Journal of Positive School Psychology http://journalppw.com
2022, Vol. 6, No. 4, 4113 – 4118

The institutionalization of international arbitration in international business and the roles and problems of international arbitration in international investment

[1]Taewook Kang

[1]Department of Law, College of Social Sciences, Kyungsung University, 309, Suyeong-ro, Nam-gu, Busan, 48434, South Korea, twkang3@hotmail.com

Abstract

The article deals with the institutionalization of international arbitration in international business and the roles and problems of international arbitration in the field of international investment. Author specially focuses on the history of institutionalization of international arbitration and the formation process of international arbitration related to investments, the problems of investment arbitration as well as the procedures of Investor-State Dispute Settlement (ISDS).

Keywords: Institutionalization of international arbitration, Geneva Protocol 1923, Medieval merchant law, Commercial issues, Investor-State Dispute Settlement (ISDS), UNCITRAL Arbitration Rules, Washington Convention (ICSID Convention).

INTRODUCTION

1. Institutionalization of international arbitration in the field of commercial trade

In 1923 in Geneva, “Geneva Protocol 1923” was adopted under the leadership of ICC (International Chamber of Commerce). The core of this was “agree to comply with binding arbitration procedures and legally recognize by each country to settle disputes arising from private transactions”. Since then, it has been amended several times and developed through Geneva Convention 1927 and New York Convention 1958. At present, no matter what country the arbitration ruling takes place in, each country has come to recognize the decision as having legal enforcement power in its own country without review in light of its own laws. Of course, there are rulings that do not have legal enforcement power in terms of legal logic.

Arbitration is different from public court trials that proceed according to established procedures, legal sources, and systems. In principle, in arbitration, both the process and procedure in which the arbitration trial proceeds follow the will of the parties to the dispute, in order to prevent leakage of personal information and business confidentiality of the parties, all proceedings of the arbitration shall be kept confidential, and those who are in charge of judging a dispute, arbitrators, receive monetary compensation for the proceedings of the arbitration trial. This is in many ways similar to the medieval merchant law. In the 20th century, with the widespread expansion of the international economy, it was a very important development that private arbitration trials similar to the practice of medieval merchant law, had developed into a system with international legal status and had binding power that is not restricted by domestic laws of each country. However, there are still many difficulties. This is because each country was limited to “Commercial issues” among civilians as the scope of arbitration trials that had to be followed regardless of whether it was consistent with domestic laws of each country. Compared to the comprehensive definition of "investment" defined in Chapter 11 of the North American Free Trade Agreement (NAFTA), thanks to the word “commercial issues”, the scope of

arbitration trials was narrowed. Therefore, no matter what arbitration ruling was made, governments of each country continued to have the right to ignore it if the decision was judged to “be beyond commercial scope and infringe, for example, on the realm of each country's public policy”. In the 1960s, however, multinational corporations began to conflict with the governments of investment countries as they expanded their production areas to countries around the world in earnest, so these problems should not be overlooked. Therefore, the Washington Convention (called ICSID Convention) for resolving investment disputes held in 1965 presented a new milestone. The Washington Convention, signed on March 18, 1965, is the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (effective October 14, 1966). In addition, it established the International Center for Settlement of Investment Disputes (ICSID) and set the rules for conciliation and arbitration conducted there. This Convention was to extend the existing private international arbitration procedure system to disputes between state and foreign investors. And UNCITRAL adopted the UNCITRAL Arbitration Rules on April 28, 1976 to promote international arbitration, and announced the UNCITRAL Model Law on June 21, 1985. The difference between UNCITRAL Model Law and UNCITRAL Arbitration Rules is that "The UNCITRAL Model Law provides a pattern that law-makers in national governments can adopt as part of their domestic legislation on arbitration. The UNCITRAL Arbitration Rules, on the other hand, are selected by parties either as part of their contract, or after a dispute arises, to govern the conduct of an arbitration intended to resolve a dispute or disputes between themselves. Put simply, the Model Law is directed at States, while the Arbitration Rules are directed at potential (or actual) parties to a dispute”.

As a result, the arbitration trial, which was a private procedure, was extended to the relationship between sovereign states and investors, and the procedure and rules were also institutionalized. In other words, it laid the groundwork for a system that would allow investors to file lawsuits against the state directly and exercise binding power over sovereign states through arbitration trials. In the early days, however, it was very different from today's direct investor-state litigation system. This is because it doesn't mean that any country's signature on ICSID must follow all decisions made in the arbitration trial set by ICSID for disputes involving all foreign investors after signing. Sovereign states were still the source of power under international law. In order for ICSID arbitration to be binding force effective in individual countries, that state must express its explicit intention in the form of “these cases do not fall within the legal jurisdiction of their country and are subject to ICSID arbitration”. Such expressions of intention can first be made through "contracts".

In addition, what's new is the introduction of Investor-State direct litigation system through Bilateral Investment Treat (BIT) or Free Trade agreement (FTA). An investment agreement is a treaty (or agreement) in which specific state will comply with ICSID arbitration under the World Bank or UNCITRAL arbitration in relation to “all investments” to “all anonymous foreign investors”. This is not a contract between specific state and specific foreign investor, but an agreement with another specific state, and the agreement has effect as a treaty between states. The treaty makes it possible to give other states collective consent that "all investors in the other state can be protected by commissioning international arbitration for all disputes arising out of all contracts related to investments. In this case, binding arbitration will be possible for disputes between “all foreign investors vs. state” arising between both states in the investment agreement. However, investment agreements pose a risk of infringing on state sovereignty of the state. If any foreign investor makes a claim, the state must respond through ICSID at any time, and whatever the dispute is made, the country shall comply with the ICSID arbitration ruling. The same is true even if the claim relates to unique legislative or administrative measures of the sovereign state. In this way, it can be said that the signing of such investment agreements is the transfer of sovereignty to foreign investors and ICSID. The signing of investment agreements began in the 1950s, but it was only happening between some developed and underdeveloped countries. Not many countries agreed to international arbitration procedures through such investment agreements. Although ICSID was established, the cases of disputes against the state were small enough to be ignored. However, as the world began to be

internationalized in earnest from the late 1980s, especially in the 1990s, bilateral (multilateral) investment agreements were exponentially signed. With the bilateral (multilateral) investment agreements spread, ICSID began its activities in earnest. Unlike ICSID arbitration, the arbitrations by international dispute settlement organizations such as UNCITRAL or ICC International Court of Arbitration, which are not obligated to announce disputes, have also begun to increase. Currently, ICSID arbitration and UNCITRAL arbitration have established themselves as two major rules in the field of international arbitration, especially international investment.

2. Roles and problems of international arbitration in international investment

International investment in international trade, namely foreign investment, because of the nature of international investment that the capital usually has been invested in the host countries for a long term, there is more likely the disputes of various forms between foreign investors and host countries. These disputes are usually resolved under the administrative or judicial remedy procedure of the host country. However, if there is a serious infringement on the property of foreign investors where the host nationalizes or expropriate the property of foreign investors that have invested in the country, it's hard to expect a fair judgment by relief proceedings under the law of that country. Because there are potential political risks associated with the investment, that is, the infringement of the investment property of foreign investors by the exercise of public power of the host country, the international community has created an international investment arbitration system as a protective device, which can be expected to be relatively more neutral in solving the disputes with respect to investment between the host country and foreign investors. In other words, international investment arbitration is meaningful in that it overcomes these difficulties using the framework of international arbitration and opens the way for foreign investors to receive relief from damage directly from the host country.

The growth of international investment activity has resulted in an increase in the number of disputes between foreign investors and States that attract investment. International arbitration as a means of resolving disputes is largely distinguished into inter-state arbitration and international commercial arbitration for settling inter-individual or between-state-and-individual international commercial disputes, where countries engage in arbitration as a sovereign entity for the former and as a private entity (corporation) for the latter.

The purpose of the system of resolving disputes between the state and the investor lies both in protecting the investor's profits and in protecting the state’s interests. In resolving a dispute through an international arbitration body and international arbitration rules, the parties have to face many challenges, but the system has so far been recognized as the fairest. It is also recognized as a universal way to resolve investment disputes in the format of multilateral, interregional and other free trade agreements and bilateral investment agreements. Although the international arbitration organizations are more objective than the national courts, there are many problems in resolving disputes. So, which stimulates the scientific and practical discussions to improve this mechanism.

Investor-State Dispute Settlement (ISDS) is the resolution of disputes between investors and countries. This is not suit proceedings but arbitration proceedings. That is, “activities of the third party to arbitrate and settle disputes by intervening between parties in dispute”. The resolution of disputes that often arise between foreign investors and the host state in the framework of the investor-state dispute Settlement (ISDS) system usually not done through the courts, but through arbitration. Which is defined as “the actions of a third party as an intermediary between the parties as a review and resolution of such disputes”. In other words, ISDS is a proceeding to settle disputes by selecting either the domestic court proceeding or the international arbitration proceeding, when investors judge those losses have been caused by violating obligations of investor protection that are specified in the investment agreement with the country of attracting investments. Because investors are allowed to choose between domestic courts and the international arbitration proceeding, though domestic courts are occasionally chosen, most investors prefer international arbitration proceedings. The reason is that, since domestic courts are more

likely to take sides of the country of attracting investments, it is hard to expect fair trails.

Therefore, the core of ISDS can be said to be the international arbitration proceeding, and the controversy over this rests on whether the investor-state arbitration proceeding is a fair and reasonable system. However, in the case of controversial investor-state arbitration of ISDS, because countries engage in arbitration as a sovereign entity based on the investment agreement, it is referred to as "investment arbitration" to differentiate it from international commercial arbitration.

Along with controversies over ISDS should be addressed first by differentiating between the substantial law and the procedural law. In particular, a caveat is that it is actually necessary to look into the ongoing controversy over ISDS by distinguishing it into the controversy over the substantial law and the controversy over the procedural law. In other words, as investor-state dispute settlement is a proceeding to settle disputes by examining whether there has been any violation of "substantive law obligations including obligations of investor protection (for instance, national treatment (NT) and most-favored-nation treatment (MFN), fair and equitable treatment, and expropriation and compensation" and "trade related investment measures (TRIMs)", those most controversial among these, such as indirect expropriation, are the problem of substantial law. It has developed from "regulatory takings" of the United States. "Expropriation" means that the government directly violates property rights of the individual (corporation), while "indirect expropriation" extends the concept of "expropriation" and includes cases where investors experience losses by the government policies without direct confiscation or nominal transfer by the government.

This paper puts forward opposition to the principle of justifying assumptions about the constructiveness and fairness of the practice of dispute resolution through investment arbitration.

First of all, the most essential rational to advocate the current investment arbitration mechanism is the problem of high possibility that trials in domestic courts are unfair. Because, as part of the country of attracting investments, domestic courts are prone to protect the country's own interest, it is hard for foreign investors to expect fair trials. Advocates therefore argue that investment arbitration is a neutral court with respect to both investors and countries of attracting investments, which can provide investors with fair trials. Though the concern over domestic courts' unfair treatment of foreign investors is an ostensibly valid argument to some extent, this cannot be a direct reason to justify adopting the current international arbitration proceedings. In other words, it also requires a demonstration that international arbitration proceedings are fair and reasonable. If the current international arbitration proceeding is very unreasonable and unfavorable to countries, this system also needs to be carefully approached. In addition, the most important reason to request using domestic courts is to respect legal sovereignty. Thus, if we suppose that we relinquish legal sovereignty of countries, then we need to consider what benefits countries obtain for this relinquishment. If there is no corresponding benefit given to countries, countries own rights should not be recklessly relinquished (Jansen, 2017; Chen et al., 2018).

The purpose for providing a high degree of protection to foreign investors by contracting investment agreements is based on the belief that such institutional mechanism can promote foreign investments for countries of attracting investments. However, there are both positive and negative views on this matter in various empirical studies examining whether investment agreements increase the foreign investment inflow, which therefore suggest no clear-cut answer to which argument is right. Furthermore, there are numerous drivers that increase the foreign investment inflow in addition to strengthening the protection for investors via investment agreements, which include invested countries' potential for economic growth, the size of markets, low wages, and abundant natural resources, and it is a very difficult task to empirically demonstrate what factors have affected corporations in their decision for investment advances and to what degree. In particular, it is even harder to find empirical studies showing that the introduction of investment arbitration has increased the foreign investment inflow. The case of China displays that investment agreements or the introduction of investment arbitration does not affect the increase of foreign investments to a considerable

extent. In other words, even though China does not provide a high degree of protection for investors, but rather made investment agreements containing several restrictions on investment arbitration proceedings, such as limiting arbitration subjects and compelling domestic administrative relief proceedings, China still attracts a greatest deal of foreign direct investment (FDI) in the whole world.

The ICSID proceeding currently adopted in investment agreements to settle disputes between investors and countries is a dispute settlement proceeding that is made to address disputes pertaining to commercial profits between parties—that is, commercial disputes. Nevertheless, current disputes in investment arbitration are disputes to address lawfulness of regulatory measures that countries have taken as a sovereign entity with regard to public interests such as environment, labor, water supply, real estate, tax, and mass communication policies (henceforth, such disputes are referred to as regulatory disputes). Such regulatory disputes are public law disputes, which, in terms of domestic laws, become subjects of trade administrative proceedings and are handled not in commercial arbitration courts but in administrative courts. Accordingly, as investment arbitration subjects are not commercial disputes, arbitrability (not every dispute is settled by arbitration, and each country's law regulates that only commercial disputes are settled through arbitration. Hence, every time the arbitration proceeding is used, it is examined whether arbitration is applicable.) may become problematic. In order to avoid this problem and utilize international commercial arbitration proceedings, properties of trade agreement disputes are legally forced to transform into commercial disputes by means of the rule "A claim that is submitted to arbitration under this Section shall be considered to arise out of a commercial relationship or transaction for purposes of Article 1 of the New York Convention".

As for the argument that investment arbitration is the global standard, the concept of the global standard is vague to begin with, and even if it is indeed the global standard, this does not mean that we have to adopt it. Moreover, the fact that the Australia-U.S. FTA allows investment disputes between investors and countries to be addressed in domestic courts of the both countries and excludes international arbitration proceedings adopted in the South Korea-U.S. FTA proves that this system is a system adopted by force to essentially maximize interests of capital exporting countries and their investors. This implies that, in the circumstance where investment arbitration had been challenged in the entire world since the effectuation of the NAFTA, the United States, who led the introduction of this system, itself acknowledged the criticism of the system by willingly abandoning the adoption of the system in the Australia-U.S. FTA. If it were indeed fair and reasonable system, advanced countries like the United States and Australia would not have abandoned it. Therefore, the investment arbitration system is never a dispute settlement proceeding that has been verified and stabilized internationally.

Today, a common standard of investment legitimacy is urgently needed, and require solving the problem of qualification and objectivity of arbitrators, transparency of the arbitration process. The investment-attracting states will understand the importance of public interests and politics, and so it is necessary to find a way to benefit both parties through cooperation and mutual trust. Moreover, continuous efforts by the international community are necessary to prevent such disputes and to resolve them rationally and effectively.

Reference

[1] Butler N. Non-Disputing Party Participation in ICSID Disputes: Faux Amici? Netherlands International Law Review, 2019. Vol. 66, Issue 1, P. 143-178. URL: https:/doi.org/10.1007/s40802-019-00132-8.

[2] Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), UN. URL: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/new-york-convention-e.pdf.

[3] Frequently Asked Questions - Arbitration under website: United Nations Commission on International Trade Law (UNCITRAL). URL: https://uncitral.un.org/en/texts/arbitration/faq.

[4] Geneva Protocol on Arbitration Clauses: E/AC.42/2 - Protocol on Arbitration Clauses, Geneva, 24 September 1923. URL: https://unctad.org/system/files/official-document/edmmisc232add37_en.pdf.
[5] Gerdy Kristin B. What is the difference between substantive and procedural law?. Pennsylvania: Perspectives: Teaching Legal Research and Writing (Temple University), 2000. Vol. 9. P. 1-4. URL: http://info.legalsolutions.thomsonreuters.com/pdf/perspec/2000-fall/2000-fall-3.pdf.
[6] History 1923 - 1958 of the New York Convention. URL: https://www.newyorkconvention.org/travaux+preparatoires/history+1923+-+1958; https://iccwbo.org/about-us/who-we-are/history/.
[7] International Chamber of Commerce (ICC) URL: https://iccwbo.org/dispute-resolution-services/.
[8] Karas M. ISDS Regimes and Democratic Practice: Creating Conflict of Interests between Governments, Investors and Local Populations. Croatian International Relations Review, 2019. Vol. 25, Issue 84, P. 36-52. URL: https://doi.org/10.2478/cirr-2019-0002; https://core.ac.uk/display/212496659.
[9] Nichols, S. Transnational Capital and the Transformation of the State: Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP). Critical Sociology, 2019. Vol. 45, issue 1, P. 137-157. URL: https://doi.org/10.1177/0896920516675205.
[10] Nikiema Suzy H. Best Practices: Indirect Expropriation. Canada: IISD, 2012. P. 5-11. URL: http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf.
[11] Theory of the Lex Mercatoria. URL: https://www.lawteacher.net/free-law-essays/commercial-law/the-theory-of-the-lex-mercatoria-commercial-law-essay.php.
[12] Van Harten, Gus. Judicial Supervision of NAFTA Chapter 11 Tribunals. Arbitration International. Volume 21, 2005. P. 495-496. URL: https://doi.org/10.1093/arbitration/21.4.493.
[13] Van Harten, Gus. Private authority and transnational governance: the contours of the international system of investor protection. Review of International Political Economy, Volume 12, Issue 4, 2005. P. 608-609. URL: https://doi.org/10.1080/09692290500240305.