is a need to conduct a detailed audit of the current Pakistan Bilateral Investment Treaty (BIT) regime to sort out the different investment treaties by their risk profile, risk of deviation from the new model BIT and their term of expiration. This would enable governments to identify which treaties would be best to renegotiate; which treaties they would like to let expire; and on which treaties they would want to focus their work on including mediation first clauses and clarified standards. This audit should include legal and economic evaluations of both, current and future investment streams, under each treaty (UNCTAD, 2015).

These policy adjustments should be supplemented by data collecting and evaluating. Pakistan should count and assess the ISDS proceedings and results, as well as the permutations whereby conflicts are resolved through consultation and mediation processes (and not litigation), the savings in ISDS time, and the cost of a case and perceptions of the fairness of the ISDS process by officials and investors. Periodic summary reports – while keeping confidentiality in mind – would increase transparency and would lay a foundation for further adjustments in policy based on facts.

Conclusion

Although Pakistan's experience with investor state dispute settlement (ISDS) under international investment protection instruments has identified both the potential benefits, the Investor States Settlement has also imposed its lurking dangers, upon Pakistan. The demands from cases such as Reko Diq have come at a real cost to be borne as well as challenging the question of how much external restriction of domestic policy is possible. Meanwhile, Pakistan needs foreign capital to fund development objectives and thus has to provide investors with legitimate promises that investments won't be expropriated or there will be arbitrary action, to which their capital isn't put at risk. There is no need to opt for sovereignty over investment, but for crafting better legal frameworks for a balance between the two.

This article has contended that Pakistan should adopt three-fold approach – revisiting the language of treaties in order to unmistakably clarify the standards and carve outs; enhance the institutions relating to contract management and prevention of disputes; and introduce mediation more systematically as an initial measure instead of an afterthought in the framework of the dispute settlement. Combined, these can lower the risk of potentially large wins, enhance the decision making process in states and keep the United States of Pakistan attractive for investments.

In conclusion, ISDS jurisprudence will be analysed based not just on the contents of Pakistan's treaties and laws, but also on how it conducts real disputes. The early and well-planned approach with investors along with proper use of mediation and strong defence where required will be an indicator of "how" a sophistication and fair partner Pakistan is. This in turn can help to enhance investment relations and prevent potential investment conflicts from going "cold turkey".

The measures put forth in the context here, if properly executed, could transform Pakistan from a Reactive Respondent to a more Strategic Shaper of the regime in which it is invested in the context of investment disputes.

Future Research

There are a number of directions for future research. Empirically, there is a need to look for detailed case studies, involving interviews with officials, counsel and investors, to come across any trends, patterns or statistics visible, not only with published awards but also with interviews, on how and why disputes arose, how they have been managed and how they have been resolved in Pakistan. This type of work can result in more strongly focused changes to contract drafting, inter agency coordination and early engagement in disputes (World Bank, 2021).

Comparative studies may involve looking into the reform of investment treaty practice and the investment treaty dispute management institutions in states with comparable economic profile and investment treaty networks, e.g., Indonesia, South Africa, and India and drawing lessons from their success stories and failures for Pakistan. Additionally, there is a potential domain in doctrinal study to know how Islamic legal principles of "contracts", "compensation" and "public interest" can be used to develop a model for the settlement of investment disputes in Pakistan in an approach which is both faithful to the constitution and compatible with international law (Kamali, 2011).

Last but not least, space is left for interdisciplinary research that connects ISDS to general issues of development policy, quality of governance and public opinion. A greater understanding of the extent to which investment disputes impact domestic investment reform coalitions, the extent to which media framing shapes perceptions of arbitration and mediation, and how outcomes from investment disputes go back into investment decisions would contribute to a broader basis for policy decisions than legal-philosophical arguments. Such questions can be explored in Pakistan's emerging practice of this field, because it provides a good laboratory.

The field for quantitative research is also available that will categorize the relationship between the treaty obligations, incidence of disputes and investment flows over time for Pakistan. This analysis could be useful for examining the extent to which investor protections are likely to draw investment to Pakistan or other factors like political stability and quality of regulation are more important. This would help inform the global debates over impact of ISDS on development (UNCTAD, 2020).

Future studies could also investigate the role of similar countries such as Pakistan in the whole process of norm generation with UNCITRAL Working Group III making strides toward concrete reform measures. Investigating the negotiation coalitions, proposal writing and voting processes could help answer the question of whose voices are heard in the development of the ISDs architecture and how can developing countries do more to represent their concerns in multilateral negotiations.

International ISDS reforms and national legal cultures and development strategies are thus being intertwined in Pakistan's changing practice, thereby providing a natural laboratory for studying this interaction.

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