

# Materialisation of the Concept of Good Governance by Effective Investment Dispute Resolution in the European Union

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## ABSTRACT

The concept of good governance constitutes a wide perspective for academic discussion because it provides a substantial theoretical background for settling many practical problems faced contemporarily by the EU. The basic assumptions of good governance have basically remained unchanged since the 90's, when the concept was introduced by the World Bank. Notably, the scholarly discussions these days reveal new facets of the said concept, when related to specific domains. The paper discusses the application of the specific elements of the concept of good governance in the field of the international investment law. Specifically, it seeks to demonstrate that the concept of good governance regulates the issue of international investments in that, among others, it requires the application of the alternative dispute resolution in order to make the investment law enforceable in the best possible way.

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## 1. INTRODUCTION

Good governance constitutes a key element which influences the rate of investments in the European Union. In order to decide on the localisation of the new projects, foreign investors carefully verify the political situation of the country in which they plan to invest and they keep track of the governmental attitude towards the foreign investors. They investigate the administration procedures which affect the business environment of the country with special consideration of the potential obstacles which may arise in relation to the state procedures. Consequently, they also focus on the potential disputes related to specific phases of the investment process.

It needs to be said that in view of the above facts, the existence of the effective court system is one of the key factors which have impact on the rate of investments in the European Union. Therefore, among others, transparent and predictable judicial proceedings which may be initiated in order to settle the disputes in question constitute a major element of the effective dispute resolution system. However, the courts cannot be considered to be the only institution which is responsible for resolving the investment disputes. The highly complex character of the said type of disputes and the necessity to have the sector-related expertise make the task a challenge for judges. Additionally, high legal fees and long-lasting procedures which withhold the investment process discourage investors from taking legal actions before the state courts.

The possible hypothesis here is that the judicial system is more effective when it is supplemented by some alternative frameworks which are supposed to complement all the

deficiencies of the court system. Specifically, the article aims at examining the hypothesis that the existence of the alternative dispute resolution mechanism, in particular the arbitration schemes, plays a significant role in materialising the concept of good governance. Before the relevant arguments are analysed the author will embark on the task of presenting the mainstream assumptions of good governance that are deemed to be crucial for the investment processes in the European Union. Further, the author will focus on discussing that court and out-of-court procedures which constitute a vital element of the effective dispute resolution system, determining the materialisation of concept of good governance. Finally, the author will elaborate on the statement that providing the out-of-court mechanism is crucial for shaping the investment-friendly environment in the European Union.

## **2. GENERAL REMARKS ON THE CONCEPT OF GOOD GOVERNANCE**

The good governance is not a new concept since it has been in the focus of interest of various institutions for more than 20 years. The concept was formulated by the World Bank in 1991 according to which governance must extend “beyond the capacity of public sector management to the rules and institutions which create predictable and transparent framework for the conduct of public and private business and to accountability for economic and financial performance.” The World Bank placed great emphasis on the three dimensions of the concept: (i) accountability, (ii) predictability and legal framework for development as well as (iii) information and transparency.

The first dimension is considered at the macro- and micro-level. At the macro-level accountability refers to the public authorities which shall bear the financial and economic responsibility for their actions. At the micro-level, accountability relates to the public affected who shall be encouraged to participate in the governmental actions and to articulate their interests. As it will be demonstrated below, accountability at the micro-level plays significant role for the participation of the beneficiaries and this approach is developed further due to its influence on the promotion of the investment process in the EU.

On the other hand, predictability and the legal framework which are considered to constitute the second dimension mean that the specific rules and regulations shall be clear and applied by impartial authorities who have limited capacity as regards the scope their actions. Such approach helps to assess the business risks, to lower the transaction costs and to reduce the governmental arbitrariness. This is particularly important for the private sector players, such as investors who are interested in maximising the profits and reduction of costs.

In order to apply the concept of good governance both of the above mentioned elements must be supplemented by the access to the information from the public and private sources and by the transparency of decision-making process. It shall be stressed here that accurate information about the economy, market conditions and intentions of government “critically affects the efficiency and competitiveness of the private sector.” On the other hand, transparency of the decision-making process is indispensable to reduce the rate of corruption.

Although the concept of good governance coined by the World Bank evolved in 1990’s, its general assumptions remained unchanged (Maldonado, 2010). In the latest literature of the subject it is emphasised that the key issues related to the concept of good governance are still on the top of the agenda of the EU institutions. Therefore, it seems to be justified to refer to them nowadays when applying the principles of good governance to the activities of the private sectors, such as investment market of the European Union.

## **3. APPLICATION OF THE BASIC PRINCIPLES CONNECTED WITH THE CONCEPT OF GOOD GOVERNANCE TO THE INVESTMENT SECTOR**

Undoubtedly, public policies and actions undertaken in order to implement the principles of good governance by public authorities affect the investments market in the EU member states. Therefore, their application in this area has a considerable influence on the attractiveness of the investment location. The basic elements of the concept of good governance mentioned above, such as (i) *predictability* and (ii) *transparency* of law, (iii) *accountability* of public institutions which deal with investors and (iv) *participation* of the private sector in the implementation of the policy decisions which reflect investors, remain up-to-date, although there are many new interpretations made by international scholars fitting in the specific conditions characteristic for a given investment environment. In what follows some remarks regarding this interpretation shall be presented.

### **3.1 Predictability of policy and legal framework**

From the perspective of the investors who locate their projects in the EU, *predictability* means that there must be a consistent policy and precise provisions of law governing the investment process in the respective member states. It implies the existence of comprehensive legislative framework encompassing the investment which is deprived of the administrative discretion. Individual decisions, left at the authority's discretion and issued only as a result of the parties negotiations, are clearly contrary to the guideline of *predictability*.

In order to consider the legal framework is predictable, it must follow the market realities. In case when the existing law is not sufficient to regulate appropriately the current investment procedures taking place in a specific member state, the government shall initiate the change of such provisions and ensure that the new regulations would be adapted to the current market situation. It is particularly important for the investment law not to fall behind with the practice. Otherwise the enforcement of such obsolete law would be difficult.

The notion of *predictability* refers not only to the existence of rules and regulations but also to their fair and clear application by relevant national authorities. In this respect law shall regulate the procedure in which administrative bodies issue the decisions. In case of the disputes arising out of or in connection with the investments, predictability requires that national courts should adjudicate coherently, that is in line with the clear legal framework.

Next, in order to state that law affecting the investment process is predictable, it should be made relatively simple and comprehensible for the market players. In particular, the procedure of the application for necessary permissions shall be short and lacking bureaucracy. The reduction of the time necessary for the formalities related to the investment process enables the investors to lower the costs and therefore it influences the investment attractiveness of the specific member states. The existence and the application of the procedures which are clear and easy to follow prevents the investors from ignoring the law and helps them to avoid corruption in this field.

### **3.2 Accountability of the public authorities**

In order to make the public authorities accountable for their actions which affect investors, it is crucial to define the scope of their responsibility. To this end it is indispensable to create a clear legal framework explicating for what and to whom the public authorities are responsible. Those issues shall be regulated both in the procedural and substantive provisions of law.

Consequently, the law must provide a clear structure indicating to the investors the possibilities of appeal from the unlawful administrative decisions. It implies that each member state should adopt a set of laws which would enable the investors to monitor the administrative procedures at each stage. Further, it needs to be determined which rules and policies those authorities shall apply and enforce within the given investment procedure. Without it the investors' right to appeal would be just a dead letter of the law.

Moreover, *accountability* means that there are preventive measures enacted which shall discourage the public authorities to act behind the law. An example of such means may be the anti-corruption legislation which helps to detect the offences committed by the public authorities within the investment process and provides appropriate sanctions for the corrupted authorities.

### **3.3 Transparency of the decision-making process**

*Transparency* refers to the governmental policy and actions which shall be open to the public. Interested investors shall be able to get information on the current and planned undertakings in the field of investment policy in order to decide on the location and to estimate the profitability of the project.

Moreover, the principle of *transparency* refers to the national investment laws which shall be translated into the internationally recognised languages. It is still problematic for the foreign investors to understand the law and procedures connected with the investment process if they are available only in the national languages of the respective member states. Lack of legal translation generates additional costs for the investors and creates delays, which finally discourages them from investing in such member states.

It is also worth pointing out the influence of media and public debates on the *transparency* of the investment process. Nowadays they not only serve the purpose of advertising the locations but also and above all they are the source of the knowledge on the government attitude and policy towards investments in the member states.

### **3.4 Participation of the private interests groups in governance**

Good governance requires cooperation between the government, civil society and various business groups. It is displayed in the form of consultancy which takes place at each stage of the policy development and enactment of the legislation. The dialogue between the entities involved is necessary to consider the different interests in the policy - and law-making process.

Such consultations and debates are beneficial for all the groups involved. Thanks to them governments are informed on the current needs of the investors. The consideration of these needs influences the quality of the decisions issued and enables the government to create the investor-friendly image which supposedly makes the member state attractive for foreign investor. In turn, investors share the responsibility for the governmental policy and actions undertaken after the consideration of their interests.

Debates initiated by the government with different groups of interests shall be formally organised and particular members of such consultations (or their representatives) shall be formally informed about the event. Otherwise the policy makers and legislators may face the charges that consultations took place only pro-forma and the real needs of the private sector were not considered. Therefore, it is recommended to involve the investors organisations and associations (if such exist in the given member state) to represent the relevant communities during consultations.

## **4. GOOD GOVERNANCE AND THE SYSTEM OF JUSTICE**

In order to ensure the predictability and stability that is necessary in the investment process there must exist a system of justice which will provide proper application of the rules of law, both by the governments and the investors. Without such control the application of the particular elements of good governance would not be possible. Traditionally, the justice system was, above all, associated with the activities of the courts. However, it will be discussed in the next point that there is also a place for out-of-court bodies whose activities

may have tremendous influence on the implementation of the concept of good governance to legal orders of the member states.

Effective system of justice was considered as a vital element of good governance already in 1990's. The emphasis was put on the activity of "independent and credible judicial system which assures that the private contractual agreements are respected and that the law is applied uniformly by the executive." According to the first aspect, the role of the judiciary consists in the enforceability of the contracts which would not be voluntarily executed without the court intervention. This task would not be fulfilled if the adjudication on the contracts enforcement would be delayed or connected with high court fees. The second point concentrates on the judicial control over the public administration which can be exercised effectively only if the judicial system has strong position.

The World Bank stressed out the need of legal reforms aiming at the improvement of the efficiency of institutions which administer laws of significance to the economy. As an example of such reform this institution proposed providing trainings on the business and economic law designated for the judges, which shall help them to take into account the market-related factors in the process of adjudication. Competence and effectiveness of the judges have a strong impact on the costs of transactions which can be considerably reduced if the judicial system is efficient. In turn, it assures the investors that the situation of the member state in which the project shall be located is reliable, which attracts the new transactions.

## **5. GOOD GOVERNANCE AND ALTERNATIVE DISPUTE RESOLUTION**

In line with the concept of good governance conflicts may be resolved not only by judges but also by extra-judicial bodies. Already in 1990's the World Bank noted the need to encourage some extra-judicial means of settling the disputes (in particular commercial arbitration) in order to help the overworked judges and shorten the time needed for the resolution of conflict. The role of the alternative dispute resolution methods in the application of the concept of good governance was appreciated by the literature of the subject after 1990's (Erbe, 2004).

In the field of investment, arbitration turned out to be specially interesting for the investors. It is commonly preferable because, compared to the litigation before national courts, it brings a lot of advantages which are discussed below.

In the first place arbitration enables the parties of the dispute to have the flexibility as regards the choice of arbitrators, legal rules, general principles for the procedure and the applicable law. This means that the parties involved enjoy significant control over the arbitration proceedings. Secondly, it is possible to detach the arbitration process from the usual legal order, as arbitration is not bound by any specific legislation. This is particularly beneficial to the parties when the administrative authorities are involved. The third advantage of arbitration over the national court adjudication is the speed of the process. Because of the fact that the national courts are constantly overloaded and the trials are delayed arbitration is often a very attractive alternative. It provides faster way of the dispute resolution, as the proceedings are less formal. Bearing in mind the complexity of the subject matter the following factors may be considered to be relevant: the investment disputes and high transactional costs connected with the delays in the investment process and the speed of the proceeding. What is more, in the commercial arbitration proceedings are confidential, which is also vital for the party when the claim is based on the infringements of investment law. All in all, considering the nature of the trans-border investment transactions, arbitration enjoys popularity among investors because of its confidentiality, the speed of the process, flexibility over the choice of arbitrators and process and wide enforcement of decision.

Not surprisingly, one of the world's leading out-of-court institutions which deals with the international investment disputes is the International Centre for Settlement of Investment Disputes ("ICSID") affiliated to the World Bank. ICSID provides the settlement of the disputes mostly by arbitration, but also by other alternative dispute resolution methods, such as conciliation and fact-finding. The main characteristic of ICSID is that it resolves only the disputes which arose between the investors and the host states and it is not competent for the resolution of the conflicts between the investors and other private entities. Unlike in commercial arbitration, information on the disputes settled by ICSID is not confidential and the arbitral awards are officially published. The ICSID emphasises that while the arbitration proceedings are pending under its auspices, the following basic principles of good governance and rule of law are ensured: transparency, impartiality, accountability and consistency (Marshall, 2006)

## **6. CONCLUSIONS**

The discussion presented above allows us to formulate some conclusions in relation to the thesis posed. Namely, the concept of good governance may be held to play a particularly significant role in the sector of investments, where the foreign investors are very careful about the national policy having influence on the choice of the location of the capital.

From among the numerous elements of good governance that were discussed in the paper, according to the author ensuring the possibility of effective pursuance of claims arising out of such transactions may be said to belong to the most important ones. Properly functioning system of justice has key significance for the investors who, in case a dispute arises, want to be sure that it will be resolved with respect of the basic legal principles.

In view of the fact that in majority of the member states the state courts are overloaded and the judges do not have the specialist knowledge in the field of investments, the alternative dispute resolution methods may be said to significant role to play. In line with the principle of good governance state courts shall provide the investors with the possibility to enforce the contracts concluded in these member states effectively and settle potential disputes arising out of them in the proper time. Since the national courts are often unable to achieve this aim, the application of the alternative dispute resolution methods would clearly mean the materialisation of the concept of good governance.

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