

# BUSINESS ISSUES BULLETIN

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## Commercial Disputes and the New National Arbitration Center

*Being able to resolve commercial disputes quickly, easily and efficiently is important to give business the confidence it needs to invest and expand. Unfortunately this is often difficult in Cambodia where both formal and informal systems of dispute resolution are not well developed.<sup>1</sup> Going to court is rarely considered viable by entrepreneurs, but other informal dispute resolution options also have major flaws. Consequently, many businesses choose to 'cut their losses' and walk away from disputes rather than pursue their legal rights and entitlements.*

*One step that the Royal Government of Cambodia is taking to improve Cambodia's commercial dispute resolution system is to introduce commercial arbitration, and currently several development partners are helping the Ministry of Commerce to consider establishing a National Arbitration Center.<sup>2</sup> This should be a positive step. The experience of many countries, including those with sound judicial systems, is that the introduction of commercial Alternative Dispute Resolution (ADR)<sup>3</sup> mechanisms helps improve the business environment by making it easier and more effective for businesses to resolve disputes. If established however, it will be particularly important that the Center is fair, independent, efficient and effective from its first day of operation in order to generate demand for its services and build the trust of the business community.*

*The concept and practice of arbitration are culturally well understood in Cambodia. One of Cambodia's most successful legal reforms is the Arbitration Council, a labor arbitration center that has been highly effective at resolving labor disputes since it was established in 2003. The Arbitration Council demonstrates that it is possible to establish a high quality ADR institution in Cambodia that is effective and corruption-free, and provides an indication that the business community may be willing to use arbitration (and mediation) to resolve commercial disputes.*

### Why Being Able to Resolve Commercial Disputes is Important

Business is always about balancing risk against potential reward. However, when the business environment is unstable or unpredictable, measuring risks and rewards becomes more difficult. For this reason having a sound legal system that provides clarity and a platform to conduct business is important to promote investment and economic growth. Countries with poor legal systems and weak or complicated commercial dispute resolution mechanisms tend to have slower rates of growth, than they would if their legal system worked better.<sup>4</sup> This is because

<sup>1</sup> This Business Issues Bulletin outlines key research findings from as yet unpublished research on commercial disputes in Cambodia's five largest cities carried out by IFC-MPDF. The research was conducted with a wide variety of businesses ranging in size from multi-nationals to sole traders, but predominantly focused on Khmer owned and managed businesses.

<sup>2</sup> Article 10 of the Law on Commercial Arbitration (enacted March 2006) requires the Ministry of Commerce to establish a National Arbitration Center for the resolution of commercial disputes. Both IFC-MPDF and the Asian Development Bank are assisting the government to consider the possibility.

<sup>3</sup> ADR usually refers to either mediation or arbitration, or some combination of the two. Business Issues Bulletin #9 (2006), focused on ADR, and copies of this Bulletin are available from IFC-MPDF.

<sup>4</sup> There is strong evidence that countries which have weak legal systems and/or poor commercial dispute resolution systems have slower rates of growth than they would have if their legal system worked better. There is also strong evidence that improving the legal and commercial regulatory environment is likely to provide a significant and measurable benefit to rates of economic growth. See for example, the World Bank *Doing Business* Reports or, 'Courts' - S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, Quarterly Journal of Economics (May 2003).



The *Business Issues Bulletin* provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Cambodia. Also included are opinions on topic from a number of relevant stakeholders.

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businesses are more reluctant to enter into contracts or commercial arrangements when they lack confidence that they will be enforced by the legal system, which in turn tends to lead to slower growth and distortions in investment activity.

In Cambodia's case although it is very positive that economic growth has been strong for several years, a better legal system may have encouraged a wider range, and perhaps even a higher rate, of investment than occurred. Looking to the future, improving Cambodia's commercial dispute resolution systems and its legal system generally will be important for Cambodia to maintain its impressive growth over the long-term, and it is why the introduction of commercial ADR is a positive step.

## **Resolving Commercial Disputes – What Do Businesses Currently Do?**

In the event of a commercial dispute, Cambodian businesses usually perceive that they have a limited range of dispute resolution options, which include: negotiation; applying informal pressure via a powerful third-party (a patron); or going to court. Confronted by these choices, businesses frequently choose to walk away from a dispute (or to accept a poor settlement) rather than to take further action such as calling on the assistance of a third party or going to court.

Negotiation is the first step Cambodian businesses usually take to resolve a dispute, and most businesses say that the lack of effective and reliable alternatives makes negotiation the best (and often the only) way to achieve a satisfactory result. Many businesses also say that for less serious disputes when negotiation fails it is generally better to 'cut your losses' and walk away from a dispute than to incur the additional money and time costs associated with going to court or enlisting the help of a third party patron.

In recent interviews with IFC-MPDF, businesses said they rarely consider going to court a worthwhile method to resolve commercial disputes, and almost every business leader interviewed stated that they would not consider doing so unless it was absolutely unavoidable. Indeed it is quite rare to find a business that has ever taken a commercial dispute to court, and many businesses (particularly smaller ones) say that they would not normally even consider going to court. Every business owner perceived the legal system to be flawed, slow, expensive and unfair. It appears that these negative perceptions are so strong and widespread that even if the court system were to improve considerably it would still take many years to repair the business community's damaged confidence and trust.

Rather than going to court, most businesses say they would consider turning to an influential and powerful third party (such as a government official or other au-

thority figure) to help resolve a dispute. Relationships of patronage are a longstanding feature of Cambodian culture and there are consistent reports that even Cambodia's largest businesses prefer to have commercial disputes privately and informally arbitrated by a third party rather than go to court. Outside Phnom Penh, a significant number of businesses report that provincial or commune leaders often act as dispute mediators. Generally, businesses say that when a patron provides dispute resolution assistance it comes at a high price, both in dollars and in terms of reciprocal obligations. Although businesses report a preference for using third-party patrons rather than going to court, in practice most businesses say they would be highly reluctant to use a third-party patron as they believe the likely costs would generally outweigh the somewhat unpredictable benefits of such assistance.

## **Making the National Arbitration Center a Success**

*We all want a National Arbitration Center that operates robustly in the interests of the private sector and the country. Involvement of the private sector in the design of the Center through consultation will encourage businesses to use the services offered by the center, and this will be one of the keys to making the Center a success.*

**Mr. Eric Haythorne,  
Lead Legal Counsel, World Bank Group**

In compliance with the spirit of the Law on Commercial Arbitration (2006) the Ministry of Commerce has recently begun consulting with the private sector and other stakeholders on the sub-decree and the design of the National Arbitration Center, and IFC's international experience establishing ADR institutions indicates that this initial design and establishment phase requires careful consideration and planning if the Center is to succeed. Based on IFC's experience a number of key success factors are detailed below.

### **• The Center meets private sector needs**

The National Arbitration Center is intended to be an institution for the private sector. However, unless the private sector is genuinely consulted and is able to provide input to its design and operation, it is unlikely that the Center will effectively meet private sector needs. Because the Center will rely on voluntary demand for its services, failure to meet the needs of the private sector would threaten its viability as business would be reluctant to use it. The Ministry of Commerce has indicated that the business community will have the opportunity to provide meaningful input throughout the design and establishment of the Center, and especially for the sub-decree that will establish and describe how it is to operate. The Ministry's determination to involve the private sector is very positive and should also help to generate awareness and build confidence in the Center.

- **Independence**

*In my opinion, an arbitration center needs to be independent and free of corruption if it is to be a success and to benefit business. An arbitration center run by the private sector would be most appropriate because it would help ensure independence from the government, and reduce the risk of corruption. Having high quality staff is also important and recruiting effective staff by providing competitive salaries will be vital to the Center's success.*

**H.E. Nguon Meng Tech,  
Director General of the Phnom Penh Chamber  
of Commerce**

The National Arbitration Center must have a good reputation for independence if it is to generate demand from the business community for its services, and businesses state that unless the Center is completely independent and impartial they would be unwilling to use it. An important signal of the Center's independence will be the Government's public withdrawal from any active or indirect participation in the Center's management and operations once it is operational.

- **Well governed and well managed**

The National Arbitration Center needs to be well governed and well managed in order to inspire the confidence of the private sector. Checks and balances are necessary to ensure that the Center's Board of Directors is answerable to its members, and that effective rules and systems exist to ensure sound day-to-day management. A sensible balance needs to be struck between the governance role of the Board and the day to day management of the Secretariat that will be responsible for practical but vital matters such as case management, assessment of membership applications, and public relations. It is important that written procedures and policies guide the Center's actions and that decisions are always properly justified in writing.

- **Respected, high quality arbitrators**

*For the National Arbitration Center to be a success the most important thing is that arbitrators must be highly qualified and their decisions must be fair. Businesses who bring disputes to the Center must be satisfied that its decisions are fair, reasonable, and uphold the law. This will promote compliance with decisions and reduce the chance of appeals. In time, making good decisions will build the Center's reputation and give the private sector greater confidence in the NAC's services.*

**H.E. Mao Thora,  
Under Secretary of State, Ministry of Commerce**

The heart of any good legal institution is the quality of its decision-making. Arbitrators must be independent, and the people who are initially selected as arbitrators must be the very best available in Cambodia. Preference should be given to those who already have arbitra-

tion experience or have experience working in commercial law and in business. A wide range of people should be selected for the first group of arbitrators to demonstrate independence and competence. If the initial selection results in a narrow pool of arbitrators, there is a high risk that the institution will be perceived to be comprised of poor quality arbitrators or 'stacked' with arbitrators who lack independence.

*We should work step by step to establish the National Arbitration Center to make sure that good arbitrators are in place, and that the reputation of the Center is sound. One of the ways to promote the Center and encourage the right people to register as arbitrators may be to find international arbitrators to become members of the Center.*

**Mr. Tan Siah Yong,  
ADB Consultant assisting the Ministry of Commerce to establish the National Arbitration Center, and partner, Piah, Tan & Partners (Singapore)**

The Center also needs good, impartial systems to ensure that any qualified person can easily become an arbitrator, and that there is no discrimination for, or against, applications to become an arbitrator. Any decision to reject an application to become an arbitrator must be made in writing with proper justification for its rejection.

An advantage of arbitration over the court system is that businesses can choose their own arbitrator(s). This provides some protection from flawed or inexperienced arbitrators, and helps ensure confidence in the ADR institution. For this reason, it is necessary to make it easy for the parties involved in a dispute to choose their own arbitrator(s), including arbitrators from other countries such as Thailand or Singapore, provided they are suitably qualified.

*The success of the National Arbitration Center depends on many factors. One important factor is to ensure that arbitrators are independent. I think that a code of ethics for arbitrators would contribute to ensuring that they remain impartial when making decisions.*

**Mr. Ly Tayseng,  
Secretary General of the Bar Association of Cambodia**

Arbitrators need training opportunities from local and international trainers. It is important that training be ongoing and compulsory for any registered arbitrator to ensure that the Center keeps improving its standards over time.

- **Published decisions**

Publicizing arbitral decisions would promote confidence in the National Arbitration Center, help ensure that dispute resolution is fair and assist to reduce the likelihood that one of the parties may appeal an arbitral decision to court. One of the ways in which the Arbitration Coun-



cil has built credibility is by publishing its decisions. Having decisions of the National Arbitration Center publicized would help to demonstrate the trustworthiness of the Center. However, due to the often confidential nature of commercial disputes, identifying information will need to be removed prior to publication.

- **Supported, not undermined by court system**

It is important that the National Arbitration Center has the support and involvement of key leaders of the judicial system and the backing of the court system. For the Center to be successful, judges will need to enforce arbitral decisions quickly and cost effectively. It is also important that courts do not review arbitral decisions except in the most extreme or exceptional circumstances, such as when there is clear evidence of fraud or impropriety.

- **Financial sustainability**

Without a sound revenue stream it will be impossible for the new Center to survive, and might threaten the Center's ability to act impartially and well. Initially, it can be expected that the international community will need to contribute funds to support the Center's operation. From a practical perspective, this further strengthens the argument for a transparent and independent Center as international organizations will be reluctant to provide funding to a weak institution. In the medium to long term, the Center will need to build a revenue model that generates sufficient income for the Center to be self-sustaining.

## **Is Business Supportive of the National Arbitration Center?**

*I think the National Arbitration Center will prove more beneficial [to the private sector] than the court system. Because the Center is expected to have highly experienced arbitrators who will be able to resolve disputes quickly it will make it easier and more efficient for businesses to solve commercial disputes. However, these benefits will only be maintained if the Center is independent and free of corruption, and if decisions made by arbitrators are enforced by the courts.*

**Mr. Prom Visoth,**  
**Senior Vice President and Head of Legal Division, ACLEDA Bank Plc.**

IFC-MPDF research in Cambodia's five largest cities, indicates that businesses strongly desire effective legal reform and are receptive to the idea of the planned National Arbitration Center, seeing it as potentially valuable alternative in the event of a commercial dispute.

At the same time businesses were unsure whether they would be prepared to use such an institution and expressed general concerns related to the Center's likely independence, and the cost, quality and enforceability of decisions. Many businesses stressed that the National Arbitration Center would need to be independent of the government and the judiciary before they would use it and that ideally it should be backed by a credible and independent international institution to build stakeholder confidence.

The success of Cambodia's Arbitration Council shows that Cambodian businesses may be willing to use and accept arbitration, though it is important to note that in the case of the Arbitration Council demand for its mediation and arbitration services is generated by the Ministry of Labor and Vocational Training which refers cases to it. By contrast, usage of the new commercial arbitration center will be voluntary, making it essential that the business community's in-principle support can be translated into actual demand for the Center's ADR services.

## **Conclusion: The National Arbitration Center—A Step in the Right Direction**

IFC's international experience shows that establishing ADR institutions such as mediation and arbitration can help improve the business environment by providing a new and effective dispute resolution option. This kind of reform is important in a country like Cambodia where the weakness of the commercial legal system deters the kinds of investments that could propel the country to a stronger rate of growth than it currently enjoys.

The National Arbitration Center has the potential to make a significant improvement to the business environment by giving businesses a much needed alternative to existing dispute resolution mechanisms. The Center may also improve Cambodia's business environment by improving business confidence, increasing certainty and demonstrating a willingness on the part of the government to foster a better legal and regulatory environment. While the National Arbitration Center should be a step in the right direction, it is nevertheless important to recognize that any new legal institution in Cambodia is likely to face considerable establishment challenges. For the National Arbitration Center, which will rely on voluntary demand from business, the Center must be independent, fair and impartial and provide high quality cost-effective dispute resolution assistance from day one or it is unlikely to be able to generate sufficient usage to succeed.