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Challenges for International Dispute Resolution in the Global Financial Crisis, Part 1

This article is an edited version of a presentation to the Chartered Institute of Arbitrators (East Asia Branch) delivered in Hong Kong on 4 May 2009. In this part, the author discusses the influence of the global financial crisis on the increasing use of arbitration in determining disputes, particularly in the context of investor-State cases. Part II will appear in the October 2009 issue and will discuss changes that are necessary to the arbitral process to make it more responsive to users' needs.

Doug Jones

Introduction

The considerable growth in the use and popularity of alternative dispute resolution (ADR) as a means of resolving a vast array of commercial disputes is tribute to a growing recognition amongst the business community that it provides a flexible and effective alternative to costly and time-consuming litigation. 'ADR' refers to the range of binding and non-binding dispute resolution techniques available outside national courts. Of these, mediation and arbitration dominate[1]. ADR (in particular arbitration, the focus of this article) is not only a useful tool for resolving domestic disputes, but has also become the method of choice for resolving international commercial disputes.

Arbitration is not, however, without its complications. The decision to include an arbitration clause in a contract, or to rely on arbitration in the case of an investment dispute, should be an informed commercial choice. Due consideration should be given to the nature of the transaction, the nationality of the assets of last resort, the place(s) where resort may be had to the courts, and the particular process of arbitration contemplated for adoption.

Recent trends in ADR

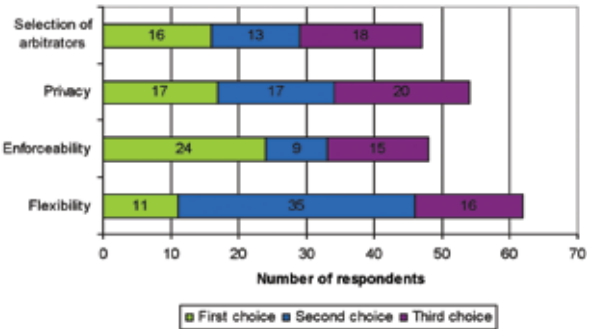
There have been significant fluctuations in recent years in the number of cases filed by parties to international transactions. Empirical evidence highlights this growth within both litigation and ADR. The two primary reasons for increased use of ADR are both major reforms to procedure (especially in arbitration) and the indirect consequences of the global financial crisis.

Party perceptions

The advantages of ADR are increasingly recognised on a global scale. ADR has come to be perceived as the primary dispute resolution tool and the first port of call should a dispute arise. Recent studies have indeed reiterated ADR's increasing popularity and have attempted to clarify the reasons for this increase.[2] In 2006 and 2008, PricewaterhouseCoopers LLP sponsored international arbitration surveys conducted by Queen Mary University of London in order to gauge how users of arbitration perceive the quality of its processes. The 2006 survey results show that the two primary factors favouring arbitration are its ability successfully to preserve business relationships and the wide enforceability of arbitral awards. Table 1 illustrates this preference.

These perceived advantages of international arbitration are encouraging commercial parties to avoid transnational litigation in favour of its more flexible alternative. Bjorn Gehle[4], in discussing the primary reasons behind this move towards relying on international arbitration[5], asserts that the main concerns of litigants are excessive time and costs, the lack of familiarity with foreign court procedures, language barriers, a

Table 1: Perceived advantages of international arbitration



Source: School of International Arbitration, Queen Mary University of London/ PricewaterhouseCoopers, International arbitration: Corporate attitudes and practices (2006), p 3[3]

lack of confidentiality and a fear that some countries may lack an impartial judiciary. These reasons, together with potential difficulties in enforcing foreign judgments, have sparked a movement away from transnational litigation towards more practical international ADR methods.

Filings in international institutions

The world's largest international arbitration bodies have each released statistics illustrating the increasing use of arbitration as a dispute resolution tool. Tables 3 and 4, Annex A and the graph at Annex B highlight in detail the growth of international arbitration. Some of the most notable figures include (i) a 38% increase in international arbitration cases filed at the International Centre for Dispute Resolution (ICDR) in the USA since 2000, (ii) an 81% increase in the United Kingdom at the London Court of International Arbitration (LCIA) during the same timeframe, (iii) a 22% increase at the International Chamber of Commerce (ICC) since 2000, and (iv) a doubling in the number of arbitration cases filed at the Hong Kong International Arbitration Centre (HKIAC) since 2000. These figures alone emphasise the rapid growth occurring within the international arbitration arena.

This influx of filings over recent years can perhaps be explained by the growing knowledge and acceptance of the benefits of ADR. However, what effect has the credit crunch had on the number of international cases filed? Is the sudden increase in filings since 2008 related to the state of the global economy?

Table 2 indicates the percentage increases in the major arbitral institutions globally. It is evident from this data that there have been significant increases in the number of international arbitrations filed in these institutions over the past 12 months, notwithstanding the effects of the credit crunch. One can reasonably infer from this information that the credit crunch has impacted positively on both the use of international arbitration and the ADR scene at large. The possible reasons for this are discussed below:

Why the credit crunch may have caused an increase in ADR

The following are possible reasons.

(i) The rise in investor-State disputes

Broadly speaking, the credit crunch has caused governments to take action in order to stimulate their respective economies. Some actions undertaken by governments around the world may breach international investment treaties. Foreign investors may come from a State that is privy to such a treaty which may potentially entitle them to damages if the government breaches such an agreement.

(ii) Demand for legal dispute resolution has traditionally been counter-cyclical

In boom times, generally speaking, failed deals are put to one side and accepted as the cost of doing business. When the economy contracts, however, companies are more likely to attempt to recoup their losses. The logic behind this is that deals become more scarce and companies are more inclined to take action to recover any losses that they may have incurred.

(iii) Incomplete contractual agreements/ termination of contracts due to inability to cover costs

In times of economic uncertainty, there are often difficulties in obtaining funding for major projects. This will have a significant effect on the ability of contractors and sub-contractors to meet their commitments. It is probable (and in fact becoming evident) that this will lead to a cutting back of costs within projects, delayed payments and eventually terminations. The natural knock-on effect has led to an increase in the number of construction and major projects-related arbitrations heard over the past six months.

(iv) Increased number of insolvency disputes

The credit crunch has caused an increasing number of insolvencies affecting both companies and individuals worldwide. In Australia, the Australian Securities & Investments Commission (ASIC) has released statistics showing a 30.16% increase in insolvency appointments from the first half of 2008 to the second half of the year.[6] The UK government has also released data from the fourth quarter of 2008 indicating an increase in compulsory liquidations of 51.6% on the same period in 2007.[7]

Historically, times of recession often result in large increases in the number of insolvencies which, in turn, increase the amount of litigation. Recent years have, however, seen an increased use of arbitration agreements in commercial contracts. Accordingly, given the current economic climate, parties to agreements to arbitrate are

Table 2: Comparison of the major arbitration institutions (% increase of number of international arbitration cases filed from 2007-2008)

Arbitral Institution	2007	2008	% Change (2007-08)
HKIAC (China)	448	602	34.38%
AAA-ICDR (USA)	621	703	13.20%
ICC	599	663	10.68%
LCIA (UK)	137	158	15.33%
SCC (Sweden)	81	85	4.94%
SIAC (Singapore)	70	71	1.43%
BIAC (China)	37	59	59.46%

Source: Singapore International Arbitration Centre, Facts and Figures: Statistics (2008) - http://www.siac.org.sg/facts-statistics.htm as at 26 February 2009

likely to find themselves dealing with insolvent companies or individuals.

(v) Arbitration in preference to litigation in times of economic uncertainty

Given the state of the current economic climate, international investors are increasingly looking to arbitration in order to avoid the perceived uncertainty of litigation in foreign court systems. Not only are the length and cost of litigation in a foreign State considered uncertain, but also the impartiality and quality of the judiciary are, at times, questionable. Accordingly, there is a notable increase in the number of commercial contracts containing arbitration clauses as investors perceive this process as more 'certain'.

Annexes A and B respectively give a full illustration of the increase in the number of international arbitrations filed over the past decade and highlight the significant growth in the number of cases filed in recent years.

A rise in Investor-State disputes?

The international economy has been under great pressure in recent years. Government policies are often the first port of call to stimulate the economy and fast-track these pressures towards economic expansion. There is however, contention surrounding the relationship between international investment protection and the State's power to handle economic crises, eg with regard to such actions as the guaranteeing of deposits in banks and the protection of domestic manufacturers. Governments must ensure that they do not breach international investment treaty obligations.

An investment treaty is a legal agreement between two countries that establishes a reciprocal arrangement encouraging foreign investment. It acts as a mechanism to protect foreign investors who wish to invest in other countries involved in such an agreement in order to encourage investment in those countries.

The development of bilateral investment treaties (BITs), multilateral investment treaties (MITs) and free trade agreements (FTAs) worldwide has been largely motivated by a desire to protect and promote foreign investment. They are increasing in importance and popularity as the basis for resolving investor-State disputes. They have a number of advantages when compared with previous methods that relied on the intervention of the investor's home State or recourse to national courts.

To claim protection under an investment treaty, a party must satisfy two essential criteria in order to be classified as a foreign 'investor'. Firstly, an investor – who may be either a foreign natural person or a foreign corporation – must show that it bears the nationality of one of the countries that is a party to the treaty. Secondly, the commercial activity undertaken within the host State must be an 'investment'. Most BITs define an investment as 'any kind of asset'. Thus, for example, a company in country A cannot merely export products to country B and claim that it is an investor in country B. Foreign investors who satisfy these two criteria may be eligible for protection under international treaties.

Common provisions in BITs

BITs vary in scope and in the nature of their protection. They afford common standards of protection that include:

(i) *National treatment clauses*, which require that the host State treat foreign investors no less favourably than domestic investors.

(i) *Most favoured nation clauses*, which ensure that the host State treats parties to one treaty no less favourably than the treatment provide to parties under other treaties.

(iii) *Fair and equitable treatment clauses*, which require the host State to avoid subjecting the investor to arbitrary or fraudulent treatment. There may also be a requirement to maintain a stable business environment that is consistent with reasonable investor expectations.[8]

(iv) *Expropriation (nationalisation) clauses*, which protect foreign investors by ensuring that the host State may not arbitrarily take their investments without prompt payment of adequate compensation. Expropriation is not limited to the seizing of assets; it may also include changes in law or policy that substantially detract from the value of an investment.

(v) *Umbrella clauses*, which provide additional protection to investors in that they elevate any breaches, by the host State, of its contractual obligations to the status of a breach of international law. Such clauses are intended to increase the motivation for host States to avoid breaching their investment treaty obligations.

Potential breaches of treaty obligations

The economic climate has caused governments to act favourably towards protecting domestic industries in order to stimulate the economy. Historically (and also recently), in times of economic uncertainty, governments have been forced to nationalise assets and industries, especially in developing countries. Issues may arise where foreign investors are treated unequally to domestic investors because of the emergency nationalisation process.

This may cause investors to look to BITs, MITs and FTAs for protection. Past examples where such issues have arisen during times of economic instability include the large scale investor-State disputes that arose as a result of government action surrounding the Asian financial crisis in 1997-1998[9] and a number of petro-dollar project disputes arising from the Middle East oil crises in the 1970s.[10]

Examples of government regulation in recent years include the following.

(i) *Guaranteeing deposits in domestic banks*

This example most recently occurred in both the US and Australia. In late 2008, Australian Prime Minister Kevin Rudd announced that the Federal Government would guarantee all deposits in Australian banks, building societies and credit unions for the following three years. This policy claims to guarantee all money that Australian banks

borrow internationally. It was later amended to guarantee deposits at *all* banks (whether domestic or international). Similar, yet more extreme, 'bail-out' packages were also offered by the US Government to domestic financial institutions.[11]

(ii) *Rescue packages for domestic manufacturers*
Many governments have provided grants and implemented trade barriers in an attempt to 'rescue' domestic industries. For example, in an attempt to stimulate the industry and to prevent job losses, the Australian Federal Government issued a $6.2 billion investment plan for domestic car manufacturers.

Whilst these actions may not have directly breached international investment treaties, caution should be taken to ensure that there is no indirect breach of treaty obligations.

A clear-cut example of where a State would be in breach of its obligations would be where it has directly breached an expropriation clause by taking control of a foreign investor's assets. Most investment treaties entered into by Australia only permit expropriation when it is for a public purpose, under due process of law, non-discriminatory and accompanied by the prompt payment of adequate compensation.

Contention arises, however, where a government action may have an indirect impact on the value of a foreign investor's assets. 'National treatment clauses' and 'fair and equitable treatment clauses' impose obligations on governments to treat foreign investors equally and no less favourably than domestic investors. Disputes may therefore arise where governments favour domestic investors in order to stimulate economic growth in times of economic crisis. This *prima facie* appears to be a direct breach of treaty obligations. Whether the host State is in breach of its international obligations will depend largely on the nature and scope of the treaty itself. However, are governments exempt from these conditions in times of economic instability? Or, must they pay compensation for breaching obligations owed to foreign investors?

International treaties often contain emergency clauses that allow governments to take certain measures where necessary. Furthermore, investor-State arbitral tribunals have held that international investment treaties do not wholly curtail a State's power to regulate in the public interest. It has been argued that the "State has the right to adopt measures having a social or general welfare purpose."[12] It should be noted, however, that tribunals have recognised that the State can go too far by completely dismantling the very legal framework constructed to attract investors.

Evidence of a severe economic crisis could therefore justify reliance on necessity under customary international law and the relevant BIT emergency clause. In fact, there is arguably a requirement to maintain a stable business environment for investors that may at times involve measures to stimulate the economy.

One could logically infer that the aforementioned activities undertaken by governments around the world may cause concern to foreign investors, which may in turn encourage them to pursue an action against that State. The statistics released by the International Centre for Settlement of Investment Disputes (ICSID) (see Table 3 below) illustrate the increase in the number of investor-State disputes throughout 2008.

The sustained growth in ICSID's caseload continued during the course of the 2008 Fiscal Year (FY). ICSID recorded its highest yearly number of cases ever administered in a one-year period, with its number of pending cases rising by 12% year-on-year and reaching 145 cases.[13] Another record 48 proceedings were instituted throughout the year.[14] 28 proceedings were concluded during FY2008 and a record 17 awards were rendered.[15] These unprecedented statistics illustrate that investors are growing increasingly concerned with international commercial agreements and are accordingly taking action to recoup any losses.[16]

Table 3: Number of international arbitration cases filed with ICSID (2006-2008)

	Year		
	2006	2007	2008
Cases administered	118	130	145
% increase	15%	10%	12%

Source: ICSID, Annual Report (2008)[17]

Investor-State arbitration has become a major growth area in dispute resolution. The question is whether its proliferation will lead to its demise, because of the unexpected effect on governments and public concern about transparency, accountability and consistency. One may therefore legitimately ask: will States retreat to the days of State protection of investors, or is the genie out of the bottle? The answer appears to be that it is unlikely that promotion of trade and increases in the efficiency of economies will be serviced by a retreat to the past. This is not to say, however, that there should not be attempts to address quickly the justified criticisms of investor-State arbitration. It is a question of tailoring procedures to be more effective in the context of investor-State arbitration, through addressing concerns about transparency and consistency. Moreover, awareness by investor and State communities about relevant processes needs to be enhanced.

Furthermore, the fact that there has been very little uptake of ADR processes other than arbitration in investor-State matters indicates that this is an area where substantial reform is possible. To be successful, non-arbitral methods must address the same concerns that face the use of arbitration in resolving investment disputes. Non-arbitral ADR mechanisms will probably only be effective if agreements actually provide for them. Failing this, voluntary participation by States will be unlikely, given the accountability problems involved in resolving these disputes by negotiation behind closed doors.

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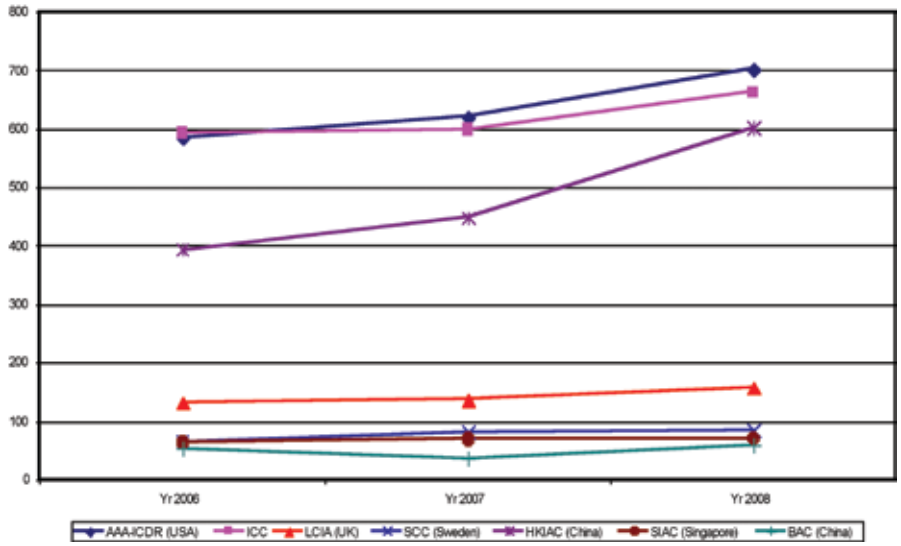
Annex A
Number of international disputes over time



Annex B
Comparison of international arbitration institutions (number of international arbitration cases filed 2000-2008)

Arbitral Institution/ YEAR	2000	2001	2002	2003	2004	2005	2006	2007	2008
AAA-ICDR (USA)*	510	649	672	646	614	580	586	621	703
ICC	541	566	593	580	561	521	593	599	663
CIETAC (China)	543	562	468	422	461	427	442	429	548
LCIA (UK)	87	71	88	104	87	118	133	137	158
SCC (Sweden)	66	68	50	77	45	53	64	81	74
SIAC (Singapore)	41	44	38	35	48	45	65	70	71
KCAB (South Korea)	40	65	47	38	46	53	47	59	47
BAC (China)	11	20	19	33	30	53	53	37	59
VIAC (Vietnam)	23	16	19	16	32	22	23	21	#
JCAA (Japan)	8	16	8	14	15	9	11	15	12
BCICAC (Canada)	3	4	4	4	4	2	5	3	#
KLRCA (Malaysia)	20	3	3	5	3	7	1	2	5
PDRC (Philippines)	0	1	2	0	0	0	1	1	#
HKIAC (China)^	298	307	320	287	280	281	394	448	602

Source: Singapore International Arbitration Centre, Facts and Figures: Statistics (2008) - http://www.siac.org.sg/facts-statistics.htm as at 26 February 2009.
** These figures are for international disputes through the ICDR (not including American disputes through the AAA)*
^ HKIAC does not distinguish cases administered by them and those for which they only provide physical services.
 # Figures are not available.

1 *Editorial note*: In Australia, as in Canada and the US, ADR includes arbitration.
2 See, for example, School of International Arbitration, Queen Mary University of London/PricewaterhouseCoopers, *International arbitration: Corporate attitudes and practices* (2008) - http://www.pwc.com/extweb/pwcpublications.nsf/docid/00D10D879C92892A802574630030F7BB/$file/international_arbitration.pdf.
3 Cited in Bjorn Gehle, *Making Arbitration More Efficient*, a paper presented at the Australian Centre for International Commercial Arbitration conference, 'International Commercial Arbitration: Making it Work for Business' (November 2008). The survey report may be downloaded at http://www.voldgiftsinstituttet.dk/dk/Materiale/Files/International+arbitration:+corporate+attitudes+and+practices+2006.
4 Special Counsel, Clayton Utz, Sydney.
5 Gehle, *op cit* (note 3), p 5.
6 ASIC, *2008 Insolvency Statistics* (2008) - http://www.asic.gov.au/ asic/asic.nsf/byheadline/2008+insolvency+statistics?openDocument as at 26 February 2009.
7 The Insolvency Service, *Policy Directorate: Statistics* (2008) - http://www.insolvency.gov.uk/otherinformation/statistics/200902/index.htm as at 26 February 2009.
8 See for example *LG & E v Argentine Republic* (ICSID Case No ARB/02/1, 2003); *Tecnicas Medioambientales Tecmed SA v United Mexican States* (ICSID Case No ARB (AF)/00/2, 2003), para 154.
9 For example, *Karaha Bodas Co LLC v Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 313 F 3d 70 (2d Cir, 2002). This case was considered a 'super dispute' and arose because of the Indonesian Government's nationalisation of its energy providers.
10 See, for example, *Kuwait v American Independent Oil Co (Aminoil)*, 21 ILM 976 (1982).
11 An interesting point to note is that *most* BITs with the US effectively exclude banks from the agreements. This grants the US Government the right to make changes to its policies with respect to its banks (notwithstanding the possible impact on foreign investors) without fear of breaching its treaty obligations.
12 *LG & E v Argentina* (note 8), para 195.
13 http://icsid.worldbank.org/ ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnualReports# as at 26 February 2009.
14 These included the registration of 31 new requests for arbitration and one new request for conciliation, bringing the total number of cases registered since ICSID's establishment to 268.
15 Nine upheld the claims in full or in part, six dismissed all claims on the merits or on jurisdictional grounds, and two embodied the parties' settlement agreements.
16 ICSID, *op cit* (note 13).
17 *Ibid.* See also the 2006 and 2007 annual reports.