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# Pakistan's Woes with Foreign Investors – Ways to Prevent the Tethyan Saga

**Kluwer Arbitration Blog**

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## **Introduction**

In July this year, an International Centre for Settlement of Investment Disputes (ICSID) based arbitration tribunal ordered the Government of Pakistan (GOP) to pay a massive \$5.8 billion to Tethyan in compensation. The legal battle between Tethyan and GOP started in 2011 when GOP refused to grant a mining lease to Tethyan after it had allegedly invested more than \$220 million to discover copper and gold reserves in Reko Diq town in Baluchistan, Pakistan. After the ICSID tribunal's decision, the GOP first announced that it will try to settle with Tethyan. However, the GOP is now reportedly seeking to review the tribunal's decision in accordance with ICSID's investment arbitration procedures after Tethyan moved a US court for enforcement of the award. The legal battle for Pakistan continues although millions have already been spent on legal costs from the public purse.

In the past, the GOP has been involved in at least 13 other high-stake disputes with foreign investors, including recently with Agility and Progas, where many more millions must have been spent in legal costs or compensation. These costs are of course in addition to losing these existing investments by entering into disputes with investors, and the loss of country's repute as an investor-friendly destination. Additionally, disputes taken by foreign investors to ICSID arbitration are difficult to manage by governments where tribunals, in accordance with their perceived mandate, are focused on resolution of the existing dispute, and payment of compensation should it be necessary, and not on maintaining working relationships between the disputing parties.

## **Preventing investment disputes**

As the GOP wants to promote foreign direct investment (FDI) to boost the country's

economic development, it must devise a clear policy to avoid disputes with foreign investors. A radical option to stop foreign investors from taking their disputes to international arbitration is to terminate the existing (around) 50 bilateral investment treaties (BITs) that provide legal bases for international arbitration to foreign investors. However, such a radical measure without strengthening the domestic regime for protecting FDI can be counter-productive. Pakistani courts have in the past, without commenting on or disputing the merits of those cases, repeatedly interfered in the GOP's dealings with foreign investors. Although in most of those cases Pakistani courts interfered due to allegations of wrong doing on part of government officials, foreign investors and their investments have been put at risk. In such circumstances, investment arbitration under the existing BITs is the only neutral and effective remedy left for foreign investors.

Instead of terminating the existing BITs, the GOP needs to make a clear and comprehensive policy to prevent disputes with foreign investors from arising at the first place, rather than trying to resolve them at a later stage through ICSID or other international arbitration. The GOP also needs to build capacities to resolve such disputes locally.

## **Ways forward**

The following sections of this post present three recommendations for the development of a comprehensive investment dispute prevention policy. These recommendations are specifically aimed at the GOP. However, they are equally useful for other developing countries that are seeking to reform their domestic policies to attract, facilitate and retain sustainable FDI that contributes to local economic and non-economic development.

### **1. Identify irritants from the start**

First, the GOP should make transparent procedures for pre-entry vetting of foreign investors and investments to identify possible irritants for both the government and foreign investors that may cause future disputes. For GOP, such irritants include any possible security and public order apprehensions. Pakistan currently has an open-admission system that does not require pre-screening and approval for incoming foreign investors. This open-admission policy requires careful reconsideration. Before foreign investors and investments are allowed into Pakistan, the GOP must consider their possible effects on public interest, public policy and public institutions; fundamental rights of citizens; the environment; critical infrastructure, technology and security of critical data; and the freedom and plurality of media and political activities. Foreign investors must also be required to submit information on, for example, their ownership

structures, origin of funding for investments, and existing and planned operations in other countries.

For foreign investors, such irritants include, for example, a lack of quality and transparency in governance and management of foreign investments, and unaccountability of public officials. Foreign investments in the government infrastructure sector are considered 'public procurements' and are governed by the public procurement regulatory authorities set up by the federal and provincial governments. These authorities have been created for improving the governance, management, transparency, accountability and quality of public procurements. However, no such public authorities exist to achieve these objectives in other areas such as investments made to exploit natural resources and the private sector investments made either solely by a foreign investor or as a joint venture with a government or a private entity. Instead, such investments are negotiated, authorised, managed or governed by the relevant government Ministries, Divisions or Departments. In line with the public procurement regulatory authorities, the GOP should consider setting up a regulatory body to scrutinise foreign investments in these areas to ensure transparency, accountability and quality before formal agreements are signed or legally binding commitments are made.

## **2. Ensure facilitation throughout the life cycle of investments**

Second, the GOP should ensure facilitation throughout the life cycle of FDI. This life cycle begins with the first key stage of strategy for attraction by invitation to invest in priority sectors and fostering linkages between foreign and domestic firms. However, effective governance of the stages subsequent to attraction is also equally important to appease foreign investors. These lifecycle stages include ease of entry, establishment and retention; during and post-completion repatriation of earnings; and, most importantly, active assistance to support positive impacts on local population and contributions to local development.

The GOP's existing policies primarily focus on the attraction of FDI and no significant attention is being paid to the post-establishment care. For effective attraction of FDI, the government has created a central coordination mechanism at the Board of Investment (BOI) to ensure liaison among various federal and provincial public authorities that deal with foreign investors. This mechanism is intended to take up the issues relating to investment proposals with the concerned government departments for timely materialization of investment projects and to resolve any obstacles posed to the establishment of investments.

However, the government needs to create a more comprehensive investment facilitation policy that includes post-establishment care. Such policy should include mechanisms for observing the progress of FDI projects during their entire life-cycle. This could be

achieved by further targeted support to ensure timely action by relevant government authorities to address any post-establishment problems faced by investors. This observation and targeted support will prevent issues from arising in the first place. It will also help identify actual issues faced by foreign investors and provide the possibility of their amicable resolution locally through negotiations before they escalate to international arbitration.

Additionally, it is important that such aftercare policy is not merely an emergency service delivered in sporadic *ad hoc* manner aimed at providing passive information or resolving instantaneous issues. Instead, it must be a strategically informed policy to promote longer term gains from FDI targeted at the development needs of Pakistan. A strategically informed aftercare policy can include, for example, training the local workers, helping with export promotion, obtaining larger premises for expansions, identifying local suppliers, helping in building a business case for new investments, and developing networks to improve productivity and competitiveness. In addition to preventing and early identification of disputes, these initiatives will help to attract new investments by boosting investor confidence and ease of doing business rating.

### **3. Create neutral and effective investor complaints and dispute resolution mechanisms**

Third, the GOP should create an effective and neutral investor complaints and dispute resolution mechanism. The BOI has announced the establishment of a dedicated cell to address grievances of investors and taking-up their issues with relevant government departments. The BOI is also considering the possibility of establishing an Alternate Dispute Resolution (ADR) Centre to provide a forum to settle investment related disputes domestically before approaching international dispute resolution agencies. As the policy with regards to these initiatives is not fully set out as yet, it is unclear how the BOI would ensure that foreign investors actively avail the services of BOI's grievances cell and ADR Centre prior to taking their disputes to international arbitration. The BOI needs to carefully weigh its options before such mechanisms are created. For example, the BOI needs to be clear as to whether it wants to create an investor complaints cell and play a supervisory or commanding role to address complaints against government departments in an effective manner, or whether it wants to play the role of a mediator for the resolution of disputes between foreign investors and government departments.

This question ultimately goes back to the BOI's mandate under the law, however, it will be more appealing to foreign investors if the BOI takes a commanding role in addressing investor complaints rather than becoming a mediator. A mediator is supposed to be a neutral intermediary having no vested interest in the dispute, and foreign investors are likely to be apprehensive of BOI's neutrality since it is primarily a mainstream government institution. A complaints cell at the BOI, on the other hand, appears to be a more

convincing option instead of a mediation centre. The BOI can take notice of the complaints made by foreign investors against government authorities and intervene in a timely and effective manner to address those complaints in the spirit of cooperation and compromise.

Instead of an ADR Centre at the BOI, the GOP should consider the creation of a government backed, but fully autonomous, investment and commercial arbitration institution having a panel of independent local and foreign arbitrators. Such arbitration institution will be more attractive to foreign investors as compared to an ADR Centre because it will be both neutral and autonomous. Resolving disputes at a local arbitration forum by a mix of foreign and local experts having an in-depth knowledge of local realities, procedures and laws will be both time and cost effective. This will also boost investor confidence and attract more FDI. Private arbitration centres, such as the Centre for International Investment and Commercial Arbitration, have evolved but such centres cannot flourish unless they are backed by the government and are included in private-public contracts as an arbitration forum. Otherwise, the best way forward is that the government creates an autonomous arbitration institution that is fully backed by the government but operates independently and in accordance with international best practices. These developments will, of course, need to come hand in hand with the modernisation of Pakistani arbitration law that is based on the colonial era Arbitration Act 1940. Useful inferences can be drawn in this regard from the recent legislative developments in India, which has – following the footsteps of arbitration institutions created by Singapore and Hong Kong – set up a high level Arbitration Council to institutionalise and supervise arbitration proceedings in India.

## **Conclusion**

As any other developing country, Pakistan needs more FDI that contributes to its sustainable development objectives. Disputes with foreign investors incur both reputational and financial costs. The GOP needs to make a clear and comprehensive policy to prevent disputes with foreign investors from arising in the first place rather than trying to resolve them at a later stage through international arbitration. A comprehensive dispute prevention policy would ensure that possible irritants for both investors and the host government are identified from the start so that both parties make informed and measured choices. Such policy would also ensure facilitation and care throughout the life cycle of FDI and not just at the time of its admission and entry. A life cycle-oriented aftercare policy would be based on continuous observation and targeted support to deal with issues that can lead to disputes. The host government can also strategically embed the aftercare policies into its long-term sustainable development objectives. Additionally, the GOP should also create a neutral and effective complaints mechanism to provide investors an opportunity to resolve their issues with public authorities amicably. In this regard, it is also imperative to develop domestic arbitration regime and institutions having

the capacity and expertise to resolve disputes with foreign investors. These policies and initiatives will prevent disputes from arising in the first place and also provide an opportunity to resolve them amicably and locally, thus avoiding enormous legal costs. They will also improve the overall business environment and Pakistan's outlook as a desirable FDI destination.

The precise suggestions made to implement these dispute prevention policy proposals in Pakistan are based on the current Pakistani normative and regulatory environment. However, these proposals are equally useful for other developing countries that can benefit from them in the specific ways they are implementable in their own normative and regulatory space.