

## INTERNATIONAL COMMERCIAL ARBITRATION

# Arbitration and Promotion of Economic Growth and Investment

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ICC arbitration was conceived by and for international business. When the International Chamber of Commerce was created in 1920 to combat insularity and protectionism in world trade, dispute resolution was seen as an indispensable part of the services it was to provide.

Recognizing that contracts, especially between partners of different cultures, are inevitably exposed to strain, misunderstanding and even, regrettably, sometimes flagrant abuse, the ICC considered it crucial to provide the business world with an appropriate means of overcoming commercial conflict. In the words of Etienne Clementel, the French Minister of Commerce at the time and one of the founders of the ICC, “freedom can truly flourish only if it finds within itself the means to achieve its own moderation”. ICC arbitration was initially developed as a means of self regulation in international commerce.

The landscape of international arbitration has evolved considerably since the ICC Court was established in 1923 and there has been significant growth in international commercial, as well as more recently, investment arbitration. Since 1923 the ICC Court has administered over 17,600 cases. However, the drivers that lead to the creation of the ICC Court remain apposite today. One of the key ingredients in any recipe for successful international trade and investment is the legal security of commercial transactions.

That security may be ensured by the apparatus of a state’s judicial system or by private means of dispute resolution. While arbitration is firmly established in countries or territories with highly developed and effective legal systems and may co-exist happily with litigation and other forms of dispute resolution, litigation before local courts does not always provide a sufficient assurance of legal security for investors, whether they are local or foreign. Investors may:

- be unfamiliar with local procedures;
- there may be a risk of partiality of local courts towards the local party (e.g. protection of local employment or state participation in the project which forms the object of dispute);

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- a risk of corruption or lack of understanding on the part of the judiciary (whether this is well-founded or not, the investor often acts according to its prejudices);
- the judgment will not be easily enforced outside of the local jurisdiction in the event that enforcement is sought against assets elsewhere (there are few treaties providing for reciprocal recognition and enforcement of court judgments);
- there is a risk of delay (some courts take up to six years to reach a first instance decision);
- there is a risk of appeals (unlike most institutional arbitration),<sup>1</sup> and
- the cost of litigation in some jurisdictions may be very expensive indeed.

Many of these concerns may be addressed by changes in practice. However, some cannot without the agreement of other states or complicated law reform. At the end of the day, perceptions may also remain that somehow a host state's court system can never be a neutral venue for a foreign investor and in some cases even for local business.

By comparison, arbitration has a number of natural advantages in an international context.

#### A. Final, Binding Decisions

Several mechanisms can help parties reach an amicable settlement – for example through mediation under the ICC ADR Rules – however all of them depend, ultimately, on the goodwill and cooperation of the parties. A final and enforceable decision can generally be obtained only by recourse to the courts or by arbitration.

Because arbitral awards are not subject to appeal, they are much more likely to be final than the judgments of courts of first instance. Although arbitral awards may be subject to challenge, usually in either the country where the arbitral award is rendered or where enforcement is sought, the grounds of challenge available against arbitral awards are limited. Very often in business relationships finality is better than prolonged uncertainty.

##### I. Neutrality

In arbitral proceedings, parties can place themselves on an equal footing in five key respects:

- Place of arbitration;
- Language used;
- Procedures or rules of law applied;
- Nationality;

1 P.E. Mason & M. Gomm-Santos, 'New Keys to Arbitration in Latin-America', 25(1) *J. Int'l. Arb.* 2008, p. 32.

- Legal representation.

Arbitration may take place in any country, in any language and with arbitrators of any nationality. With this flexibility, it is generally possible to structure a neutral procedure offering no undue advantage to any party.

#### *II. Specialized Competence of Arbitrators*

Judicial systems do not allow the parties to a dispute to choose their own judges. In contrast, arbitration offers the parties the unique opportunity to designate persons of their choice as arbitrators, provided they are independent. This enables the parties to have their disputes resolved by people who have specialized competence in the relevant field.

#### *III. Speed and Economy*

Arbitration is usually faster and less expensive than litigation in the courts, although not always and there is a danger in seeking to emulate the judicial process through arbitration. A complex international dispute may sometimes take a great deal of time and money to resolve, even by arbitration. However, the limited scope for challenge against arbitral awards, as compared with court judgments, usually offers a clear advantage.

Arbitration offers the parties the flexibility to set up proceedings that can be conducted as quickly and economically as the circumstances allow. In this way, a multi-million dollar ICC arbitration was once completed in just over two months following the establishment of the Terms of Reference.

#### *IV. Confidentiality*

Arbitration hearings are not public, and only the parties themselves receive copies of the awards. That is not to say that they are always confidential. This will often depend upon the *lex arbiti* and there may be exceptions to any general obligation of confidentiality. Listed companies, for example, may have reporting obligations but the hearings themselves are usually conducted in private.

Above all it is the neutrality, flexibility, and predictability of international arbitration that continues to ensure its role as the dispute resolution mechanism of choice in international trade throughout the world and the best means of promoting legal security and consequently investment. Arbitration's promotion of the rule of law facilitates economic development.

Economic development requires not only that there be predictable and fair rules to govern business activities but that these rules are actually enforced. Protection of property and contract rights and their effective enforcement provide assurances to investors that disputes arising in these contexts will be properly resolved and that the investors will be able to predict the cost of doing business. By accomplishing those objectives, arbitration contributes to the favorable business climate and thus promotes economic growth. In turn, the growth of international arbitration is also a product of economic growth.

However, even if one takes for granted the precept that arbitration by its nature facilitates international trade and investment that is not enough. Using arbitration tribunals may solve the problem of effective dispute resolution, but this does not ensure compliance with the final ruling and this is of course crucial to investor confidence. If the losing party chooses to ignore the ruling, the winning party has to enforce it by making use of courts, bailiffs, and other execution organs in a place where that party has assets. Since the defendant's most valuable assets tend to be located in his home jurisdiction, the institutions in the other parties' country of origin ultimately determine whether or not the winning party can enforce his or her claim.

In other words, the domestic institutions in the exporter's home country are the ultimate fallback option for effective contract enforcement. A partnership between the Courts and arbitration is necessary for the system to work effectively. Uncertainty about the reliability of these institutions undoubtedly will affect the importer's willingness to trade with firms from that country.

There are few, if any, empirical studies which show the link between adequate dispute resolution mechanisms and foreign investment. However, there are some studies which do conclude that the quality of the trading parties' domestic legal institutions has a statistically significant effect on trade.<sup>2</sup>

Therefore, one needs to examine what instruments are available to ensure such reliability. The first and most obvious of these is the New York Convention.

## B. Adoption of NY Convention

To date, 145 countries have adopted the 1958 New York Convention on the reciprocal enforcement and recognition of arbitral awards, which requires all member states to enforce foreign arbitral awards without reviewing their substance. Adoption of the New York Convention by a given country can signal a country's willingness to enforce foreign arbitral awards impartially, to which foreign entrepreneurs respond by collectively changing their trading behavior.

One study by Berkowitz, Johannes Moenius and Katharina Pistor concludes that ratifying the New York Convention does indeed have a measurable impact on a country's trading patterns.<sup>3</sup> First, those countries that have ratified the convention now export more complex goods even in the absence of high marks on domestic institutional quality.<sup>4</sup> Second, ratification of the New York Convention triggers a process of institutionalization.<sup>5</sup> Third, ratifying an international convention is a more credible signal than ratifying a unilateral declaration, because

2 D. Berkowitz & J. Moenius & K. Pistor, *Legal Institutions and International Trade Flows* 4, available at <[www.pitt.edu/~dmberk/Berkowitz%20Moenius%20Pistor.pdf](http://www.pitt.edu/~dmberk/Berkowitz%20Moenius%20Pistor.pdf)>.

3 *Id.*, p. 14.

4 *Id.*

5 *Id.*

deviations will be noticed not only as domestic aberrations, but as violations of the international legal order as well.<sup>6</sup>

The evidence suggests that the ratification of the New York Convention affects the perception of a country's institutional quality independently of tangible legal reforms. Ratifying the New York Convention alone may not be sufficient to convey a signal, but ratifying it without reservation almost always does.<sup>7</sup>

However, while ratifying the New York Convention may send a strong signal, failure to comply with its rules can undermine a country's credibility as a trading partner.<sup>8</sup> Credibility requires more than just signaling a willingness to join the international club, tangible domestic reforms and changes in attitude are required.

### C. Regional Conventions Dealing with Arbitration

Other conventions promoting international arbitration also have impact on improvement of business and investment climate. They are European Convention on International Commercial Arbitration (Geneva, 1961), the Inter-American Convention on International Commercial Arbitration (Panama, 1975), the European Convention Providing a Uniform Law on Arbitration (1966), Arab Countries - Convention Arabe D'Amman Sur L'Arbitrage Commercial (1987), the OHADA Treaty on the Harmonization of Business Law in Africa (Port-Louis, Senegal, Title IV deals with arbitration).

### D. Investor State Arbitration

Currently, 157 countries signed the Washington Convention providing for ICSID arbitration for disputes between investors and states.<sup>9</sup> In addition, there are over 2,000 bilateral investment treaties, which provide for arbitration by ICSID or other institution, such as ICC or the Arbitration Institute of the Stockholm Chamber of Commerce.

There does not appear to be much empirical evidence to support the conclusion that bilateral investment treaties have any direct impact on encouraging foreign direct investment. However, it is possible that a country's conclusion of investment treaties is one of many variables that affect investors' decisions, others being the potential financial risks and benefits to the investor, the stability of an investment environment, the availability of appropriate human capital, access to

6 *Id.*

7 *Id.*, p. 16.

8 *Id.*, p. 35.

9 There are currently 157 signatory States to the ICSID Convention. Of these, 146 States have also deposited their instruments of ratification, acceptance or approval of the Convention.

effective enforcement procedures, embedded personal and professional relationships, and other factors.<sup>10</sup>

While the availability of investment treaty arbitration may play some role in influencing investment determinations, the specific scope and impact of that role has not been articulated.<sup>11</sup> There is, however, some supporting evidence that a country, which becomes a signatory to the Washington Convention is much more likely to attract investment than a country which has not.<sup>12</sup>

Investment arbitration is a relatively new process that has only been tested thoroughly within the last decade and has been the subject of some recent criticism. If nothing else, investment arbitration provides an additional layer of protection to investors and, most importantly, signals a government's commitment to the rule of law, bolstering the confidence of investors that their property rights are secure.<sup>13</sup> It is probably fair to say that by supporting domestic and international commercial arbitration governments do better to promote economic growth.

#### **E. UNCITRAL Model Law on International Commercial Arbitration**

A modern arbitration law also facilitates trade inflow, economic growth, and foreign investment. To be attractive for foreign investors, a national arbitration law or arbitral institution rules should provide for a considerable party autonomy and contain only a few mandatory rules.

Rather than inventing their own arbitration system, emerging economies would be well advised to adopt UNCITRAL Model Law on International Commercial Arbitration, if not entirely, at least as a starting point.<sup>14</sup> It provides a single, comprehensive law which reflects international consensus, which makes it more transparent and accessible for foreign investors, thus promoting investment.<sup>15</sup>

Additionally, in jurisdictions lacking reported cases or commentary, the UNCITRAL Model Law provides an opportunity to benefit from extensive commentary and databases in many languages which can assist in implementing and interpreting the law.<sup>16</sup>

10 S.D. Franck, 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law', 19 *Pac. McGeorge Global Bus. & Dev. L.J.* 2007, p. 337 and 339, available at <[www.ssrn.com/abstract=882443](http://www.ssrn.com/abstract=882443)>.

11 *Id.*

12 Shaughnessy, *supra* note 4, p. 323.

13 Policy Framework for Investment 27, OECD (2006), available at <[www.oecd.org/dataoecd/1/31/36671400.pdf](http://www.oecd.org/dataoecd/1/31/36671400.pdf)>.

14 Shaughnessy, *supra* note 4, p. 322.

15 *Id.*

16 *Id.*

## F. What Makes a Good Seat? Arbitral Institutions and National Courts

It has often been said that the most crucial factor in choosing the place of the arbitration is the reputation of the city for the quality of its hotels and the gastronomy of its restaurants! One might be inclined to argue that for this reason Paris has historically been one of the cities of choice for international arbitrations.

Perhaps there is a sliver of truth in this, but in addition to the factors I have already identified there are of course many other serious legal and practical considerations that the parties will take into account when choosing the place of the arbitration.

The choice of the place of arbitration is the foundation of an effective arbitration agreement and the parties' selection of the seat is usually not merely a matter of convenience. Anyone who is involved periodically in arbitration and especially legal counsel who specialize in this particular area will often have formed strong opinions from experience on where they consider to be a 'good place' of arbitration. When sophisticated and well advised parties pick the place they will weigh up a number of factors and choose somewhere appropriate to their circumstances and the dispute likely to arise under the contract.

Among the most important factors is the reliability of the local courts. Although the lack of predictability of the courts in a developing country and inexperience will likely deter large investors at first, a country can attract investors over time by achieving the reputation of being an arbitration-friendly venue.

National Courts may be involved in arbitration proceedings in a number of different ways and their roles may be seen as arbitration friendly or not according to the actions they take:

- Courts at the place of enforcement;
- Courts at the place of arbitration;
- Courts which may have jurisdiction over the parties or their assets or material documents or witnesses.

The enforcement of awards is of course important and is often where the most attention is paid and the most criticism.

What does it mean to be arbitration friendly? It means that the courts should adopt an international approach to the recognition and enforcement of arbitral awards which is consistent with the principles embodied in the New York Convention. In other words, courts should look to the overriding intent of the parties in their arbitration agreement, which is for their dispute to be settled by arbitration in whatever form specified.<sup>17</sup> National standards and preferences should not

<sup>17</sup> *Id.*

influence the decisions of national courts whose assistance is sought in connection with an international arbitration.<sup>18</sup>

Further, national courts should respect the parties' choice of arbitration as the only means of dispute resolution. If the agreement to arbitrate is not honored, what chance is there of other aspects of the commercial agreement being respected?<sup>19</sup> A failure to do so damages "the fabric of international commerce and trade, and imperils the willingness and ability of businessmen to enter into international commercial agreements."<sup>20</sup>

That is not to say that courts should simply slavishly enforce all arbitration agreements and awards, there is also a danger in that approach. Whilst in economic terms finality - and some of the other benefits of international arbitration - require the exclusion of judicial intervention, the protection of fundamental rights also requires some judicial involvement. There is a balance to be struck, but there is no doubt that the attitude of the courts is the single most important factor for a state to establish itself as a safe venue in which to arbitrate.

Arbitral institutions also play a role in improving business climate in a given country. An arbitral institution needs to be effective and be trusted, not only by the legal or business community, but also by the judiciary. It must operate with transparency and according to a set of internationally acceptable rules and procedures, must be led by credible people, must charge reasonable fees in light of the value of the specific dispute and in relation to the costs generally associated with dispute resolution in the particular country, must have great interest in ensuring that awards will be enforced through rules, procedures, education, and training programs of lawyers, arbitrators, and judges.<sup>21</sup>

## G. Conclusion

The significant growth and success of international arbitration as a means of resolving commercial international arbitration practices demonstrates that the international arbitration promotes economic growth as much as it is a product of economic growth and globalization.

Improvement in the rule of law in developing countries, in addition to providing an alternative dispute resolution forum, improves business climate and attracts foreign investment and trade. Important components of international arbitration that can contribute to that effect are effective national arbitration laws, adoption of the New York Convention and other regional arbitration conventions, adoption of investment arbitration mechanisms, education and the development of

18 *Id.*

19 *Id.*, p. 197.

20 *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), according to US Supreme Court.

21 Shaughnessy, *supra* note 4, p. 329.



arbitration-friendly domestic courts. These factors create the right climate for investment.

The ICC experience is that developing economies are increasingly becoming major players in international arbitration but still have some distance to go before they have all of the necessary ingredients to create the right climate for international arbitration.