PITFALLS IN THE DOMESTIC AND INTERNATIONAL COMMERCIAL ARBITRATION IN PAKISTAN

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Introduction:

Arbitration is a well-known and increasingly popular alternative dispute resolution method. It is a safe, cost-effective, and time-efficient alternative dispute resolution method. The arbitration system saves both parties time and money by avoiding lengthy legal proceedings. In the Indian subcontinent, arbitration has been practised for many years under the name "Panchayat." Even in the absence of a legal system, the Panchayat served to settle conflicts. In these panchayats, decisions were made in accordance with ethical standards, cultural norms, and religious principles, and the decisions made by the panchayat were respected and held in high regard. (Kumar, 2017)

During the British Raj (1858–1947), the Panchayat system underwent a period of decline. The British legalized local arbitration and replaced it with a codified system of law. (Hussain & Arafat, 2022) They enacted numerous regulations, leading to the enactment of the Arbitration Act of 1940, which governs arbitration in Pakistan. Following Pakistan's independence in 1947, the Panchayat system was reinstated and is still widely used in rural areas, where it is carried out in accordance with cultural norms and usages. There are no provisions in the 1940 Act regarding the Panchayat system, and its amendment has the potential to harmonise the country's arbitration system. (Mukhtar. 2016)

Pakistan introduced international arbitration by signing and later implementing the New York Convention in 1958 by enacting the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Act and the Arbitration (International Investment Dispute) Act in 2011. Although Pakistan has signed the UNCITRAL Model Law on International Commercial Arbitration, it has not yet been incorporated into domestic law. A stable and comprehensive system of international arbitration has become a necessity at the current time to attract foreign investors and other stakeholders to the country. However, Pakistan needs to improve in many areas of international arbitration, particularly in the enforcement and recognition of foreign awards and lex arbitri. (Rizwan Hussain, 2012) These challenges are explained in this essay using case laws.
1.1 The legislative evolution of arbitration:
The first legislative step in the subcontinent can be traced back to 700 BCE as mentioned in the ancient Hindu scriptures of the "Brhadaranayaka Upanishad." Three primary bodies known as purga (local courts), srenis (people engaged in similar businesses), and kulas (members concerned with social matters of a specific community) were used to adjudicate arbitration proceedings and were collectively known as panchayats. (Kumar, 2017) The Privy Council recognised these Panchayats as a legitimate source of resolving disputes in a territory in the case of Vytla Sitanna v Marivada Viranna and others. (Vytla Sitanna v Marivada Viranna and others AIR) The legislative evolution of arbitration in the subcontinent can be traced back to around 1700 BC during the Reg Veda period. Village communities known as "sabhas" existed, which later evolved into "panchayats," existed (Attaullah & Saqib, 2018). Panchayat, which is 2500 years old, dealt with both criminal and civil matters. Its decisions used to be final and irreversible because they reflected society's religious and cultural beliefs (Roder & Shinwari, 2015).

Panchayats were a respected means of resolving conflicts until the East India Company was granted exclusive rights to operate in some Mughal states in 1612. Following a century of successful trade and a shift in the Subcontinent's power dynamics, the British began codifying laws in arbitration by establishing "controlled local bodies." Panchayat was completely abolished in British-controlled areas in 1765 and was replaced by the office of "Patwari," who kept the village record. (Khan, 2022) The "Bengal Regulation Act" of 1772 established the concept of referring disputes to a tribunal for arbitration, making it the first codified regulation of its kind. (Bengal Regulation Act 1772) This was followed by the "Bombay Regulation Act" of 1799 and the adoption of similar regulations in Madras under the "Madras Regulation Act" of 1802. (Bombay Regulation Act 1779 ) (Maniruzzaman & Ali Chishti, 2019) The first legislative council for India was established in 1834. However, the first codified form of arbitration did not come into effect until the introduction of the Code of Civil Procedure in 1859, which laid out the procedures for enforcing and recognizing arbitral awards. (Maniruzzaman & Ali Chishti, 2019) The Indian Arbitration Act of 1899 was established to provide a legal framework for arbitration. (Indian Arbitration Act 1899) However, this act only applied to the presidency towns of Madras, Bombay, and Calcutta.

The Civil Procedure Code of 1908 was enacted to modify, formulate, and broaden the scope of the Indian Arbitration Act of 1899. (Code of Civil Procedure 1908) However, the provisions of the Indian Arbitration Act of 1899, combined with the technicalities of the CPC of 1908, caused enormous confusion, and paved the way for the creation of the Arbitration Act of 1940. (The Arbitration Act 1940) On March 11, 1940, the Indian Arbitration Act of 1940 was passed and implemented throughout India on July 1, 1940. After independence, both India and Pakistan adopted this act, which was more precise, thorough, and systematic than previous acts, and had a broader scope of application. Many provisions in the act were a step in the right direction, such as allowing parties to appoint up to three arbitrators themselves as well as giving courts the authority to modify or appoint the arbitrator and arbitration award. (Mukhar, 2016)
1.2. Legal Framework of Arbitration in Pakistan:
Following its independence in 1947, Pakistan enacted the Arbitration Act of 1940, which is still in effect today. Arbitration is a recognized method of resolving disputes, according to the 1973 Pakistani Constitution. (Constitution of Pakistan 1973)

The resolution of disputes through arbitration is also provided for by the Electricity Act of 1910, the Cooperative Societies Act of 1925, and other laws in Pakistan. Section 89A was added to the Code of Civil Procedure Act by Ordinance XXXIV of 2002, on the recommendation of the Law Commission, to advise civil courts to persuade parties to opt for arbitration. Pakistan signed the New York Convention in 1958 and enacted the Arbitration (International Investment Dispute) Act and the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Act in 2011. (The Convention on the Recognition and Enforcement of Foreign Arbitral Awards)(The Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards)

1. The Arbitration Act of 1940:
The main legal instrument governing arbitration in Pakistan is the Arbitration Act of 1940. However, the awards are enforced and recognized under the 2011 Enforcement and Recognition Act. The Arbitration Act of 1940 has two schedules, seven chapters, and forty-eight sections. It covers and regulates all forms of arbitration, excluding those listed in section 47 of the Act of 1940. If the parties agree to hold the arbitration in Pakistan, the proceedings are governed by the provisions of the Arbitration Act of 1940. Other provisions are in accordance with Schedule II of the 1908 Code of Civil Procedure. The courts are given a supervisory role under the Act. As a result, the court should prefer to uphold the award rather than overturn it, unless there are compelling reasons to set it aside. The arbitrator issues an award at the conclusion of the proceedings, which must be written and signed by the arbitrator and supported by plausible grounds. The decision must be concise, and unambiguous. If the award is made in Pakistan, it must be filed with the civil court of competent jurisdiction. If it is made outside of Pakistan, it must be filed with the High Court. The award can be challenged within 30 days. (The Arbitration Act 1940)

2.1 Flaws of the Arbitration Act of 1940:
The Arbitration Act of 1940 had some positive features, such as allowing parties to appoint arbitrators and giving courts the power to modify or appoint arbitrators and awards. However, it had significant flaws, such as only addressing domestic arbitration and not international arbitration or the recognition of foreign arbitral awards. This led to a time-consuming and inefficient implementation, as criticized by the Supreme Court in the Guru Nank Foundation v. Rattan Singh case. (Guru Nanak Foundation v Rattan Singh)

The cultural aspect of the arbitration system in Pakistan is also important, with rural people often using cultural arbitration procedures that are free and based on equity, religious, and cultural norms. However, the Panchayat and Jirga systems used in rural areas are not covered by the 1940 Act and are still prevalent today. While Jirga laws were established in Khyber Pakhtunkhwa in 1977, other
provinces require attention to ensure consistency with rural Pakistani society's customs and usage. (Mukhar, 2016)

Despite its shortcomings, the Arbitration Act of 1940 remained in effect in India until 1995 and is still in effect in Pakistan. India later passed the Arbitration and Conciliation Act 1996, which incorporated international standards of arbitration and the UNCITRAL Model Law on International Commercial Arbitration. In contrast, Pakistan has yet to incorporate the UNCITRAL Model Law into its domestic laws. (Hussain and Arafat, 2022)

3. Pitfalls of International Arbitration:
Pakistan is facing significant setbacks that prevent it from progressing in international arbitration, and there are two major areas in which Pakistan needs to improve to thrive in this field. These areas are the recognition and enforcement of foreign arbitral awards, and lex arbitri. The following paragraphs explain each of these areas with the help of case law. (Hussain, 2012)

3.1 Enforcement and Recognition of Awards

The 1958 New York Convention on the Enforcement and Recognition of Foreign Awards deals with cross-border contractual relationships and has provided a platform for multinational corporations and foreign investors to enter into international agreements with confidence that their rights will be protected, and awards will be fair. The Convention has been ratified by 169 states to date and was first implemented in Pakistan through an ordinance in 2005, followed by renewals in 2006, 2007, 2009, and 2010, and finally ratified by a parliamentary act in 2011. (Jilla, 1988) In practice, Pakistani courts were unable to adapt to the radical change in the law, and as a result, the recognition and enforcement of foreign awards were delayed, making such awards obsolete, or inconsistent judgments were rendered contrary to established principles of arbitration. (Raza, 2020)

3.2 Lex Arbitri:

The procedural law of arbitration, also referred to as Lex arbitri or, more specifically, lex loci arbitri in accordance with UNCITRAL model law, is a crucial aspect of the arbitration process. The purpose of lex arbitri is to ensure that the parties face no procedural obstacles during the arbitration procedure. The Code of Civil Procedure 1908 and The Arbitration Act 1940 deal with lex arbitri in Pakistan. The Act of 1940 lacks important provisions relating to the confidentiality of arbitral proceedings, the arbitrator's power to select governing law other than the one chosen by the parties, the arbitrator's power to order interim measures, and the arbitrator's power to decide on his own jurisdiction. Taisei Corporation v. A.M Construction is an example of a case where this inconsistency was observed in the decision, which is still pending due to this procedural error. (Raza, 2020)
3.3 Case Laws:
3.3.1 Taisei Corporation v. A.M Construction
3.3.1.1 Brief facts:
A construction contract was established between two parties, and it was decided that the International Chamber of Commerce would be given the authority to appoint an arbitrator. And the place of arbitration will be Singapore, with Pakistani law as the governing law. The respondent in this case referred the dispute to the ICC, and an award was made. The respondent was ordered to pay the ICC's administrative expenses of $42,500 and the cost of arbitration of 23,073,952 Pakistani rupees. The respondent was notified of the award via a letter sent to Lahore. Respondent filed an application with the Lahore civil court, claiming that because the award was received in Lahore, the Lahore civil court has territorial jurisdiction to hear the case. (Taisei Corporation v. A.M Construction)

3.3.1.2 Legal Issues:
The first legal issue was territorial jurisdiction, and the second was foreign award. It was argued that none of the parties, resided or did business in Lahore and the agreement was not signed in Lahore. Except for the fact that the award was made in Lahore, the Civil Court has no territorial jurisdiction over the award or its proceedings. Second, it was a foreign award, and under Section 3 of the 2011 Act, the High Court has exclusive jurisdiction to deal with such awards. The respondent stated that several meetings had taken place in Lahore, so there is no issue of territorial jurisdiction. Furthermore, the respondent claimed that this award is not a foreign award because the parties' agreement was signed in 2008 and the Act of 2011 could not be applied retroactively.

3.3.1.3 Held:
The Civil Court agreed with the current respondent and granted jurisdiction to the court, as well as declaring that the award could not be safely presumed or taken to be a foreign award. The Lahore High Court and the Sindh High Court both upheld the ruling. This case is still pending in Pakistan's Supreme Court.

3.3.1.4 Analysis of the judgement.
There is no doubt that the domestic award enforcement and recognition mechanism was used to enforce and recognize a foreign award. The court interpreted Section 14 of the Arbitration Act of 1940, as well as Sections 6 and 7 of the 2011 Act, in this decision. Although the court's ability to enforce and recognize the award is limited under the Act of 2011, the general remedy provided by the Arbitration Act of 1940 can be used. Because the award, in this case, was international rather than domestic, the applicability of the Arbitration Act of 1940, which only deals with domestic awards, appears perplexing and ambiguous. According to Article V (1)e of the New York Convention, actual jurisdiction rests with the competent authority at the seat of arbitration, which was Singapore. In this case, the Lahore civil court relied on a judgement reported as 1981 SCMR 494, which was reported at least two decades before the 2011 legislation. And the Lahore High court relied on 1998 SCMR 1618. This is not to be expected from courts, which are required to operate
with extreme caution. Relying on judgments issued when there was a different system for international arbitral implementation will result in nothing but a miscarriage of justice.

3.3.2 *Rossmere International Limited vs. Sea Lion International Shipping Inc.*

In this case, the High Court of Balochistan recognized and admitted the foreign award in 2017, but denied its enforcement on the grounds that the award debtor did not have a bank account or any assets within the court's territorial jurisdiction. The court also established an intriguing procedure in its decision, requiring an award creditor to file a civil suit for enforcement and recognition in the court of territorial jurisdiction where the award debtor has assets (in the case of assets) or a bank account (in the case of a money award). The 2011 act aimed to address this procedural flaw, but it failed. (*Rossmere International Limited vs. Sea Lion International Shipping Inc.*) Section 9 of the Act of 2011, which outlines the procedure for award enforcement and recognition, does not address rules pertaining to this procedural issue. Because the court did not adopt a pro-enforcement approach in this judgment, the jurisdiction might lose its appeal to foreign businesses and investments, which can be a significant threat to a developing economy like Pakistan.

3.3.3 *Orient Power Company vs Sui Northern Gas Pipeline Limited (Encouraging enforcement trend)*

3.1.3.1 Brief facts.

In the last year, there has been a shift in Pakistan's approach to international arbitration. Regarding the foreign award, the Supreme Court of Pakistan used a pro-enforcement approach in the case of *Orient Power Company vs. Sui Northern Gas Pipeline Limited.* (*Orient Power Company vs Sui Northern Gas Pipeline Limited*) The brief facts of the case are that Orient Power Company and SNGPL entered into a gas supply agreement that included a take or pay clause and a gas supply agreement (GSA). This agreement required SNGPL to supply Orient with a stipulated quantity of gas. In return, Orient had to make a payment to SNGPL. According to the agreement, the seat of arbitration had to be in London, and any disputes had to be resolved by the London Court of International Arbitration (LCIA). Pakistani law had to be the governing law. Disputes arose between the parties, and the matter was referred to the LCIA, which appointed the arbitrator and issued two awards against the Orient. According to the award, Orient was required to pay SNGPL 603,202,083 rupees. During the arbitration, the arbitrator used international law rather than Pakistani law to interpret the Take or Pay clause. The arbitrator stated that because Pakistani law does not provide for the interpretation of the take-or-pay clause, he relied on international law instead. His remarks are as follows:

“I have considered the authorities cited by both counsel on the reception and application of foreign authorities in determining the interpretation and validity of the take-or-pay clause and am satisfied that, as there is a lacuna in Pakistani law with regard to its interpretation and validity, these foreign authorities would, although not binding, be of persuasive authority. I am not prohibited by Pakistani law from considering them, indeed, should do so” (Hussain, 2020)
The award was recognized and enforced by a single judge of the Lahore High Court. (SNGPL v. Orient Power Co. Ltd) Orient filed an appeal against this order in the Lahore High Court division bench. The award debtor claimed that the arbitrator used international law to interpret the take or pay clause, whereas he was obligated by the GSA to use Pakistani law. Because of this, the take or pay clause was a penalty clause that, if enforced, would result in the unjust enrichment of the award holder, which is contrary to Pakistani public policy. It was also claimed that the take-or-pay clause is governed by Section 74 of the Contract Act of 1872. One of the grounds for refusing foreign awards mentioned in Article V of the New York Convention of 1958 and Section 6 of the 2011 Act is that the award is contrary to the state's public policy.

3.1.3.2. Held:
The High Court rejected these arguments, stating that the take or pay clause does not violate Section 74 of the Contract Act and that the award is not contrary to Pakistani public policy, and thus it was enforced and recognized. (Orient Power Co. Ltd v. Sui Northern Gas Pipelines Ltd) The appeal was dismissed by the Supreme Court on the same grounds. (Orient Power Company vs Sui Northerin Gas Pipeline Limited) The Supreme Court stated that the public policy exception should not be used as a backdoor to evaluate the merits of a foreign arbitral award or to create grounds not available under Article V of the New York Convention, as this would render the requirement to recognize and enforce foreign arbitral awards null and void. It was further stated that this type of intervention would effectively eliminate the necessity for arbitration agreements since parties would be encouraged to challenge foreign awards on public policy grounds. (Orient Power Company vs Sui Northerin Gas Pipeline Limited) (Ullah, 2016)(Sharif, 2022)

3.1.3.3. Analysis:
This decision was undeniably significant in the realm of foreign arbitral award enforcement. However, as a model decision and landmark judgment, certain additional measures and a deeper understanding of the many terms involved in the enforcement of foreign arbitral awards were possible, as it was before the Supreme Court, but this was not thoroughly examined. While many jurisdictions around the world take a restrictive approach when dealing with such issues, the Supreme Court focused solely on the quantum of the award in terms of public policy. (Hussain, & Arafat, 2020)

While this decision encourages the enforcement of foreign awards, it also discourages arbitration practice. The reason for this is that the Supreme Court ignored two critical points when deciding the case at hand. One, does the arbitrator have the authority to deviate from the law selected by the parties in the arbitration agreement? Second, is the arbitrator permitted to make comments about the country's legal system? (Hussain, 2020) The arbitrator in this case not only chose a law other than the one chosen by the parties but also commented on the presence of gaps in Pakistan's legal system for interpreting the take or pay clause. However, this practice of arbitrator is considered against the LCIA rules and is also contrary to judgment in Dallah v. Pakistan. (Dallah v Pakistan) According to 22.3 LCIA rule, the arbitrator is required to apply the law chosen by the parties to
decide the merits of their dispute and may only do so if such a choice was not made by the parties. “The Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute. If and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate.” (LCIA Arbitration Rules 2014)

Nonetheless, in the case under consideration, the arbitrator applied legislation that was not chosen by the parties. In the case of Dallah v. Pakistan, the English Supreme Court refused to enforce the award made by the ICC tribunal in Paris. This was because the ICC tribunal used transnational law in the arbitration proceeding rather than French law. The court ruled that because the arbitration was held in Paris, French law should have been applied as the governing law in the proceedings, implying that the parties had implicitly chosen French law as the guiding law in the arbitration proceedings. The enforcement of the award was denied because the tribunal deviated from the parties' implicit choice of law. However, the Supreme Court of Pakistan took a different stance than the English Supreme Court on this same issue. (Dallah v Pakistan)

3.1.3.4. The Supreme Court has ruled on the applicability of the UNCITRAL model law:
The Supreme Court stated in the above case that;
“In a commercially fast-paced world, where the world is essentially a global village, it is regrettable that Pakistan, although a signatory to UNCITRAL, has till date did not incorporate the provisions of the Model Law into its domestic law and the Foreign Arbitration Act makes no mention of incorporation by reference.” (Orient power company v. SNGPL) This is the first time in the history of Pakistan, that the Apex Court of the country has proposed the importance of incorporating UNCITRAL model law into domestic legislation.

4. Conclusion and Recommendations:
Arbitration in Pakistan has a twin-fold origin that is based on the ancient system of Panchayat and the English arbitration system. The problem in Pakistan is that most arbitration proceedings are conducted in accordance with societal norms and practices that are not specified in the current Arbitration Act 1940. Some parts of the country still use the ancient panchayat system, while others use the Act of 1940 to conduct the arbitration. As a result, the country's arbitration procedures are inconsistent and incongruous. The act of 1940 is not only old, but it also lacks provisions relating to recent developments in the field of arbitration. The government of Pakistan should either amend the existing Arbitration Act 1940 or create a new comprehensive arbitration law to make the system more efficient and ensure that the decision is carried out by the state's executive branch. (Rao Idrees, 2020)

According to Justice Saqib Nisar, the Act of 2011 brought Pakistan closer to achieving good standards of international arbitration. (Justice Nisar, 2018) However, if a mature approach had been taken at the time of the 2011 Act's enactment, Pakistan would have met its goal by 2023, but Pakistan is still lagging in this regard. The 2011 Act does not address all the procedural issues that courts face
in enforcing and recognizing the award. The *Rossmere case* is an example of this limitation of the 2011 Act. In this case, it was also observed that a lack of clarity on the procedure resulted in inconsistent rules regarding whether the award holder should file a civil lawsuit or what criteria the court must follow when exercising its discretion. Legislative action is required to eliminate such contradictions. (Naveed, & Yasir, 2022)

The court used its discretion in the *Teisei case* to apply the general remedy in Section 14 of the Arbitration Act of 1940 to a foreign award because the suitable remedy was not available in the 2011 Act. The courts' role is thus to fill the gaps and to enforce and recognize the awards in a justifiable manner. When it comes to international arbitration, it is critical that the power of courts be defined in the most precise terms possible. This flaw was overcome in the *Orient vs SNGPL case*, in which the Supreme Court critically examined the importance of foreign award enforcement and recognition and stated the importance of enacting the UNCITRAL Model Law. (*Taisei Corporation* ) (*Orient Power Company vs Sui Northerin Gas Pipeline Limited*)

Modernization of lex arbitri is also highly suggested for resolving procedural issues in arbitration processes. This can be accomplished by incorporating the UNCITRAL Model Law into Pakistani domestic legislation. (*The UNCITRAL Model Law, 1985*) The English Arbitration Act of 1996 is remarkable in overcoming these procedural barriers. (*Arbitration Act 1996*) It is also a leading example of arbitration-friendly jurisdiction. It is recommended that Pakistan harmonize its arbitration laws with the English Arbitration Act 1996 to prosper in the realm of international arbitration. (*Hassan, 2018*) The UNCITRAL Model Law was drafted to assist governments in reforming and modernising their arbitration procedures to meet the demands and standards of international commercial arbitration. It establishes regulations for the arbitration agreement, the composition and jurisdiction of arbitrators, and the limits or scope of the court's involvement in the arbitration action. Arbitration in Pakistan suffers from a lack of adequate law and enforcement of international awards, particularly the mechanism for enforcing foreign arbitral awards. Pakistan could consider adopting the UNCITRAL Model Law into its local legislation. This would create an opportunity for Pakistan to overcome the procedural hurdles in the arbitration.
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