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FEATURE ARTICLES

Investor–state arbitration in the ASEAN Economic Community

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The free flow of investment is a key component of the ASEAN Economic Community (AEC). Higher levels of investment between ASEAN member states will increase the likelihood of disputes arising between private investors and governments. In response, the ASEAN Comprehensive Investment Agreement (ACIA), a multilateral treaty that provides the legal foundation for the AEC's liberalised investment regime, establishes an investor–state dispute resolution mechanism ('ISDR mechanism'). The ISDR mechanism can be a useful, albeit limited, tool for resolving disputes between investors and ASEAN governments.

This article examines the ISDR mechanism and discusses both its merits and limitations.

How the ISDR mechanism works

Scope of claims

An investor can make a claim under the ISDR mechanism if a host state breaches its ACIA obligations and the investor incurred loss or damage arising from the breach. The ACIA's host country obligations are those commonly found in conventional bilateral investment agreements. These include the following:

- *National treatment*: other ASEAN-based investors must be given the same treatment as domestic investors.
- *Senior management*: a host country cannot require its nationals to be appointed as senior management in an investment vehicle (but can require that locals comprise the majority of the board of directors).
- *Fair and equitable treatment*: other ASEAN-based investors must receive equitable treatment by the host state (eg, due process, security, etc).
- *Compensation*: a host country cannot discriminate against ASEAN-based investors with respect to compensation arising from losses due to armed conflict or civil strife.
- *Free flow of capital*: a host country cannot restrict the free flow of capital in relation to an investment project.
- *No expropriation*: an investment cannot be expropriated or nationalised (except under limited circumstances).

Despite being called 'comprehensive', the ACIA in fact applies to a limited number of industries. These are: manufacturing, agriculture, fishery, forestry, mining, and services related to these sectors. The ACIA's signatories have also submitted extensive reservations that further limit the scope of the treaty's coverage.

Additionally, only certain types of investors are eligible to receive the ACIA's benefits. Judicial persons are considered investors; natural persons are not. Further, investors that are owned or controlled by a non-ASEAN national and do not have substantive business in their 'home' ASEAN state are ineligible.

Pre-claim conciliation

The ACIA requires disputing parties to first seek conciliation. The investor must serve the host state with a written notice. The burden is on the investor to present the legal and factual basis for the dispute. The investor can then submit its claim for arbitration if the dispute cannot be resolved within 180 days of the host state's receipt of the notice.

Choice of arbitration and governing law

Investors can choose where to submit their claims. The first option is a host state court or administrative tribunal. ASEAN countries

are, however, at varying levels of development regarding judicial independence and the rule of law. Local courts may be biased toward the state and susceptible to influence, corruption or lobbying.

The second option is to arbitrate under the International Centre for Settlement of Investment Disputes (ICSID), or the ICSID Additional Facility Rules (Additional Facility Rules). This is a favourable option for investors, as the ICSID was created for investor–state arbitration. Established in 1965, it has significant experience handling investor–state disputes. Moreover, the ICSID's awards have 'final judgment' status in the courts of countries that are members of the Washington Convention, the multilateral agreement that created the ICSID.

To arbitrate under the ICSID, ACIA requires that both the host state and investor's home country are parties to the Washington Convention. However, Laos, Myanmar, Thailand and Vietnam have not yet acceded to the Washington Convention. For cases involving these countries, arbitration under the Additional Facility Rules may be possible. The ACIA allows arbitration under the Additional Facility Rules when either the host country or the investor's home country are members of the Washington Convention. As such, a dispute between a Thai investor and the government of Myanmar, for example, would not be eligible for arbitration under the ICSID or the Additional Facility Rules.

The third option is to arbitrate at a tribunal under the Rules of the United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL tribunals have presided over many investor–state arbitrations, including in Southeast Asia. Moreover, UNCITRAL tribunals have awarded significant damages to investors in a number of cases, making it another viable choice for investors.

The investor's final option is to arbitrate at an ASEAN regional arbitration centre. The default centre is the regional centre for arbitration at Kuala Lumpur. Most ASEAN countries have commercial arbitration centres. However, their experience in handling investor–state arbitration is limited. Despite this, regional proximity could keep costs reasonably low. Parties may also be more familiar with local centres.

Arbitrators

The arbitration tribunal comprises three arbitrators, though the parties may agree on a different number. Each party appoints one arbitrator. The third arbitrator must be mutually agreed on by the parties. Importantly, the third arbitrator, who is also the chairperson of the tribunal, must be from a non-ASEAN country. The third arbitrator also cannot have permanent residence in either the host country or the investor's home country. Decisions are reached by majority vote and are binding.

Awards

Awards for damages are comprised of monetary compensation with interest or restitution of property. Punitive damages are prohibited. A party can enforce the award after it is apparent that the losing side will not seek revision or annulment proceedings. Enforcement can also take place after such proceedings are complete. Each ASEAN state is required to allow for the enforcement of an award in its territory.

Merits

The ISDR mechanism can boost investor confidence by making available impartial legal means to resolve disputes. Governments have inherent advantages when dealing with foreign investors. Ministries can deny licences and justice, as well as seize assets. If an investor complains, they may no longer be welcome, or even subject to judicial or extrajudicial attention. Requiring governments to explain their actions before a neutral arbitration body is beneficial for the investment environment and the rule of law. This adds to investor confidence and fosters regional investment.

Additionally, the ISDR mechanism can expand the pool of investors to small and medium-sized entities. If a foreign investor faces unfair treatment by a host state – and arbitration is not an option – an investor's only recourse may be to ask their home country to assist through diplomatic channels. This option is generally available only to the largest and most influential companies. Investor–state arbitration, however, allows smaller-sized entities to seek legal recourse, adding to investor confidence.

The ISDR mechanism also assists to remove politics from investor–state disputes. Without the arbitration provision, an investor's home state may have to support a claim by diplomatic or economic pressure. However, the ISDR lessens the risks associated with such 'state-to-state' confrontation.

This is consistent with the overall ASEAN goal of establishing an integrated economic 'community'. As such, political factors may not play a role as to how a dispute is resolved. This idea is reinforced by the use of the third 'non-ASEAN' arbitrator. The appearance of neutrality serves to give the tribunal and the ISDR mechanism greater legitimacy.

Limitations

A major limitation of the ISDR mechanism is that it is 'tied at the hip' to the ACIA. Since the ACIA covers a limited number of industries, so does its dispute resolution mechanism. And when the reservations are included, the actual areas of investment that can be brought to arbitration are even more restricted. This begs the question of whether coverage is so narrow that the ISDR mechanism is rendered impractical.

The ISDR mechanism is also untested. The ACIA came into effect in 2012, but to date no claims have been brought. It is therefore uncertain how the mechanism would be practically applied. There are no precedents to assist future cases. However, two ASEAN-related cases were brought under ACIA's 1987 precursor, the Agreement for the Promotion and Protection of Investment Protection: *Yaung Chi Oo Trading Pte Ltd v Myanmar* and *Cemex Asia Holdings Ltd v Indonesia*. While no damages were awarded in these cases (*Yaung Chi Oo* was decided on jurisdictional grounds and *Cemex Asia Holdings Ltd* was settled), the fact that they were brought shows that an ASEAN-based investor–state arbitration mechanism can work.

Another challenge for the ISDR mechanism is enforcement of arbitral awards. Enforcement of an award against a sovereign state is inherently burdensome. This is true not just in the ASEAN region, but for all investor–state disputes. And enforcing an award in a host state poses particular difficulties. An investor would generally have to seek enforcement in a domestic court. The court may be reluctant or legally precluded from enforcing the award against its own government.

Investors have other options available, but none too favourable. For instance, an investor can try to settle with a government instead of enforce the award. However, this would almost certainly result in a significantly reduced payment (if a settlement is agreed to at all). Alternatively, an investor can seek enforcement of a host country's assets in a third country. While this has been done, it is challenging, as state assets can be subject to immunity. Additionally, the third country may be reluctant to enter into a diplomatic fray with the host country.

Conclusion

The ISDR mechanism has the potential to be a useful tool for resolving disputes between investors and ASEAN governments. The availability of impartial legal recourse can foster the confidence that investors need to do business abroad. Such confidence would, of course, be further strengthened if a case is brought to show that the mechanism works. As the AEC comes to fruition and investment increases, it may only be a matter of time.

The ISDR mechanism can also serve as a model for future investor–state dispute resolution in ASEAN. While the AEC is to become effective in 2015, it will take much longer for the 'free flow of investment' to become a reality. The AEC is a work in progress, and so is its investor–state dispute resolution mechanism. On balance, the ISDR mechanism is beneficial to ASEAN's economic development and the rule of law in the region.

Note

1 This summary is designed to provide general information only and is not offered as specific advice on any particular matter.