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ASEAN SYNERGY TO OVERCOME CHALLENGES IN INVESTMENT ARBITRATION

Herliana*

Abstract

Cambodia, Indonesia, Lao, Malaysia, Thailand, and the Philippines, have been sued by foreign investors through international investment arbitrations (IIA). No matter whether the outcome is favorable or not, those countries have spend significant time, energy, and financial resources to arbitrate. ASEAN countries are not in advantageous position in IIA. The first and the most obvious reason is language barrier. Arbitration proceedins are mainly conducted in English. Consequently, the arbitrators and counsels more often than not come from English speaking countries. Not only do they lead to high cost, but also they lack of familiarity with South East Asia's social, politics, economic, culture and customs. This may influence how they treat the cases such as the interpretation of provisions specifically designed to protect foreign investors such as: national treatment; fair and equitable treatment; most favored nation; and also in deciding jurisdictional issues. Bilateral Investment Treaty (BIT) as a legal basis for foreign investment activities aim to provide protection for foreign investor. On the other hand, it also serves as a mean to facilitate economic development in the host states of investment. Unfortunately, BITs often contain excessive and limitless protection clauses in order to attract foreign investors. This may endanger host states position as it can be used as a weapon by the investors to sue the host states. In responding to this fact, it is necessary to strengthen cooperation among ASEAN members in dealing with foreign investors through BIT. The ideal picture will be that SEA is pro-market and pro-arbitration reform. It is unavoidable that in order to protect themselves from harsh investors as well as intricate arbitration, ASEAN would be better off having its own investment arbitration center run by its experts. Thus, the short-term challenge is to equip legal practitioners, business players and academicians with more knowledge, skills and experiences in dealing with investment disputes. The long-term step will be to negotiate model of investment treaties applicable in the region and to harmonize national investment laws. These efforts are strategic opportunities for ASEAN as single market to keep balance between promoting investment, protecting investors and the host states at the same time.

Keywords: *International investment, arbitration, Bilateral Investment Treaty*

I. INTRODUCTION

Foreign Direct Investment (FDI) is an important factor to South East Asian (SEA) countries because it facilitates economic growth which is a crucial element to poverty reduction. Countries in this region have liberalized their markets to attract FDI, but there were some impediments included relatively ineffective commercial laws as well as

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high level of state involvement in protecting local companies.¹ This is one of the reasons why in early 2000 China and India was more attractive as a destination of FDI than SEA.²

However, as the production costs and wages in China and India increase rapidly, FDI interests in SEA soar.³ Another factor for the rise of FDI is that SEA countries have taken steps to improve their commercial law, infrastructures and increasingly liberalized their economies. As a result, Indonesia, Malaysia, Thailand, Singapore and the Philippines outrun China in FDI flow. The FDI flow into those SEA countries rose by 7% in 2012, while in China it fell by 2,9%.⁴

The more FDI activities, the more likely for investment disputes to arise. SEA countries such Indonesia, Malaysia, Thailand, Vietnam, Myanmar, and the Philippines have faced investment arbitration brought by foreign investors. Despite the facts that the number of investment disputes is relatively low compared to the number of investment flow in this region, the effect of such arbitration is quite alarming to the states that have been affected.⁵ Arbitrations have created much displeasure in this area. The tribunal's expansive interpretation of umbrella clause has resulted in an award against the Philippines.⁶ The Philippines disappointed with investment arbitration which led to its refusal to include investment arbitration in free trade agreement made between the Philippines and Japan.⁷ The excessive awards resulted from the method of calculation of damages rendered against Indonesia has

¹ Vivienne Bath and Luke Nottage, *Foreign Investment and Dispute Resolution Law and Practice in Asia*, Routledge, 2011, page 7.

² *Ibid.*

³ "Asia Pacific Investment Climate Index" available at: <http://www.vrienspartners.com/wp-content/uploads/2013/07/VP-Asia-Pacific-Investment-Climate-Index-2013.pdf>.

⁴ Sophie Song, South East Asia received more FDI than China, Which is now World's third largest foreign investors, available at <http://www.ibtimes.com/southeast-asia-receives-more-foreign-direct-investment-fdi-china-which-now-worlds-third-largest>, Accessed on 13 March 2014

⁵ M Sornarajah, Asian Views of Foreign Investment Law, in Nottage, *Foreign Investment and Dispute Resolution Law and Practice in Asia*, Routledge, 2011, Vivienne Bath and Luke Nottage (eds) page 248

⁶ *SGS v Philippines*.

⁷ M Sornarajah, See note 6.

been criticized and led to disobedience towards the decision.⁸

Malaysia has had problems in regard to how the tribunal defines the term of investment. According to Malaysia, there was no investment and therefore there have been sufficient ground for dismissing the arbitration.⁹ Instead, the arbitrators went off on a long discursion on the meaning of an investment. Similarly in Thailand, arbitration resulted in displeasure. With decisions made against the SEA states base on unsound reasoning, there would be greater scrutiny of foreign arbitration clauses in investment treaties.

This paper argues that the current practice of BIT drafting needs to be remodeled by limiting the scope of investment protection. This includes redressing the use of international investment arbitration. The current practice of IIA is heavily western oriented by using English as the main language in the proceeding, and the use of procedural law (*lex arbitri*) created by international entity based in the United States or Europe. Those carry negative consequences for ASEAN members such as: language barrier; financial burden; and lack of expertise to defend themselves which then lead to unfavorable outcome. Furthermore, the Tribunals in current system are often preoccupied with the commercial interests and excessive protection of foreign investors without considering the host countries' concerns through policy considerations. Such a pro-investor attitude put ASEAN countries as the host states of investments in the position of unable to defend their economic development agendas.

ASEAN as a group has a strong bargaining position against foreign investors. The member countries should be able to negotiate as a collective, both regionally and multilaterally when dealing with investors from outside ASEAN. This is especially in negotiating protection clauses such as Most Favored Nation (MFN); Fair and Equitable Treatment (FET); and National Treatment (NT). Those kind of protection shall be precisely drafted to limit their applicability. Additionally, in dispute settlement area, ASEAN members should use IIA as a complement to local adjudication not vice versa. Further, in negotiating BITs proposal to employ arbitration center in SEA should be in

⁸ Amco vs Republic Indonesia.

⁹ Malaysian Historical Salvors, SDN, BHD v. the Government of Malaysia

the priority instead of directing dispute to center located outside the region.

This paper is significant because while investment arbitration has been researched widely, less is done in ASEAN. SEA has not received adequate attention from current literature despite the fact that SEA is a region of growing importance in global affairs, which attract great number of FDI. The road map of this paper is as follow: Part A, introduction, provides overview of developments of international investment worldwide and in South East Asia. It begins by arguing that despite the need to foster economy through protecting foreign investment activities, balance approach towards protecting the host states of investment is necessary. This chapter acknowledges the importance of state-investor arbitration, and at the same time shows vulnerability of SEA countries towards investment arbitration. It further emphasizes that in respond to such vulnerable position, ASEAN as a group should take action together.

Part B points out the role of Bilateral Investment Treaty (BIT) and IIA. In the current practice, arbitral tribunals have been relatively too flexible in giving protection to foreign investors through excessively wide interpretation on treaty provisions. Partly, this reflects bias in arbitral proceedings as a pro-investor approach. The reluctance by tribunals to address host state's interests appears to be driven largely by their approach on treaty interpretation. The tribunals misstate the purpose of BIT as only to protect investors and neglect the reality that host states also intend to develop their economy when signing the treaty.

Part C focuses on ASEAN opportunities in dealing with FDI. This part describes the chances and possibilities to modify the current practice of treaty making and treaty protection in order to provide more favorable conditions for host states without sacrificing protection for FDI. Part D discusses necessary conditions to be fulfilled to undertake modification of the current practice. It proposes several alternatives to maintain balance between protection and economic development. Part E is conclusion which underlines the strength of ASEAN to attract FDI despite such modification in FDI protection.

II. BILATERAL INVESTMENT TREATY AND INTERNATIONAL INVESTMENT ARBITRATION

Bilateral Investment Treaty (BIT) is an international agreement made by two countries, which establish the terms and conditions for investment made by national or company of one state in another state.¹⁰ BITs serve as a legal foundation for foreign investment activities, which guarantee of protection as well as a mean for economic development in the host states. The unique characteristic of many BITs is that they contain provision on the use of investment arbitration as a mean to settle investment disputes between FDI and the host states.¹¹¹² Most BIT requires that after negotiation fail, the disputes should be brought to arbitration instead of host state's court due to possibility of bias.

There is no agreement among scholars on whether BITs increase FDI as shown by Swensen in her chapter. The divergent views rise from: Tobin-Rose Ackerman; and Hallward- Driemer claiming that BITs do not increase FDI. On the contrary, Salacuse-Sullivan and Neumayer-Spess using larger sets of countries contends that BITs increased FDI.¹²

As the legal basis for entering host states, most of provisions in BITs contain clause of protected interests given to foreign investments.¹³¹⁴ It is perceived that foreign investors are in a weak position due to the possibility of abuse by the host government. However, despite such a protection, BITs actually carry another objective to enhance economic cooperation between the contracting parties. By signing the BIT, host states expect to gain more economic growth.

Thus, not only for the investment, but adequate protection should also be given to the host states since they also bear certain costs. Sala-

¹⁰ Susan Rose-Ackerman and Jennifer L. Tobin, "Do BITs Benefit Developing Countries?" in Chaterine A. Rogers and Roger P. Alford, *The Future of Investment Arbitration*, Oxford University Press. page 131.

¹¹ M. Sornarajah, *The International Law on Foreign Investment*, 3rd edition, Cambridge, 2010, page 187.

¹² Deborah L Swensen, "Why Developing Countries Sign BITs" in Karl P Sauvant and Lisa E Sachs. Eds. *The effect of treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*, 2009. page 437.

¹³ Surya P Subedi, *International Investment Law: Reconciling Policy and Principle*, 2nd edition, Hart Publishing, 2012, page 82.

cuse points out that host country of investment bear four costs associated with their policy to open door to FDI: inability of the local industries to compete with FDI, FDI intervention towards political process, security risks, and possibility of introduction of dangerous technologies which may damage the local environmental, cultures and health.¹⁴

Definition of investment varies in every BIT. Most definition covers “every kind of asset” or “any kind” and followed by lists of assets.¹⁵ This broad definition often creates difficulties when dispute arises before arbitral tribunals. Furthermore, protection clauses in BIT are also numerous and unclear. MFN, FET and NT which meant to attract investors and protect their activities need to be interpreted in line with economic development in the SEA context. Those ambiguities in BIT explain why the job of resolving dispute which involve interpretation activities should be done by people who understand the context where the disputes arise.

BITs are also the basis on which dispute settlement through arbitration is resorted. The International Center for the Settlement of Investment Disputes (ICSID) is often referred to facilitate investment dispute. Because it does not have permanent arbitral tribunals, the ICSID allows independent arbitral tribunals and arbitration mechanisms to hold proceedings under its rules, and all contracting member states agree to enforce and uphold arbitral awards in accordance with the ICSID Convention.¹⁶ The following table shows ASEAN countries involvement in investment agreement:

¹⁴ Jeswald W Salacuse, *The Law of Investment Treaty*, Oxford, 2010, page 37.

¹⁵ Kenneth J. Vandelde, *Bilateral Investment Treaties: History, Policy, and Interpretation*, Oxford, 2010, page 122.

¹⁶ K.V.S.K. Nathan, *The ICSID Convention: the Law of the International Center for Settlement of Investment Disputes*, Juris Publishing, 2000. page 51

COUNTRY	ICSID	ACIA (ASEAN Comprehensive Investment Agreement)	BIT's Partner per June 2013
Brunei Darussalam	Party	Party	6 countries
Cambodia	Party	Party	22 countries
Indonesia	Party	Party	63 countries
Lao	Not Party	Party	23 countries
Malaysia	Party	Party	67 countries
Myanmar	Not Party	Party	6 countries
Philippines	Party	Party	35 Countries
Singapore	Party	Party	41 Countries
Thailand	Signatory party but not ratify	Party	39 Countries
Viet Nam	Not Party	Party	60 countries

Source BIT's partners: http://unctad.org/Sections/dite_pccb/docs/bits

ICSID Convention is designed to promote the settlement of disputes between state and private foreign investors. It aims to contribute to the promotion of economic development.¹⁷ Investment dispute arbitration administered by the ICSID is accounted for the largest number of investment disputes.¹⁸ Article 25 of ICSID Convention stipulates the jurisdiction of the ICSID tribunal as for legal dispute arising directly out of an investment between a contracting State and the national of another contracting State which the parties to the dispute consent in writing to submit the dispute to the ICSID.

ICSID has several unique aspects for example its proceedings are free from the interference of local courts where the proceeding is con-

¹⁷ http://www.univie.ac.at/intlaw/wordpress/pdf/100_icsid_epil.pdf, Accessed at 15 January 2014.

¹⁸ Ucheora Onwuamaegbu, *International Dispute Settlement Mechanisms-Choosing Between Institutionally Supported and Ad Hoc; and Between Institutions, in Arbitration Under International Investment Agreements: A Guide to the Key Issues*, Katia Yannaca-Small, ed, Oxford 2010, page 63

ducted. Unlike other international arbitration which requires other instrument in recognition and enforcement, ICSID provides for automatic recognition of its awards in member countries upon the presentation of a copy of the award certified by the Secretary General.¹⁹

Roles of arbitral tribunal in determining the outcome of cases provides argument why it is necessary to have tribunals members who understand not only investment law, but also the local cultures treaty interpretation does matter in deciding legal issues of the disputes and how the applicable law of interpretation, Vienna Convention on the Law of Treaty (VCLT), regulates this issue. Tribunals should employ the Vienna Convention as a mean to provide sound, convincing decisions in order to support international investment law through balancing investor's rights with responsibility and developing a more neutral approach toward host states and investors. This indicates the challenges facing the ICSID arbitral tribunals when applying the law to the facts.

In the last few years, ICSID has been criticized for being costly, inconsistent, lack of transparency and bias against developing countries. This has caused some developing countries like Bolivia, Ecuador, and Venezuela to withdraw from ICSID. In Indonesia, there is a growing concerns on whether to withdraw from ICSID.²⁰

III. WHAT OPPORTUNITIES ASEAN HAS FOR INVESTMENT ARBITRATION

The number of arbitration under the investment treaties increases significantly during the last two decades. On the contrary, the perception of legitimacy of arbitral decisions decreases as consequences of conflicting decisions, excessive awards, and lack of transparency. In responding to this dilemma, ASEAN members can respond in three ways:

1. The first is withdrawal from the system of investment arbitration like what have been done by Bolivia, Ecuador and Venezuela.

¹⁹ ICSID Convention, Article 54

²⁰ Prof. Hikmahanto Juwana stated that Indonesia should withdraw from ICSID due to various reasons available at <http://www.thejakarapost.com/news/2014/04/02/indonesia-should-withdraw-icsid.html>.

This response is based on the belief that the ICSID arbitration is costly, inconsistent, lack of transparency and bias. The time, energy and cost of arbitration outweigh the benefits that ICSID brings to state.²¹

2. The second response is to renegotiate current BIT or change strategy for future investment treaties so that there is an exclusion of certain sectors from arbitration.
3. The third has been to argue new types of defenses to liability.²² Balancing between investor's protection and host state's interests shall become priority. Interest of the state in certain areas such as the environment, labour rights and the health and welfare of citizens has led to the statement of exceptions in the treaty.²³

Those ways can be used to prevent possibility of unfair and bias arbitral award which expanding the meaning and scope of the provision of the investment treaties beyond what has been intended by the host states. In short, the law of protection needs to be rethought. ASEAN members shall be cautious about vague protection clauses such as FET, MFN, NT and umbrella clause by avoiding or limiting the scope of their application. This is for example:

- Fair and equitable treatment shall not deny justice in legal or administrative proceedings. FET.
- Most-Favored Nation not to encroach upon procedural issues but merely apply to substantive issues. MFN is a condition where the state recipient must receive equal advantages as the "most favored nation" by the country granting such treatment.
- National treatment which obliges the host states to treat foreign investors and local investors equally should be limited for example it is not applicable for infant industry.
- Umbrella clause should be avoided because it is too broad and can be widely interpreted. Umbrella clause imposes an international treaty obligation on host countries that requires them to respect obligations they have entered into with respect to investment.

²¹ M. Sornarajah, *The International Law on Foreign Investment*, 3rd edition, Cambridge, 2010, page 453.

²² *Ibid.*

²³ *Ibid. Page 454.*

Further change that needs to be made is signing treaty with limited or no arbitration right in it. In respect to investment arbitration, there has been some suggestion that dispute resolution provisions are one of the strongest investor protections in investment treaties.²⁴ However, there is still debatable whether decision to invest is significantly influenced by the existence of investment arbitration.²⁵ Foreign investors may be more concerned with obtaining profit and maintaining good relationship with the government for future projects.

As Frank shows in her research, reliance on domestic court and absence of international investment arbitration does not stop FDI to come in China. This suggests substantive matters outweigh procedural matters in investment treaties. There are some conditions where investors are keen to gain a place or developing market. This is considered as more important than the investment arbitration rights granted by BIT.²⁶

Therefore, investment arbitration administered by international institution is not a must. Rather than being a substitute, investment arbitration is merely a complement of domestic court or domestic ADR. Instead, ASEAN members can refer to dispute settlement center in the region with legal practitioners from the area. This is not only to keep the cost reasonable but also to maintain that people involve in the dispute understand the context of the dispute socially, politically and therefore the outcome would be fairer.

IV. NECESSARY CONDITIONS FOR CHANGES

In order to be able to make modifications and to use the opportunities effectively, there are certain conditions to be met:

A. ESTABLISHED DISPUTE RESOLUTION SYSTEM

ASEAN members can agree not to refer to international arbitration or to give limited rights to redress investment dispute to international arbitration. This is such as:

²⁴ Susan D. Frank, *Foreign Direct Investment, Investment Treaty Arbitration and The Rule of Law*, *Global Business & Development Law Journal*. Vol. 19, page 356.

²⁵ *Ibid.*

²⁶ Susan D. Frank, *Ibid.* page 359.

- Requiring parties to engage in negotiation, mediation or conciliation administered by local dispute settlement body
- Determining what dispute can go to international arbitration and what disputes must go through local courts or local dispute settlement body.
- Designate arbitration center within the region as institution designated to settle investment dispute: Singapore International Arbitration Center (SIAC), Kuala Lumpur Regional Arbitration Center (KLRAC) or Indonesian Arbitration Board (BANI) can be empowered to carry out the jobs.

This effort is important to foster the development of the rule of law in national court or ADR center in the region. Besides developing local judicial institutions, this is also benefiting in promote confidence in the overall process of resolving investment disputes.²⁷ Using ADR center outside the host states will ensure the neutrality and fairness of the dispute settlement process due to independent adjudicators.

B. ECONOMIC AND POLITICAL STABILITY

Political instability is regarded as a hinder for economic growth due to the possibility of frequent policy changes.²⁸ A study by Alesina and Perotti shows that the less stable the social- politics situation, the riskier the investment activity is. As a consequence, the number of investment may lower.²⁹ Having said that, ASEAN countries need to address any political instability by mitigating its effect on the sustainability of economic policies.

C. MARKET LIBERALIZATION MODEL

Market liberalization can remove barriers to FDI that may create difficulties to access the countries. The economic liberalization process begins by relaxing these barriers and relinquishing some control

²⁷ Susan D. Frank, *Ibid.* page 368.

²⁸ Ari Aisen and Francisco Jose Veiga, *How Does Economic Instability Affect Economics Growth?*, available at <https://www.imf.org/external/pubs/ft/wp/2011/wp1112.pdf>.

²⁹ Alesina, A. and Perotti, R. "Income distribution, political instability, and investment."

European Economic Review 40, 1996, page 1203- 1228.

over the direction of the economy to the private sector. This idea is in line with the ASEAN Comprehensive Investment Agreement (ACIA) to facilitate the free flow of investment in the ASEAN region as an integrated investment area.³⁰ Liberalization policy in ACIA is designed to attract foreign investment from States outside ASEAN region, not merely to facilitate investment among ASEAN States.³¹

V. CONCLUSION

ASEAN as a group with 600 million populations of a single market, abundant natural resources and comparatively inexpensive labor will surely be an attractive destination for FDI. The high number of FDI level in the region has proved that SEA has been very attractive to invest. Considering its strategic position, ASEAN has wide opportunity to work as a group in creating a state-investor dispute resolution center. There are many ways for ASEAN countries to draft provisions in investment treaties to balance the need of FDI protection and its interest to develop the economy. ASEAN may review

There is no need to provide unnecessary extensive and limitless protection to FDI. The focus for now should be how to create a sustainable economic development in the region with the assistance of FDI without having to sacrifice member's interests. Therefore, modification of the existing treaties and changing the model of future treaties are worthy of note. The goals of SEA countries to develop their economies should be taken into account when negotiating treaty terms or provisions. ASEAN members should work together to focus upon minimizing risk in investment by maintaining political and social stability and improve the capacity of dispute resolution mechanisms. Additionally, regional cooperation to provide incentives for foreign investors is also necessary.

³⁰ Article 1 of ACIA

³¹ ASEAN Investment Report as quoted from Vivienne Bath and Luke Nottage, *The ASEAN Comprehensive Investment Agreement and 'ASEAN Plus'-The Australia-New Zealand Free Trade Area (AANZFTA) and the PRC-*

ASEAN Investment Agreement, Sydney Law School Legal Studies Research Paper No. 13/69, September 2013, <http://ssrn.com/abstract=2331714>.

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