

## **Dispute Settlement in Cross-Border Public-Private Partnerships with Diplomatic Agendas: Learning from the Kaesong Industrial Complex\***

**Soo-hyun Lee**

*This paper examines the ways in which administrative barriers and uncertainty surrounding the resolution of a dispute have obstructed the Kaesong Industrial Complex (“KIC”) from reaching its potential, not only as a unique form of public-private partnership, but also as a diplomatic gesture of progressive good faith. To help wind back some of these hindrances, this paper suggests that introducing an independent, international forum and standardized rules for dispute settlement is necessary. This mechanism would have to be sensitive to two objectives in relation to the KIC, the first is that of being able to ensure the continued operation of the facility in the instance of a conflict due to the high actual, opportunity, and diplomatic costs of a shutdown. The second objective that this dispute settlement mechanism must fulfill is to resolve disputes with minimized hostility. Given the exogenous nature of disruptions to the KIC’s operations, inciting greater tension via this mechanism would be self-defeating. This paper proposes the use of the Energy Charter Treaty and its Secretariat for the resolution of disputes in responding to these two objectives.*

**Keywords:** *Dispute Settlement, Kaesong Industrial Complex, Korean Relations, Public-Private Partnership*

### 1. INTRODUCTION

Public-private Partnerships (“PPP”), as the term is used hereafter, refers to “long-term contractual arrangement[s] between a public entity or authority and a private entity for providing a public asset or service in which the private party bears significant risk and management responsibility” (World Bank, WWW). Under the penumbra of this inclusive<sup>1</sup> definition stands the Kaesong Industrial Complex (“KIC” or “Complex”). Tucked away in one of the most isolated states in the world, North Korea, and still in its nascent form, having been operational only since 2004, the KIC represents an oft-cited yet rarely explored PPP. Unique in origin and distinct in composition, the KIC pushes the bounds of the definitional understanding of “PPPs,” as it promises opportunity and brings with it risk that no other PPP can similarly lay claim to.

While South Korea closed the KIC early in 2016, this paper takes a retrospective view of the Complex in order to identify its unique characteristics as a PPP that was created as a form

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\* The views expressed herein are those of the author alone and do not necessarily reflect the views of any of the institutions to which the author is affiliated.

<sup>1</sup> “This broad definition encompasses a range of contract types, which can be described in different ways—there is no standard, internationally accepted definition of PPP[.]” See World Bank Group 2014. *Public-Private Partnerships Reference Guide* (2nd ed.). Web. Accessed 2015 Mar. 15. Available at: [<http://www.scribd.com/doc/236899332/PPP-Reference-Guide>]. Hereinafter, “World Bank Reference Guide”.

of development assistance and diplomatic goodwill. In light of these characteristics, this paper suggests that in order maintain good relations, the KIC and PPP projects like the KIC must construct an independent dispute settlement mechanism that can cater to such specific characteristics. Given the cross-border and public interest nature of these projects, one such dispute settlement mechanism can be assessed as being successful within this specific scope of disputes if it accomplishes at least two objectives: (1) continued operation and (2) minimized hostility. This paper contends that the best way to accomplish such objectives while maintaining an effective dispute settlement mechanism is to model one such mechanism after that envisioned by the Energy Charter Treaty (“ECT”). After providing an overview of the KIC in Section 2 and diplomatic character of the KIC in Section 3, Section 4 identifies the specific compatibilities of the ECT with the KIC in the design of an ideal system of dispute resolution.

## 2. THE KIC: A PPP ON ITS OWN TERMS

At its core, the KIC is a joint business venture between North and South Korea (the “DPRK” and “ROK,” respectively) that established a manufacturing complex in Kaesong, North Korea where South Korean firms employ North Korean labour to produce goods, which are exported abroad by using South Korea as an intermediary.

Whereas PPP projects generally arise following a procurement process where financing is secured through public bidding,<sup>2</sup> the origin of the KIC was far less formal, reminiscent, rather, of something straight out of fiction. In 1998, Chung Ju-yung, the late founder of the South Korean corporate conglomerate the Hyundai Group, trekked to the DPRK capital, Pyongyang, bringing with him some 500 head of cattle as a gift for his North Korean counterparts (Lee, 2013: 7). At this meeting, he proposed a slew of inter-Korean economic cooperation projects, including the KIC (Lee, 2013: 4). Chung Ju-yung was born in the North prior to the division of the Korean Peninsula, and thus made this historic voyage to Pyongyang with the intention that his business propositions trigger rapprochement between the Koreas (Sullivan, 1998: WWW). Following Chung’s passage into the North, in June of 2000, the two Koreas held their first-ever summit meeting, during which the two states formally agreed to, among other things, commencement of the KIC (Jun, 2013: WWW). The Complex became operational in 2004.

Party to this inter-Korean PPP is the DPRK government and, on the South’s side, the Korea Land and Housing Corporation, a wholly owned entity of the ROK government, along with Hyundai Asan, a corporate arm of the Hyundai Group (Lee, 2013: 8). Thus, as PPPs contemplate only those contractual arrangements involving public and *private* entities, the KIC qualifies as such because it involves, not only Seoul and Pyongyang, but also a private actor, Hyundai Asan.

Though its origin and composition are unconventional, the mechanics of the KIC are quite simple: South Korean firms ship raw materials to their subsidiaries based at the KIC; under South Korean managerial leadership, North Korean workers manufacture those raw materials into consumer goods; thereafter, those labour-intensive products are shipped back

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<sup>2</sup> See generally Public-Private Partnership in Infrastructure Resource Center, *Procurement Processes and Bidding Documents*, PPP OVERVIEW (last visited Mar. 15, 2015), <http://ppp.worldbank.org/public-private-partnership/overview/practical-tools/procurement-bidding>.

**Figure 1.** Geographic Location of the KIC

Source: AFP (Agence France-Presse), 2013

to South Korea for retail sale domestically or export abroad.<sup>3</sup> As of December 2014, the KIC served as host to approximately 120 South Korean firms employing around 53,000 North Korean workers (Jun, 2013: WWV).

For all PPPs, “the private party is accountable for project finance, and bears significant risk and management responsibility” (World Bank, 2014: 14). In the case of the KIC, while North Korea provides the land and workers, the pseudo-private party, South Korea, supplies virtually everything else (Jun, 2013: WWV). South Korea provisions the raw materials and intermediate goods required for production, manages the electricity, water, gas, and waste management services at the manufacturing facilities, and provides transportation for the North Korean workers in and around the KIC (Lee, 2013: 12). Most of all, Hyundai Asan, in 2002, paid North Korea \$12 million USD for the land rights to the Kaesong site (Nanto, Manyin, and Mark, 2011: 11).

“A central characteristic of a PPP contract is that it ‘bundles’ together multiple project phases or functions” (World Bank, 2014: 18). The KIC was constructed according to a multi-phase “Master Plan,” pursuant to which the first phase, initiated in 2002, called for construction of 800 acres in the Industrial Zone that would host 300 ROK firms employing 100,000 DPRK labourers. The second phase contemplates the development of an additional 1,200 acres, and, by the conclusion of the third and final phase, the KIC will be comprised of 4,800 acres, 1,500 South Korean businesses, and 350,000 DPRK workers (Nanto, Manyin, and Mark; 2011: 7). Though the development of the KIC has, to-date, lagged behind the ambitious 3-phase Master Plan, the Complex has nonetheless achieved marketable success.

<sup>3</sup> See Kim, Ho Cheol. 2008. “Does Annex 22-B of the Proposed United States-Korea Free Trade Agreement Contemplate and Allow for Trade with Respect to North Korea.” 40 *GEO. J. INT’L L.* 67: pp. 72-76 (discussing stages of production at the KIC). Only approximately 10 percent of KIC-manufactured products are exported to third-party countries; rather, the majority are consumed in South Korea, where they received, under ROK law, exemption from duties.

In 2013, the KIC, boasting an operation rate at around 85%, reached a cumulative production volume of \$2.2 billion USD per annum (Ministry of Unification, 2014: 78).

From these operations, North Korea earns around \$100 million annually, principally, in the form of real estate leasing fees, social insurance taxes, and, most notably, DPRK workers' wages. Wages are paid by the ROK firms directly to the North Korean government, which then subsequently redistributes said wages to the labourers in local currency. The DPRK regime, thus, collects much-needed foreign exchange from this joint venture (Gwertzman and Noland, 2013: WWW). For the South, it benefits from the PPP by way of access to a cheap labour force; North Korean workers at the Complex earn but around \$63.30 USD per month (Hyundai Asan, WWW). Further, the ROK government has provided South Korean firms political risk insurance, low-interest loans, and highly favourable corporate tax rates of 10 to 14 per cent, which constitutes only half of what firms doing business in South Korea are normally subject to (Nanto, Manyin, and Mark; 2011: 6, 12).<sup>4</sup>

Beyond, however, merely providing the DPRK with hard currency and the ROK with cheap labour, the KIC provides the North with commercial infrastructure, and, the South, an avenue for inter-Korean engagement. Regarding the former, construction of the KIC has brought supporting infrastructure to the North, all of which has been financed exclusively by the South. South Korea has constructed at the KIC a job training centre, waste treatment plant, and electricity substation. Further, in a country where energy security is at a premium, per the KIC, the (South) Korea Electric Power Corporation connected North Korea to a South Korea-based 100,000 kilowatt power-transmission line that sends high-voltage electricity to the North (Nanto, Manyin, and Mark; 2011: 7). The two sides have also announced plans to implement a rail line across the demilitarized zone ("DMZ"), which, if completed, will connect the KIC directly to South Korea. The implementation of such infrastructure has enabled the North to attract foreign investment coming from outside the Korean Peninsula.<sup>5</sup>

**Table 1.** The KIC, by the numbers. Source: South Korean Ministry of Unification

	End 2005	End 2006	End 2007	End 2008	End 2009	End 2010
No. of South Korean Manufacturing Firms	11	15	65	93	118	121
Approx. No. of North Korean Workers	6,000	11,000	23,000	39,000	42,000	47,000
Approx. No. of South Korean Workers	N/A	700	800	1,500	960	~500
Annual Production Value	\$15mn	\$74mn	\$185mn	\$250mn	\$256mn	\$323mn
Exports to 3 <sup>rd</sup> Countries (ie., not South Korea)	N/A	\$20mn	\$40mn	\$36mn	\$29mn	\$37mn

<sup>4</sup> Further, the KIC corporate tax is exempted for five years following the first fiscal year that a company generates profits and a 50 percent deduction thereafter for the ensuing three years.

<sup>5</sup> In June of 2014, it was reported that a German firm, specializing in industrial needle making, opened a sales offer at the KIC. Kwaak, Jeyup S. *German Firm to Open Sales Office Inside North Korean Complex*, WALL STREET JOURNAL (June 10, 2014), <http://blogs.wsj.com/korearealtime/2014/06/10/german-firm-to-open-sales-office-inside-north-korean-complex/>.

South Korea, on the other hand, though serving as the private entity to this PPP, has nonetheless been motivated largely by extra-financial considerations. As is well-documented, since the division of the Peninsula in 1953, inter-Korean relations have been profoundly turbulent, marked by bellicose rhetoric, unpredictable acts of armed aggression, and unstable relations in general. The Korean War concluded with an armistice, not a peace treaty, and thus the two states remain technically still at war. The KIC, however, has emerged from this context as a sustainable vestige of détente on the Peninsula. As the “centrepiece of North/South economic cooperation,” (Gwertzman and Noland, 2013: WWW) the KIC has constituted approximately three-fourths of all trade between the two Koreas, and it has endured even when other avenues of inter-Korean economic engagement have faded.<sup>6</sup> As such, Kaesong presents a viable channel for achieving liberalization and market reform in North Korea and diplomatic breakthrough between Seoul and Pyongyang (Nanto, Manyin, and Mark, 2011: 1-5).

The significance of the KIC as a PPP, therefore, transcends mere dollars and cents. As one study has explained,

*At its narrowest sense, the KIC is a business venture in which participants are seeking profits and business advantages...At a somewhat wider set of interests, the KIC provides a channel for rapprochement between the DPRK and South Korea...as a confidence-building measure between two countries...At a still wider set of interests, the KIC may be the proverbial camel's nose under the tent in attempts to reform, liberalize, and modernize the North Korean economy (Nanto, Manyin, and Mark, 2011: 15-16).*

Indeed, China's economic liberalization was triggered, in part, by installation of special economic zones (“SEZ”) that granted foreign investors access to Chinese markets and, likewise, Chinese society exposure to the outside world. In total, the KIC “represents an opportunity to build a more stable foundation for inter-Korean relations that could underpin the ability to address deeper and longer-term issues critical for the security and prosperity of both Koreas” (Babson, 2013: WWW).

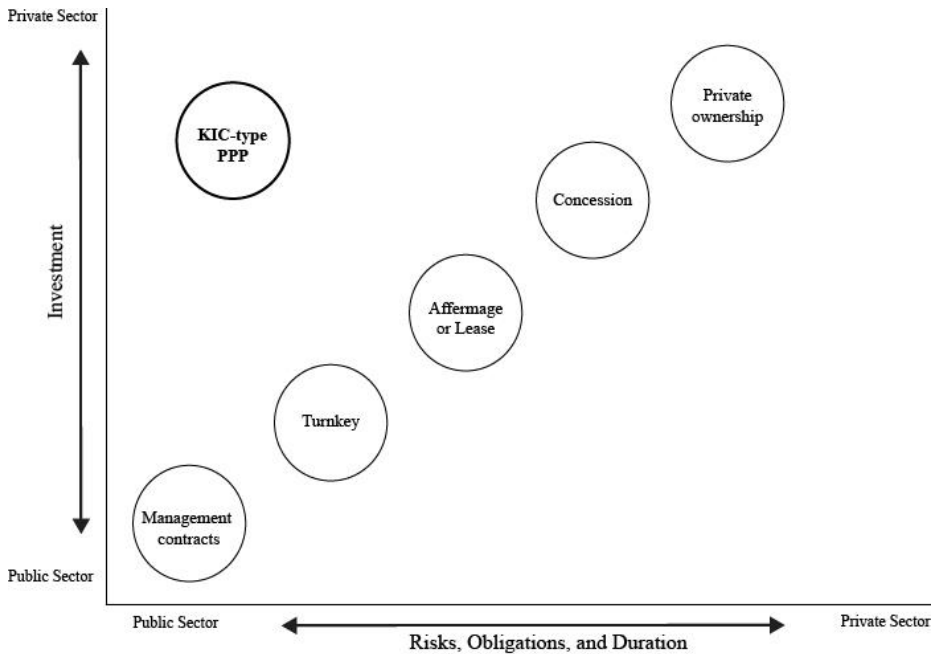
While the KIC is divergent from typical PPP models, its mechanics are more of a combination of different types rather than a completely outlying model. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) identified five models of PPPs (UNESCAP, 2008: WWW). based on the distribution of two factors between the public and private sectors: (1) investment or the ownership of private capital assets and (2) the assumption of risk, responsibilities associated with the investment, and duration of contract.

The KIC resembles a combination of three PPP models: management contract, turnkey, and private ownership. In a management contract model, the public sector retains ownership over the facility and employs private contractors for operations. In the case of the KIC,

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<sup>6</sup> In addition to the KIC, another Hyundai-brokered inter-Korean initiative was the Mt. Kumgang tourism venture, which allowed South Korean nationals to travel to North Korea. In 2008, however, the program was indefinitely suspended after a South Korean female tourist participating in the program was fatally shot by a North Korean soldier, for allegedly having entered a prohibited area at the Kumgang resort. Bong-jo, Rhee. *Tours to Mt. Kumgang Should be Resumed*, KOREA FOCUS (July 12, 2012). Available at: [[http://www.koreafocus.or.kr/design2/layout/content\\_print.asp?group\\_id=104183](http://www.koreafocus.or.kr/design2/layout/content_print.asp?group_id=104183)].

**Figure 2.** Basic features of PPP models with KIC-type PPP, Source: Author based on UNESCAP.



however, labour is managed by the Central Special Development Guidance Bureau, a part of the DPRK government, and equipment is procured and maintained by the Inter-Korean Cooperation District Policy Planning Division of the Ministry of Unification, Republic of Korea. Individual firms from the private sector then engage into a Build-Own-Operate (BOO) arrangement with Kaesong Industrial District Management Committee, a special purpose vehicle. These individual sponsors receive the revenue from the sale of their goods and services to their users while paying the costs of production to the public entities that manage labour and the KIC itself. The construction of the KIC also presents aspects of a turnkey, or Design-Build, arrangement with the private sector, in this case two entities: the Hyundai Asan Corporation and the Korea Land and Housing Corporation. While these entities receive further explanation in the next section, it is important to note that while the KIC is a unique PPP, which as this article argues is caused by the diplomatic intent of the KIC, it is an amalgamate of different PPP categories.

While the prospective benefits of the KIC extend beyond those traditionally implicated by PPPs, so, too, however, are its risks. When the Complex first opened, the Hyundai Research Institute estimated that, upon the KIC reaching full operational capacity, the North stood to gain an astounding \$9.55 billion USD over the course of a nine-year period (Nanto, Manyin, and Mark, 2011: 12). Although it remains uncertain whether the KIC will ever fully develop according to the aforementioned 3-phase Master Plan, the DPRK government – by way of tax assessments, labourers’ wages, and real estate fees – has already accrued substantial funds from the joint venture. Considering that the North neither paid any monies for, nor contributed any assets to, the Complex, all hard currency derived therefrom constitutes pure profit for the DPRK.

**Figure 3.** Productivity at the KIC

Source: South Korean Ministry of Unification

In contrast to certain political aid, revenues earned from the KIC come with no conditions attached; neither the ROK government nor Hyundai Asan impose restrictions on how the North spends what it gains from this business venture. Consequently, the KIC enables hundreds of millions of dollars in unchecked capital to flow to a state that, in direct contravention of international law, has relentlessly pursued a nuclear weapons program and proved itself willing to commit unprovoked acts of armed aggression within the Northeast

Asia theatre.<sup>7</sup> Income is fungible, and thus, as the Complex's operations expand, more unchecked capital will accrue to the North, thereby increasing the risk that the otherwise bankrupt DPRK state will become capable of funding its nuclear ambitions.<sup>8</sup> This PPP, therefore, has triggered concern that the KIC is arming – by funding – the enemy.

While it is admittedly unclear how much, if any, of the KIC-derived revenues are being funnelled by the North to its nuclear weapons program (Nanto, Manyin, and Mark, 2011: 18),

<sup>7</sup> In Spring of 2010, North Korea, in an unprovoked act of armed aggression, sank a South Korean navy vessel near the Northern Limit Line. This resulted in the death of ROK sailors on board. Then, just months later, in November of 2010, North Korea shelled South Korean island Yeongpyeong. See generally Scott Snyder and See-won Byung, *The Northeast Asian Response to North Korea's Provocations*, *The Rusi Journal* Vol. 156 No. 2 (2011), available at <http://asiafoundation.org/resources/pdfs/201104SnyderandByun.pdf>.

<sup>8</sup> See Nanto, Manyin, and Mark (2011) at 18 (noting that “anything that increases revenue to the Pyongyang regime has the potential to contribute to the DPRK’s military (including its missile and nuclear program)”). Some have posited that the DPRK’s nuclear program, per the country’s “military first” policy, is assured funding from the government independent of the Complex, thereby intimating that the KIC will enable North Korea’s nuclear ambitions. See *id.* It is, however, irrefutable that the extra capital injected into the DPRK by way of the KIC advances the prospect of a nuclear North Korea (by affording the impoverished state with monies it otherwise would not have).

it is precisely the uncertainty surrounding whether this PPP is indirectly financing the DPRK's path to nuclear statehood that is most troubling. Consequently, it is actualization of the benefits promised by the KIC that precipitates manifestation of its gravest risks.

### 3. THE DIPLOMATIC NATURE OF THE KIC

The brief introduction to the KIC set forth above is indicative of the complicated social, political, and historical dimensions of an ambitious project started nearly 20 years ago. The characteristics of the KIC are fairly unique insofar as PPP projects are concerned in that it brings together what one may see in cross-border energy projects with diplomatically oriented official development assistance. Whether a KIC-type project can be adopted elsewhere in different contexts would depend on extrapolation that is beyond the scope and capacity of this study, but this study highlights circumstances of the KIC as a form of cross-border infrastructure that began, to some extent, as a diplomatic gesture.

Before, however, considering the unique characteristics of the KIC, an important question to ask is whether the Complex is an isolated phenomenon or if it is replicable elsewhere. The extent to which a shared culture, history, and language between North and South Koreans enables successful operation of the KIC must be seriously considered. In a light-hearted documentary broadcasted by the Korea Broadcasting System (KBS), employees appeared to have many opportunities to bond and that there exists a sentiment of mutual interest and comradery.<sup>9</sup> Yet, while a shared language may help reduce communication breakdown, these linkages may no longer play a prominent role in the productive aspect of the Complex. The future value of the Complex, if refined and implemented correctly, may make it and similar projects a staple strategy in empowering growth through economic cooperation rather than the traditional sender-recipient state dynamic implicit to most development aid.

A defining aspect of the KIC is a high level of government involvement. Figure 5 illustrates the organizational structure of the Complex. This high level of involvement reflects the highly political nature of the KIC, granting controls to both States that would be otherwise be unimaginable in an infrastructure project with commercial motivations. The original PPP may have been between South Korea and two entities, Hyundai Asan and the Korean Land and Housing Corporations, but after the Complex came into operation, both the South and North Korean governments entered into another PPP with the Kaesong Industrial District Management Committee (KIDMAC), which is a private enterprise registered in both countries that acts as a special purpose vehicle (SPV).

While this is quite unique in and of itself, the ongoing levels at which each government is involved is also another notable divergence. This may be because the KIC originally started as a way to improve inter-Korean relations, meaning that ongoing tensions between the two countries and changes in world power balances ultimately made the KIC less of a development project and more into a mutual guarantee. This guarantee was premised on the rationalism suggested in economic transactions – in this case, the promise of wealth to North Korea and human capital for South Korean firms.

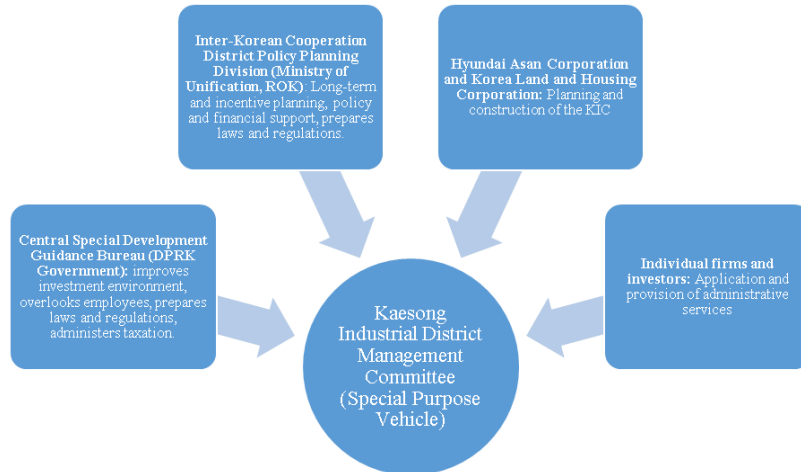
Yet the ongoing involvement of the governments has been more about power struggle in an ongoing rivalry between the countries and not so much intended to improve the economic performance of the KIC.

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<sup>9</sup> The documentary can be viewed on YouTube at [<https://www.youtube.com/watch?v=hE8qYX7zVGc>].



**Figure 4.** Organizational Structure of KIS



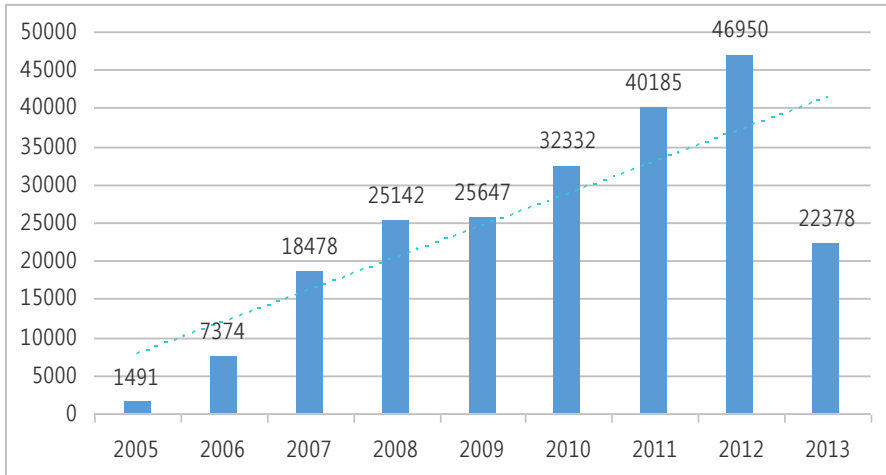
Source: Kaesong Industrial District Management Committee (KIDMAC)

Thus, it resulted in the faltering performance of the Complex and stunted growth in its potential. Recommendations by the Hyundai Economic Research Institute in its 10 year evaluation of the KIC corroborated this conclusion, identifying the need to separate economics and politics in the operation of the Complex. Politicization resulted, and will continue to result, in the deterioration of investor confidence as well as diminished efficiency for existing firms. Examples include various incidences where, when in response to political conflict, the North prevents its workers from getting to the Complex or the South chooses to shut down all operations completely. At the time of writing, the most recent incident was the unilateral increase of wages for North Korean employees by their government, inciting resistance from South Korean firms.<sup>10</sup>

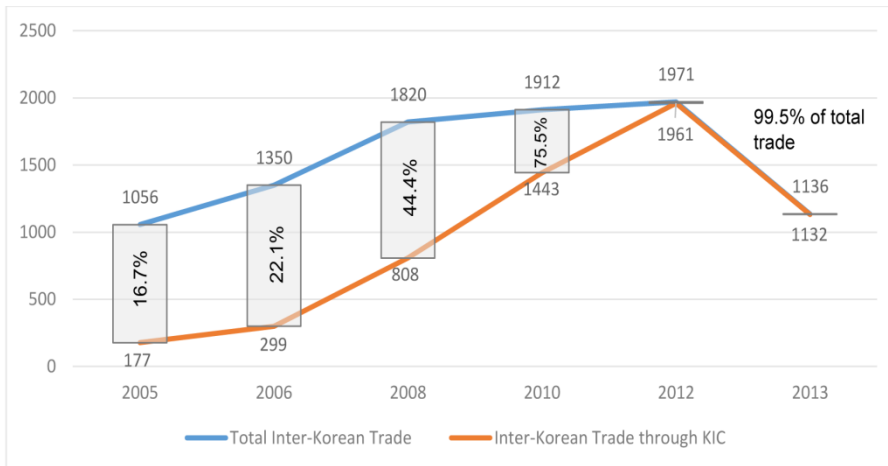
While the KIC presents unique characteristics as a PPP, in terms being a form of cross-border infrastructure with development assistance motives, the Complex yet again presents fascinating aspects warranting further study. South Korea as the Sender State does not profit from its continued involvement in the KIC. Rather, one could say that it is losing potential sources of tax revenue by providing special subsidies and tax deductions for firms operating inside the Complex. North Korea, as the Recipient State, as most of the employees inside the Complex are North Korean, benefit from the arrangement in many dimensions, including knowledge transfer, access to exchangeable currencies, and increased gross national income. In this way, as an ODA project, the Complex’s economic productivity over its years of operation is clear, as represented in Figure 6. Beyond productivity, the role of the KIC as a platform for exchange between the North and the South, as represented in Figure 7, cannot be overlooked. However, before the KIC can fully realize its potential, the government must be able to strike a delicate balance in how deeply involved it wants to be. The level of involvement does have consequences such as lost profits.

<sup>10</sup> The website “North Korean Economy Watch” has been monitoring coverage on this incident. [http://www.nkeconwatch.com/category/dprk-organizations/state-offices/bureau-of-special-zone-development/kaesong-industrial-district-development-committee/]

**Figure 5.** Annual Output of KIC (in 10,000USD), Source: Hyundai Research Institute (2014)<sup>11</sup>



**Figure 6.** KIC and Total % of Inter-Korean Trade (in million USD)



Source: Hyundai Research Institute (2014)

This is vividly illustrated in Figure 6 where there is a huge drop in output in 2013 when a political dispute occurred.

Conversely, the government cannot remain entirely detached in a project like the KIC, as it must continue to play a crucial role in the settlement of disputes. The application of national arbitration law may not always be appropriate for disputes at the Complex, especially because it involves conflicting laws, public interest considerations, as well as

<sup>11</sup> Hyundai Research Institute. “10 Year Assessment of and Development Proposal for Operating the Kaesong Industrial Complex” (in Korean). *VIP Report* 14-44 (Issue 595). Web. 2014 December 8. Accessed 2016 December 29. Available at: [<http://hri.co.kr/board/reportView.asp?firstDepth=1&secondDepth=2%20&numIdx=24476>].

technical aspects that may go beyond the competency of the courts of a single State.

#### 4. DISPUTE RESOLUTION IN KIC TYPE PROJECTS

Given both the unique characteristics of the KIC as well as the diplomatic intention of the Complex, establishing an independent method of dispute resolution is essential to not only the operation of the KIC, but also potential to future considerations including reproduction of such projects in other contexts. The settlement of disputes in projects like the KIC should prioritize two goals: (1) continued operation and (2) minimized hostility. The importance of pursuing these goals in creating a DSM is enshrined in the very reasons why PPPs can be helpful methods to boost socioeconomic development. In economies like that of North Korea where there is highly limited domestic resources available for financing (DRAF) or can benefit greatly from the efficiency and technology of private sector entities, such cooperation can help to develop the infrastructure necessary to stimulate economic growth while engaging in modern market practices. When PPP projects involve the public interest, such as the construction of public transportation, ongoing disputes that halt operations can result in private sector entities withdrawing from the project or even scintillate hostilities that may drive away other potential partners. For these reasons, ensuring that the KIC and other projects like it or in similar circumstances continue to operate smoothly and do not drive away potential private sector entities interested in PPPs is of certain significance.

While the KIC has its own set of regulations for the settlement of disputes, the mechanisms in place to enforce such procedures have questionable reliability and independence, partly due to political reasons. These regulations include the exhaustion of other measures, namely reconciliation and expert adjudication, before proceeding into arbitration. This applies to all disputes that arise in the complex, including labour and insurance claims. Investment disputes not settled through alternative dispute resolution are referred to the North-South Commercial Arbitration Board, which is composed of four arbitrators, two from each country (ROK Ministry of Unification, 2015). While many of the procedures surrounding dispute resolution at the KIC follow international standard practice in writing, Chapter 5, Article 16 of the “Commercial Dispute Resolution Agreement” states that, while under normal circumstances arbitral awards will be enforced, “special circumstances” may nullify an award and those circumstances are defined by the North-South Commercial Arbitration Board. Yet the role of this mechanism during the shutdown of the Complex in December 2008, April to September 2013, and early 2016 was insignificant, presenting additional variable costs for each day of potential production halted, compounding the fixed costs for firms at the KIC. This can be interpreted as a form of expropriation, which is a claim that Korean firms may not pursue, but is certainly within the realm of possibility with international enterprises, which enjoy not only the tax benefits of Kaesong, but also the privileges and rights of the investor granted by South Korean law.

Given the unique objectives of dispute resolution for the KIC and projects of similar characteristics, the Energy Charter Treaty presents valuable insights that may be useful as a reference. The remainder of this section identifies portions of the ECT that are especially applicable to the KIC in achieving the two objectives identified above.

#### **4.1. Expert Adjudication as Mediation**

The Energy Charter has mandatory expert adjudication procedures before parties may pursue arbitration or litigation. This is to both provide the amicable resolution of a dispute through reconciliation as well as provide resolution methods that are less costly and time-consuming as judicial relief. Since PPPs like the KIC include government expenditure, it is within the society's interest to reduce halted production since each unproductive day accrues opportunity costs whose burden would in some proportion be offset by costs to society. The reason why the ECT is particularly enlightening in application to the KIC is that the ECT dealt with specific types of disputes, providing procedures towards resolution that are often not found in more common arbitration procedures. Additionally, as energy related projects tend to be related to a nation's infrastructure, both PPPs and energy projects under the ECT take on a certain sensibility towards a nation's development. Thus, by adopting this preliminary mediatory exercise through the election of a third-party panel of experts available through intermediaries like the United Nations Development Programme, the World Bank Group, or the Energy Charter Secretariat's expert roster can help bolster the effectiveness of these measures.

#### **4.2. Lowering Administrative Barriers to Trade**

As pronounced in its preamble, the ECT seeks to liberalize international trade through the removal of barriers to trade in "Energy Materials and Products and Energy-Related Equipment," technologies, and services, as well as to establish a "secure and binding international legal basis" for such trade and investments (Energy Charter Secretariat, 2014: WWW). Pursuant to this endeavour, the ECT emphasizes avoiding the escalation of disputes that may obstruct the flow of relevant areas of trade. There are generally two ways that the ECT attempts to accomplish this objective.

The first is its general compliance with investment agreements at large on topics such as investor rights and compensation. Article 10(1) and Article 13(1) provide fair and equitable treatment to investors as well as ensures the prompt, adequate, and effective compensation for expropriated assets. Yet given the public good nature of the infrastructure projects that fall under the ECT, the definitions of expropriation and compensation are developed in more detail than one would see in a typical investment treaty. This includes the exact valuation of the investment in Article 13(2) and compensation requirements for the expropriation of investor assets following the nationalization of the "Area in which an Investor or any other Contracting Party has an Investment" (ECT, 2014: 34). Article 21(5b)(iii) adds to this definition by identifying the possibility of taxation as being a form of expropriation (ECT, 2014: 43), or creeping expropriation. Ensuring the procedural rule of law on matters of investor rights would ensure that not only foreign investors, but also national investors of from each of the contractual state parties may experience improved confidence. Government guarantees on investments act as attractive incentives for such projects, which need not be nullified by risk of expropriation.

The second is a dispute resolution process that begins with and generally revolves around the capacity to assess technically the nature of the dispute while ensuring the continuous flow of energy pursuant to Articles 7(6) and 7(7) regardless of the incidence of a dispute. The Secretary-General of the Energy Charter Secretariat shall appoint a conciliator who is

experienced “in the matters subject to dispute.” The conciliator, a third-party to the dispute, will attempt to “seek the agreement of the parties to the dispute to a resolution thereof or upon a procedure to achieve such resolution.” If there is no resolution within 90 days, the conciliator will make recommendations while interim measures are applied (ECT, 2014: 26).

In the case of interim measures, the ECT Secretariat supports the resolution of disputes based on sufficient technical knowledge. As is elaborated in Annex D, *Interim Provisions for Trade Dispute Settlement*, the Secretariat will produce a final report that details with “every substantial issue raised before the panel and necessary to the resolution of the dispute” (ECT, 2014: 105) with comments from the Contracting Parties. Annex D also adds to the interim proceedings the selection of arbitrators, whom the Secretary-General may designate based on a “dispute settlement roster.” Selection from the roster is done “strictly on the basis of objectivity, reliability and sound judgement and, to the greatest extent possible, shall have expertise in international trade and energy matters [...]” Dispute resolution under the ECT is largely elaborated in Article 26, which does not provide substantial deviation from international arbitration in general practice. However, consistent with the goals of the ECT, these procedures first require the exhaustion of means to an amicable settlement for a period of three months, which provides for the corresponding conciliation period of 90 days stated in Article 6 and 7. After the conciliation period has passed, Article 26(3a) indicates that Contracting Parties give their “unconditional consent to the submission of a dispute to international arbitration.”

While the above provisions may specifically apply to energy projects, the same conditions can be transferred to the continued operation of a manufacturing plant such as the KIC. While they do lack the technicality of cross-border energy facilities, the principles behind continued operation and third-party arbitration are especially valuable for the KIC and similar projects, as identified earlier in this exposition. Indeed, it may be argued that the limited success of the KIC is primarily due to the inconsistent operation of the Complex, swayed by fluctuations in the political climate.

Once the dispute reaches international arbitration, the ECT identifies three potential outlets in Article 26(4): the International Centre for the Settlement of Investment Disputes (ICSID); arbitration, sole or ad hoc, via the UNCITRAL Arbitration Rules; and proceedings through the Arbitration Institute of the Stockholm Chamber of Commerce. In terms of an ad hoc arbitration, Article 27 of the ECT lays out rules regarding the appointment of arbitrators and the enforcement of awards, all of which do not deviate significantly from the texts of the UNCITRAL Rules.

Those States that do not provide unconditional consent to arbitration after the initial filing of the dispute are listed in Annex ID of the ECT. According to Article 26(3) of the ECT, those countries listed in Annex ID are then required to provide a written statement of their respective “policies, practices, and conditions in this regard to the secretariat” at the same time that the ECT is ratified. While such a written statement may help to improve the transparency surrounding an Annex ID-listed State’s general behaviour when it comes to the resolution of disputes, confidentiality takes precedence. Article 6(6) provides that there will be no requirements of information that may contradict national laws of the Contracting Parties in relation to the “disclosure of information, confidentiality, or business secrecy” (ECT, 2014: 24). Article 20 further elaborates on transparency requirements, stating that while relevant “laws, regulations, judicial decisions, and administrative rulings of general application made effective by any Contracting Party, and agreements in force between Contracting Parties, which affect other matters covered by this Treaty” are to be made

readily available for reference, this does not require the Contracting Parties to disclose information that is interpreted as confidential.

The enforcement of an arbitral award in the ECT is in many ways favourable as an approach to the political manoeuvre of interrupting the plant's functions. The international element of these procedures may additionally strengthen the governance structure and rule of law in connection to the KIC, an impact that has been noted in academic literature.<sup>12</sup>

## 5. CONCLUSION

This paper examined the ways in which administrative barriers and uncertainty surrounding the resolution of a dispute have obstructed the KIC from reaching its potential, not only as a unique form of public-private partnership, but also as a diplomatic gesture of progressive good faith. To help wind back some of these hindrances, this paper suggested that introducing an independent, international forum and standardized rules for dispute settlement is necessary. This mechanism would have to be sensitive to two objectives in relation to the KIC, the first being able to ensure the continued operation of the facility in the instance of a conflict due to the high actual, opportunity, and diplomatic costs of a shutdown. The second objective that this dispute settlement mechanism must fulfil is to resolve disputes with minimized hostility. Given the exogenous nature of disruptions to the KIC's operations, inciting greater tension via this mechanism would be self-defeating. In responding to these two objectives, this paper proposed the use of the Energy Charter Treaty and its Secretariat for the resolution of disputes.

The projects that include the ECT are often those that are cross-border and complex, many times rendering conventional forms of dispute resolution ineffective or even detrimental to the project's goals. The expert adjudication as a form of mediation, interim measures, and a third party arbitral forum together provide a stable mechanism for the resolution of disputes without erecting obtrusive administrative barriers that may depress trade.

Regarding the long-term and public nature of the projects of both energy and PPP projects, there are further conclusions made here. The ECT prioritizes both the expedited resolution of disputes as well as ongoing operation of energy services such as transit. Discontinuation and delay present externalities that may not be present in construction and infrastructure projects at large. For instance, the construction of a pure public good through a PPP can present diminished marginal social benefits with the further allocation of costs and resources that are accrued during the delay period. Thus, delays presents considerable weights in the cost-efficiency in such projects and should, when possible, be avoided.

Delmon (2010) described a comprehensive concession agreement as employing a mixture of dispute resolution mechanisms that best minimizes the "detriment to [the contracting parties'] working relationship" (Delmon, 2009: 406). This echoes the recommendations given in the UNCITRAL Legislative Guide on Privately Funded Infrastructure Projects, which calls for the need for the use of dispute settlement mechanisms "that avoid as much as possible the escalation of disagreements between the parties and preserve their business relationship; that prevent the disruption of the construction works or the provision of the

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<sup>12</sup> See, for instance, Wilt (2008), Kanetake (2016), Goldsmith and Levinson (2009); Ginsburg, Chernykh, and Elkins (2008).

services; and that are tailored to the particular characteristics of the disputes that may arise” (UNCITRAL, 2000: 174). In order to continue benefiting from such innovative projects as the Kaesong Industrial Complex, it is imperative to buffer those mechanisms that ensure the systematic and peaceful resolution of disputes. Otherwise, a single disagreement may lead to the collapse of something worth preserving.

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