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CLIENT UPDATE

Pakistan decides to roll back its BIT regime. But will it get the desired result?

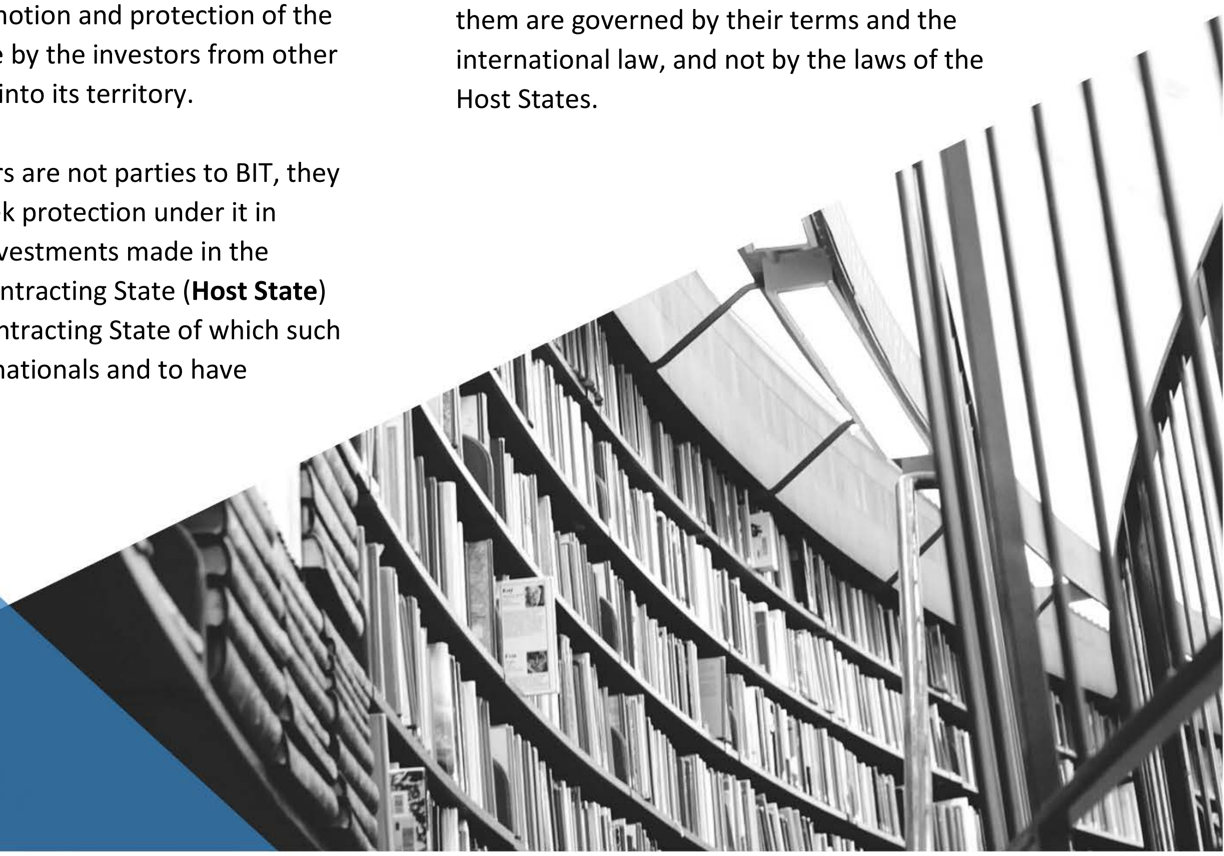
Even if Pakistan terminates all of its BITs, still, it will remain open to ICSID claims from foreign investors for a considerable period owing to presence of sunset clauses of varying duration in almost every BIT signed by Pakistan.

What is a Bilateral Investment Treaty (BIT)?

BIT is an agreement executed between two sovereign States which contain reciprocal promises from each State (**Contracting State**), inter alia, for promotion and protection of the investments made by the investors from other Contracting State into its territory.

While the investors are not parties to BIT, they are entitled to seek protection under it in respect of their investments made in the territory of the Contracting State (**Host State**) other than the Contracting State of which such investors are the nationals and to have recourse to dispute resolution mechanism laid down therein for settlement of their disputes with the Host State.

BITs normally provide for settlement of disputes thereunder through independent international forums. BITs and any disputes originating out of them are governed by their terms and the international law, and not by the laws of the Host States.



Who is entitled to protection under a BIT?

Most BITs offer protection to all nationals, both natural and corporate, of the Contracting States. In some cases, the protection is extended to any subsidiaries incorporated by the nationals of the Contracting States in any third State.

On the other hand, some BITs contain denial of benefit clauses where a Contracting State may refuse to allow protection to a corporate body having no substantial business activities in the Contracting State under whose laws it is organized. A precise answer to this question will depend upon the terms of the relevant BIT.

What type of investments are protected under a BIT?

Each BIT defines the investments in respect of which the treaty protection may be claimed. Such definition is generally very board, covering almost all type of assets of an investor in the territory of the Host State ranging from movable and immovable properties to claims to anything having an economic value. However, to qualify as an "investment" under a BIT, such asset must have been acquired in accordance with the laws of the host State.

What type of protections are offered by a BIT?

The main object of BIT is to specify the treatment the Host State must provide in its territory to the investors from the other Contacting State. Each BIT specifies its own standards of treatment, which may vary depending upon the negotiations between the Contracting States.

Generally, a BIT may contain following standards of treatment:

- *Fair and equitable treatment:* The Host State shall accord fair and equitable treatment to the investments made in its territory by the investors of the other Contracting State.

- *Full protection and security:* The investments of the investors from other Contracting State shall be provided full protection and security in the territory of the Host State which shall not impair the management, maintenance, use, enjoyment, or disposal of investments.

- *National treatment:* The Host State shall accord treatment to the investments made in its territory by the investors of the other contracting State which shall not be less favorable than that accorded by the Host State to its own nationals.

- *Most Favored Nation treatment:* The Host State shall accord treatment to the investments made in its territory by the investors of the other Contracting State which shall not be less favorable than that accorded to the investors of any third State.

- *Protections against expropriation:* The Host State shall not expropriate or nationalize (or take any other measure having the same effect) any investment made by the investors of other Contracting State except where such expropriation is made in the public interest, on a non-discrimination basis, under due process of law, and against prompt, adequate and effective compensation.

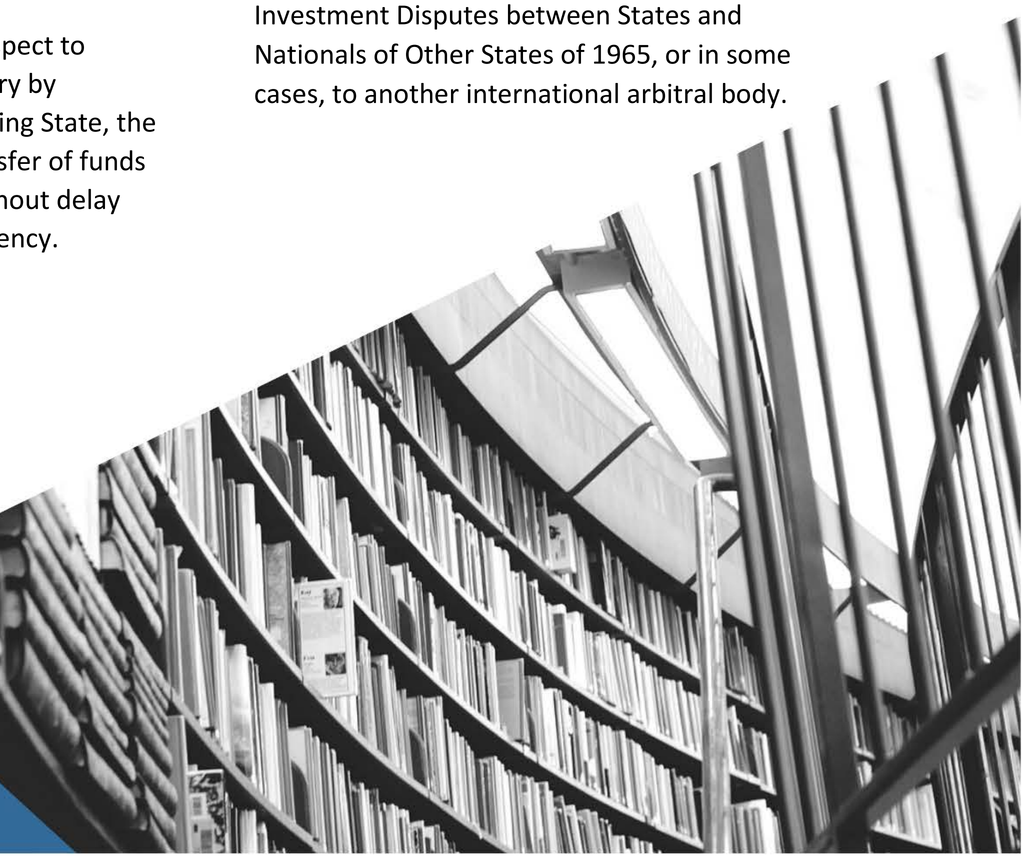
- *Free transfer of funds:* With respect to investments made in its territory by investors of the other Contracting State, the Host State shall allow free transfer of funds into and out of its territory without delay and in a freely convertible currency.

What dispute resolution mechanisms are provided under the BITs?

Majority of BITs contain two separate dispute resolution mechanisms, one for settlement of disputes between the Contracting States and another for settlement of any disputes between the Host State and the investors of the other Contracting State (**Investor-State Disputes**).

In respect of the Investor-State Disputes, the dispute resolution mechanism provided in a BIT will depend upon the terms negotiated between the Contracting States.

Typically, a BIT would provide for a "*cooling off period*". If the dispute is not amicably resolved within the cooling off period, the investor would have the option to submit the dispute for settlement to the International Centre for the Settlement of Investment Disputes (**ICSID**) under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965, or in some cases, to another international arbitral body.



The ICSID arbitration is the most significant advantage of bringing an investment under a BIT, due to the ease of enforcing ICSID awards.

Why Pakistan wishes to roll back its BITs?

BITs have been considered to have some, if not much, influence on the foreign direct investment inflows into developing countries as they provide enhanced stability and predictability for the foreign investors.

At the same time, however, some scholars have observed that the obligations embedded in BITs can also impose costs on developing countries, which "*constrain their sovereignty by entering into treaties that specifically limit their ability to take necessary legislative and administrative actions to advance and protect their national interests*".

This is a never-ending debate, and each side has its own arguments.

The total number of BITs signed globally has raised to 2,852 out of which 2,298 are in force. Pakistan was a pioneer in the BIT regime having concluded the first ever BIT with the Federal Republic of Germany back in the year 1959. Reportedly, at one point, Pakistan had one of the largest portfolios of BITs held by a developing country.

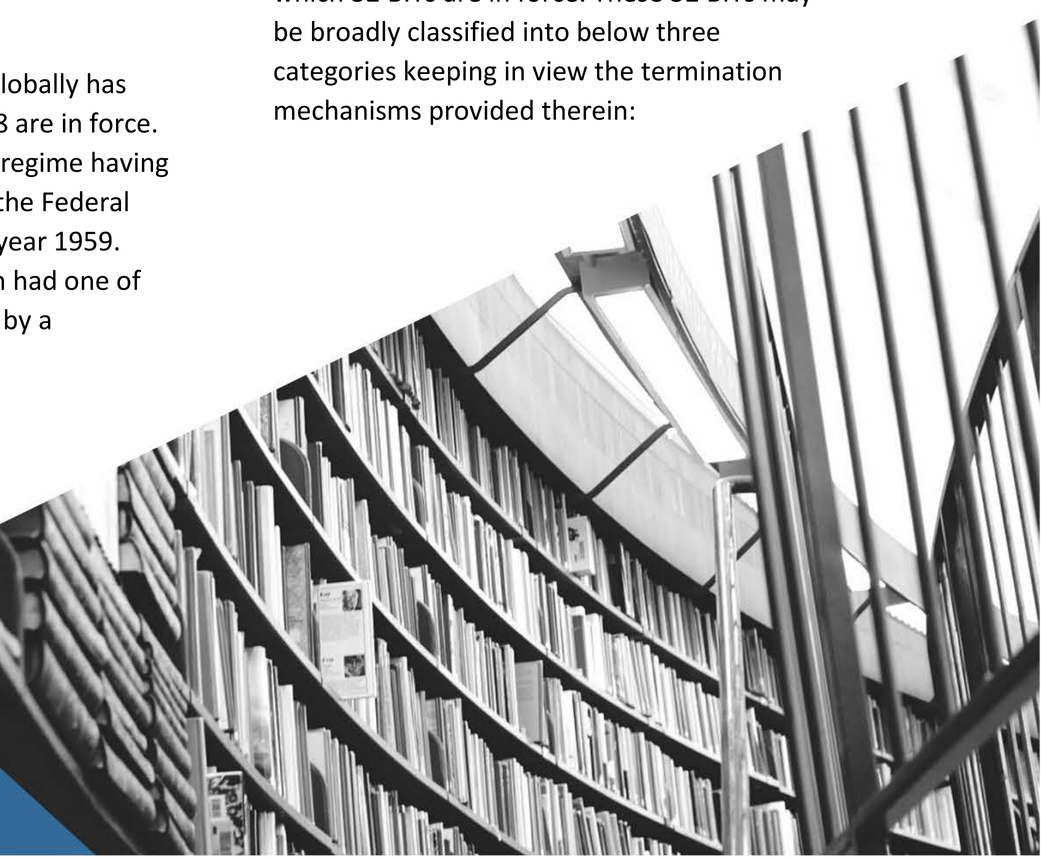
However, this process slowed down after Pakistan faced its first ICSID claim lodged from Société Générale de Surveillance (SGS) under the Switzerland-Pakistan BIT. Since then, Pakistan has faced around ten ICSID claims including the one which resulted in the issuance of one of the largest ICSID awards in history in favor of any foreign investor.

Even in those instances where Pakistan won ICSID cases, it had to bear substantial legal costs.

This appears to be the main reason why Pakistan wishes to roll back its BIT regime. The recent statement of the Chairman of the Board of Investment, the Pakistan's main agency to negotiate BITs, reported by the local media confirms this fact.

Closing remarks.

Till to date, Pakistan has signed 52 BITs, out of which 32 BITs are in force. These 32 BITs may be broadly classified into below three categories keeping in view the termination mechanisms provided therein:



- Pakistan may terminate BIT at any time by serving an advance notice of a specified duration upon the other Contracting State.

- Pakistan should wait for the original term of BIT to expire. Pakistan may terminate BIT by serving an advance notice of a specified duration upon the other Contracting State before the end of the original term of BIT, or at any time thereafter during the renewed term of BIT.

- Pakistan should wait for the original term or the renewed term of BIT to expire. Pakistan may terminate BIT by serving an advance notice of a specified duration upon the other Contracting State either at the end of the original term or the renewed term of BIT.

The duration of the advance termination notices to be served by Pakistan under each BIT varies and ranges between six months to twelve months.

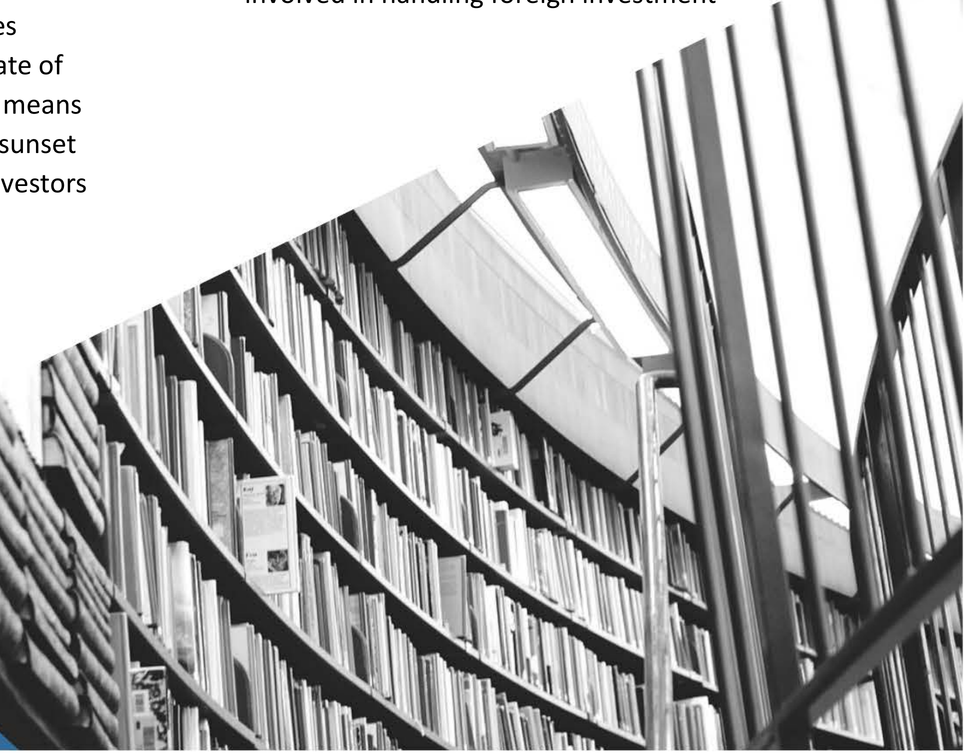
Each of the above 32 BITs contains a "sunset clause". The duration of protection under the sunset clause of each BIT varies. It ranges between 5 years to 20 years from the date of termination of the relevant BIT. What it means is that, for the duration provided in the sunset clause of the relevant BIT, the foreign investors shall continue to enjoy the substantive protections under that BIT even after a valid termination by Pakistan.

As stated above, Pakistan's main consideration for rolling back its BITs regime seems to be certain unfavorable decisions rendered by ICSID tribunals against Pakistan. However, Pakistan must understand the root cause(s) of these unfavorable decisions and take practical measures to eliminate such cause(s).

BITs should not be blamed for any institutional incapacity or a disregard of the international law principles governing foreign investment by Pakistan's decision makers. Instead of rolling back its BIT regime, what Pakistan really needs to do to avoid BIT claims against it in the future is to:

- develop, *at all institutional levels*, a clear understanding of the BIT and ICSID regimes, how they operate, and the consequences in case a breach of an obligation under these regimes has occurred;

- build capacity of institutions and those involved in handling foreign investment



cases to scrutinize each case while admitting foreign investment to eliminate the need of taking any *coercive* measure at a subsequent stage that may be considered unfair or inequitable under the relevant international law standards or which may constitute an improper expropriation under those standards; and

- engage with its counterparty to renegotiate an existing BIT where it *genuinely* limits Pakistan's ability to take necessary legislative and administrative actions to advance and protect its true national interest.

This path may be long, but it seems to be the right path.

Termination of BITs may not serve any useful purpose for Pakistan. It will further shy away any genuine investors from Pakistan which is already hitting very low on foreign direct investment for several years even though the promotion of foreign investment has been a priority for Pakistan for many years.

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