

# Responding to Public Concerns over Investor State Dispute Settlement Clauses In APEC Free Trade Agreements

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## Abstract

*Prepared for a recent presentation for APEC Member Economies, this paper surveys how APEC Member Economies have responded to public-interest-based criticisms in ISDS through multilateral negotiations, treaty and investment agreement drafting and administrative measures. While no other APEC Member besides Australia has decided to forgo ISDS altogether, the language in APEC investment agreements shows clear progress towards acceptance of major public interest concerns in recent years. At the same time, there is no sign that a consensus is emerging among Members to amend the basic institutional features of ISDS.*

KEY WORDS: investor state arbitration, multilateral investment agreement, exceptions clauses, trade sustainability impact assessment, arbitrator conflict of interest

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## I. Introduction

After a steep rise in the number of investment agreements including investor state dispute settlement or “ISDS,” a few APEC Members have recently reconsidered including ISDS in their FTAs under mounting criticism from national assemblies, environmental, labor, and human rights NGOs and even jurists. In April 2011, Australia’s “Gillard Government Trade Policy Statement”<sup>1)</sup> announced that Australia would discontinue the practice of including ISDS provisions in its trade treaties. On November 16

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1) Australian Department of Foreign Affairs and Trade, *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity*, <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html#promotion>.

2011 the President of Korea acknowledged the domestic opposition to ISDS by promising the National Assembly that he would renegotiate the ISDS provisions of the KORUS-FTA<sup>2)</sup> if the National Assembly would agree to ratify the treaty.<sup>3)</sup> These events show how a negative impression of ISDS, once an obscure topic understood only by arbitrators and law professors, has swiftly entered public consciousness. Moreover, several of the most complicated and expensive investment arbitration claims have involved widespread public opposition to large-scale foreign investment projects for natural resource extraction or for water distribution.<sup>4)</sup> These cases reflect a costly breakdown in relations between the foreign investors and the governments and civil society stakeholders of the host country, which can, in severe cases, diminish the attractiveness of a host country for investment.

As the costs and frequency of investor state arbitration has risen, critics have pressured governments for more accountability through a reassessment of the institutional features of investment arbitration to promote transparency and to level the playing field for the public sector.<sup>5)</sup> On this occasion of the APEC Capacity Building Workshop on FTA Implementation,<sup>6)</sup> I have been asked to discuss public criticism of ISDS in FTAs and to highlight Member best practices and APEC recommendations that pertain to the criticisms of ISDS. How are the APEC Member Economies currently addressing the public-interest-based objections to ISDS? In this paper, I will summarize a few of the most commonly voiced criticisms and show how APEC Member Economies have been adapting wording in the investment chapters of FTAs. Then I will discuss how individual Member Economies have used various strategies to mitigate the

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2) The Free Trade Agreement between the United States of America and the Republic of Korea U.S.-S. Kor., Apr.2007, renegot. Dec. 3, 2010, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> [hereinafter KORUS-FTA]).

3) "Lee Vows, *Renegotiation of Key Clause in US FTA*, KOREA TIMES, Nov. 15, 2011, available at [http://www.koreatimes.co.kr/www/news/nation/2011/11/113\\_98838.html](http://www.koreatimes.co.kr/www/news/nation/2011/11/113_98838.html).

4) Cf. *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12 Award, (June 2006), *Tecnicus Medioambientales Techmed SA v. United Mexican States*, ICSID Case NO. ARB(AF)/00/2 Award, (May 29, 2003).

5) See generally, GUS VAN HARTEN, *INVESTMENT TREATY ARBITRATION AND PUBLIC LAW*, Oxford University Press, 2007.

6) APEC Capacity Building Workshop on FTA Implementation, Jeju Island, S. Kor., (Nov.16, 2012).

cost and frequency of investment claims, and to foster better relationships between local stakeholders impacted by investment and by including local stakeholder arrangements in individual contracts with investors. While no other APEC Member besides Australia has decided to forgo ISDS altogether, the language in APEC investment agreements, particularly FTAs, shows clear momentum towards incorporation of issues of public concern. On the other hand, APEC FTA practice as yet reveals no clear consensus to amend the fundamental institutional features of ISDS. The lack of agreement in APEC parallels the current global divide<sup>7)</sup> over whether investment arbitration should continue under the norms and procedures evolved from international commercial arbitration or adopt more judicialized proceedings with a heightened level of state supervision appropriate for public law bodies.<sup>8)</sup>

## II. Core Substantive Provisions in Investment Chapters of APEC FTAs

ISDS has been identified by the APEC's Committee on Trade and Investment as one of the core elements of APEC FTAs in a survey on existing FTAs<sup>9)</sup> The investment provisions of APEC FTAs broadly are

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7) For example, the controversy has played out recently in the UNCITRAL Working Group on Transparency in Investor State Dispute Resolution. In January 2013 a working group agreed to a set of rules making most of the documents and proceedings public which would apply to all future investment treaties that refer to the UNCITRAL Rules unless the Contracting Parties to the investment agreement expressly opt out. See Eric Luke Peterson, *UN Group Finalizes Transparency Rules But They Won't Automatically Apply to Stockpiles of Existing Treaties*, INVESTMENT ARBITRATION REPORTER, (Feb. 14, 2013); UNCITRAL, Working Group II (Arbitration and Conciliation), A/CN.9/765, *Report of Working Group II (Arbitration and Conciliation) on the work of its fifty-eighth session* (New York, Feb. 4-8, 2013), [http://www.uncitral.org/uncitral/en/commission/working\\_groups/2Arbitration.html](http://www.uncitral.org/uncitral/en/commission/working_groups/2Arbitration.html).

8) Gus Van Harten and Martin Loughlin, *Investment Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L., no. 1, 2006. See also Jason Webb Yackee's summary of theories of investment arbitration as a system of public governance in, Jason Webb Yackee, *Controlling the International Investment Law Agency*, 53 HARV. J. INT'L L., no. 2, 395-397, Summer 2012.

9) APEC Investment Expert's Group, *Identifying Core Elements in Investment Agreements in the APEC Region*, Dec. 2007, APEC# 207-CT-01.14.

meant to serve three purposes: investment liberalization, investment promotion and investment protection.<sup>10)</sup> The core substantive investment protection features of APEC FTAs are the non-discrimination provisions on National Treatment (“NT”) and Most-Favored Nation (“MFN”), and the provisions for Fair and Equitable Treatment (“FET”), expropriation, compensation for loss, transfer of funds and transparency.<sup>11)</sup> Substantial variation exists in the extent of their legal protection afforded by these clauses due to differences in wording. As a threshold issue, each substantive provision must be read carefully against the definitions of investor and investment that provide standing for bringing a claim under the treaty in order to determine its scope.

The investment chapters of APEC FTAs can be classified into two kinds: those that cover the pre-establishment phase and those that cover post-establishment treatment. The distinction is important in investment arbitration because conflicts can arise over the framework for screening foreign investors and whether an investors’ expectations of a stable legislative framework was violated when a regulation changed after admission or because they received prior “specific assurances.”<sup>12)</sup> Treaties that specify NT or MFN in the admission or establishment of investments cover pre-establishment treatment.<sup>13)</sup> Two common approaches among APEC Members are pre-establishment treatment subject to non-conforming measures in a negative list as in the KORUS-FTA<sup>14)</sup> and pre-establishment treatment according to a positive list as in the Thailand-Australia FTA.<sup>15)</sup> APEC recommends that Members accord NT in the establishment phase,

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10) *Id.* at 31.

11) *Id.* at 23-31.

12) In *Methanex v. United States*, the tribunal identifies five conditions for specific assurances: 1) that the assurance is given by the regulating government 2) to the foreign investor itself, 3) at the time the investor is contemplating making the investment 4) the commitment must be specific, and 5) assurance must be given in good faith. *Methanex Corporation v. United States of America*, NAFTA Award, Part IV. Ch D. ¶ 7 (Aug. 3, 2005).

13) Anna Joubin-Bret, *Admission and Establishment in International Investment Agreements*, in PROTECTION OF FOREIGN INVESTMENT THROUGH MODERN TREATY ARBITRATION (2010).

14) *Supra* note 2.

15) Thailand-Australia Free Trade Agreement, Thai.-Austl., art. 903-907, available at [http://www.dfat.gov.au/fta/tafta/tafta\\_toc.html](http://www.dfat.gov.au/fta/tafta/tafta_toc.html).

subject to domestic laws.<sup>16)</sup>

Member FTAs nearly all state that expropriation is prohibited unless it is for a legitimate public purpose and carried out in a non-discriminatory manner with prompt and adequate compensation.<sup>17)</sup> Aside from the direct seizure of assets, most investment tribunals today also consider investors' claims regarding indirect expropriations through other government actions, including legislation, executive decrees, judicial orders, or administrative actions such as denials of a permit, that deprive an investor of the substantial value of the investment.<sup>18)</sup>

APEC has made comprehensive suggestions to its members concerning transparency standards. At a minimum, APEC core obligations of transparency are to cooperate, to consult, to exchange information and notify, to respond to questions, to establish contact points; and to publish the designated material (laws).<sup>19)</sup> The idea of transparency is also extended to investor treatment in the host state's judicial system. Traditionally considered part of a fair and equitable treatment claim, many APEC FTAs deal with transparency of the legal system in detail in the investment chapter or elsewhere in the FTA. The APEC Model Chapter on Transparency for FTAs and RTAs spells out in detail standards for due process in the host states' administrative proceedings (Article 8)<sup>20)</sup> and for

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16) The 1994 APEC Non-Binding Investment Principles state: "With exceptions as provided for in domestic laws, regulations and policies, member economies will accord to foreign investors in relation to the establishment, expansion, operation and protection of their investments, treatment no less favourable than that accorded in like situations to domestic investors." APEC SECRETARIAT, APEC GUIDE TO THE INVESTMENT REGIMES OF THE APEC MEMBER ECONOMIES, (6<sup>th</sup> ed. 2007). available at <http://www.apec.org/Press/News-Releases/2007/~//media/F5A13BFFFE284C8994CC9C88CF6D777D.ashx>

17) APEC Investment Expert's Group, *Identifying Core Elements in Investment Agreements in the APEC Region*, Dec. 2007, APEC# 207-CT-01.14, .at 25.

18) *Metalclad Corp. v. Mexico Award*, ICSID Case No. (ARB)AF/97/1, (Aug. 30, 2000), ¶ 103.

19) APEC Investment Experts Group, *Transparency in International Investment Agreements*, APEC#211-CT-01.10, Jan. 2012, at 9.

20) 1. With a view to administering in a consistent, impartial and reasonable manner its measures of general application, each Party shall ensure, in its administrative proceedings, that: a. wherever possible, persons of the other Party that are directly affected by a proceeding are given reasonable notice, in accordance with the procedures provided for in its domestic laws and procedures, when a proceeding is initiated, including a description of the nature of

review and appeal (Article 9).<sup>21)</sup>

### III. Frequently Contested Features of ISDS

#### 1. *Disincentives to Legislation and Enforcement of Environmental and Health Regulations*

Critics have pointed to Phillip Morris' recent investor state arbitrations against Uruguay and Australia<sup>22)</sup> for instituting anti-smoking regulations and Vattenfall's suit against Germany<sup>23)</sup> for phasing out nuclear energy as proof that investment arbitration restricts the police powers of states to regulate for the welfare of their citizens. A considerable amount of claims

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the proceeding, the legal basis in accordance with which the proceeding is initiated, and a general description of any relevant issues; b. persons of the other Party that are directly affected by a proceeding are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; c. its procedures are in accordance with the domestic law. Article 8, APEC Model Chapter on Transparency for FTAs and RTAs

21) 1. Each Party shall establish or maintain judicial, arbitral or administrative tribunals or procedures, for the purpose of the prompt review and, where warranted, correction of administrative actions regarding matters covered by this Agreement. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter. Where such procedures are not independent from the agency entrusted with the administrative decision concerned, the Party shall ensure that the procedures in fact provide for an objective and impartial review. 2. Each Party shall ensure that in any such tribunals or procedures the parties to the proceedings are provided with: a. a reasonable opportunity to advocate for their respective positions; and b. a decision based on the evidence. 3. Subject to appeal or further review procedures as provided for in its domestic law, each Party shall ensure such decisions shall be implemented by, and shall govern the practice, of the offices or authorities with respect to the administrative action at issue. *Id.* Article 9

22) Philip Morris Brand Sàrl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7; Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12.

23) Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Nuclear Energy GmbH, Kernkraftwerk Brunsbüttel GmbH und Co. oHG, Kernkraftwerk Krümmel GmbH und Co. oHG v. Federal Republic of Germany.

have included challenges environmental regulation, and some public health regulations as violations of fair and equitable treatment provisions or indirect expropriations.<sup>24)</sup> When new health dangers are discovered, States will be forced to bear the commercial risk on behalf of companies in order to take steps necessary to protect their public, critics argue.<sup>25)</sup> States will prefer not to exercise preventative measures that might delay investment projects, such as environmental impact statements, because of fear of legal retaliation for lost profits, creating a chilling effect on environmental and health regulation, they say.<sup>26)</sup>

## 2. Criticisms of Institutional Features

Three institutional features of ISDS in particular have attracted negative attention: the possibility of conflict of interest among arbitrators, the lack of review of awards, and the lack of openness of the proceedings.<sup>27)</sup>

### 1) Conflicts of Interest

Opponents of ICSD say that the tribunals are composed of primarily of lawyers from large law firms who rely on multinational firms for their business, resulting in a process skewed in favor of investors.<sup>28)</sup> An OECD recent report cites a study finding that over 50% of ISDS arbitrators have acted as counsel for investors in other ISDS cases while it has been estimated about 10% of ISDS arbitrators have acted as counsel for States in

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24) For a list of environmental disputes decided in investment arbitration from 2000-2011, see Jorge Vinuales, *Foreign Investment and the Environment in International Law*, CAMBRIDGE, 2009 at 18-22.

25) See generally, Valentin Vadi, *Public Health in International Investment Arbitration*, ROUTLEDGE, 2013.

26) Marie-Claire Cordonier Segger, et al. *Sustainable Development in World Investment Law*, KLUWER LAW, 2011, at 121.

27) UNCTAD, *Reform of Investor-State Disputes Settlement: In Search of a Roadmap*, IIA ISSUES NOTE (May 2013), [http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf); Fiona Marshall, *Defining New Institutional Options for Investor State Dispute Settlement*, INSTITUTE FOR INTERNATIONAL DEVELOPMENT, June 2009.

28) Nathalie Bersconi-Osterwalder, et. al, *Arbitrator Independence and Impartiality: Examining the Dual Role of Arbitrator and Counsel*, presented at the Annual Forum for Developing Country Investment Negotiators, New Dehli, 2010.

other cases.<sup>29)</sup> It has been suggested that arbitrators have a structural conflict of interest in deciding on whether they have jurisdiction to hear each ISDS dispute because they are in effect deciding whether they will continue to be active (and be paid) for substantial additional work on the case in question.<sup>30)</sup> In addition to its economic impact in the case at hand, expansive rulings on jurisdiction may contribute to expanding the scope of ISDS arbitral business in the future.<sup>31)</sup> The rules for disclosure of conflict of interest are much less demanding than for national judicial systems and under national arbitration laws. While NAFTA Chapters 19 and 20 for state-to-state arbitrations list the situations in which arbitrators must disclose their relationships to the parties,<sup>32)</sup> the author is not aware of parallel stipulations for investment in any ratified treaty.<sup>33)</sup> In ICSID arbitration, before or at the first session of the tribunal, each arbitrator is required to fill and sign a disclosure declaration, but there are no rules as to what conflicts of interests must be disclosed.<sup>34)</sup>

## 2) *Inconsistency of Outcomes*

Critics of ISDS say the lack of appellate review in investment arbitration leads to inconsistent and unfair outcomes. Indeed in several cases separate arbitrations have led to the opposite outcome on the same government measure. And it is not uncommon for different tribunals to disagree about the meaning of the same treaty provision. The dense universe of investment

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29) OECD Secretariat, *Public Consultation on Investor-State Dispute Settlement Scoping Paper*, 2012, <http://www.oecd.org/daf/internationalinvestment/internationalinvestmentagreements/50291642.pdf>, at 42-48.

30) *Id.*

31) *Id.*

32) NAFTA Code of Conduct for Dispute Settlement Procedures under Chapter 19 and 20, <http://www.nafta-sec-alena.org/en/view.aspx?conID=658&mtpiID=ALL>.

33) The European Commission's recent proposal for investor state dispute settlement addresses the arbitrator conflict of interest comprehensively in an annex. European Commission, *Note for the Attention of the Trade Policy Committee of the European Council (Services and Investment): Text on investor state dispute settlement for EU agreements*, 5-6-2012. See also [www.iisd.org/itn/2012/07/19/analysis-of-the-european-commissions-draft-text-on-investor-state-dispute-settlement-for-eu-agreements](http://www.iisd.org/itn/2012/07/19/analysis-of-the-european-commissions-draft-text-on-investor-state-dispute-settlement-for-eu-agreements).

34) ICSID Arbitration Rules, Rule 6, available at <https://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>.

treaties has created incoherent and fragmented states of international investment law<sup>35)</sup> creating an environmental of legal uncertainty that can lead to abuse of the legal system.<sup>36)</sup> Appellate review is necessary for good governance,<sup>37)</sup> some argue.

Instead of appellate review, the ICSID Convention provides for an internal review procedure.<sup>38)</sup> An *ad hoc* Tribunal will be established to review whether one of five circumstances were present to invalidate the award.<sup>39)</sup> Errors of law are not grounds for annulment, even if manifestly unwarranted.<sup>40)</sup> Annulment does not preclude the parties from making the same claims in another arbitration. ICISD Arbitral awards are annulled less frequently than they are upheld.<sup>41)</sup>

It must be remembered that different investment tribunals are often faced with interpreting the same wording which may have different intended meanings in the context of different treaties, making a universal appellate review mechanism practically impossible at this point.<sup>42)</sup> The

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35) Stephen Schill, *The Multilateralization of Investment Law*, CAMBRIDGE UNIVERSITY PRESS, 2009.

36) David A. Gantz, *An Appellate Mechanism for Review of Arbitral Decisions in Investor-State Disputes: Prospects and Challenges*, 39 VAND. J. TRANSNAT'L L. 39, 74 (2006).

37) For an argument that an appellate mechanism would enhance both the consistency and legitimacy of investor arbitration, see Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005).

38) Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 1965, 17 U.S.T. 1270. .

39) The conditions under Art. 52 are a) That the Tribunal was not properly constituted; b) that the Tribunal has manifestly exceeded its powers; c) that there was corruption on the part of a member of the Tribunal, that there has been as serious departure from a fundamental rule of procedure; or e) that the award has filed to state the reasons on which it is based. *See id.*

40) "Disregard of the applicable rules of law must be distinguished from erroneous application of those rules which, even if manifestly unwarranted, furnishes no ground for annulment." *See CMS Gas Transmission Co. v. Argentina, Annulment Decision, ICSID, Case No. ARB/01/8, ¶ 50 (Sept. 25, 2007).*

41) Between 2001 and 2010 13 out of 21 applications for annulment were rejected. ICSID, ICSID Caseload Statistics for 2011-2, at 15.

42) The tribunal in the OSPAR convention noted the conundrum in a different context. "The application of international law rules on interpretation of treaties to identical or similar provisions of different treaties may not yield the same results, having regard to, *inter alia*, differences in the respective contexts, objects and purposes, subsequent practice of parties and *travaux préparatoires*." *See Dispute Concerning Access to Information under Article 9 of the*

difficulty with coherence has been ameliorated to some extent by treaties that provide a procedure for requesting interpretive notes from the States through Joint Commissions.<sup>43)</sup>

### 3) Confidentiality of Proceedings

It is often argued that unlike international commercial arbitration, investor state dispute settlement should be fully open to the public because of the significant public interests involved. The public interest is implicated in ISDS because a) ISDS often involves public service sectors; b) Government regulation enacted for public welfare purposes may be the subject of the dispute; c) The presence of a government in the arbitration triggers good governance obligations; d) The costs of defending claims and financing compensation awards will draw on public funds; e) The threat of arbitration from an investor can have a 'chilling' effect on government policy and prevent the raising of environmental standards, health and safety standards, and labour conditions.<sup>44)</sup>

Unlike national court systems and public international law tribunals, however, the proceedings of investor state arbitrations are not made public in accordance with a general duty of confidentiality owed by the tribunal subject to the agreement of the parties.<sup>45)</sup> Most treaties allow a choice for arbitration rules from among ICSID and UNCITRAL arbitration rules, less frequently including Permanent Court of Arbitration or International Chamber of Commerce or other institutional arbitration, each carrying with it different rules for the confidentiality of proceedings. The ICSID Center administering ICSID arbitrations is mandated to maintain a register of petitions and notices of the proceedings and to publish excerpts of the legal

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OSPAR Convention (*Ireland v. U.K.*), Perm. Ct. Arb. ¶ 141 (final award of July 2, 2003). .

43) The NAFTA Free Trade Commission (FTC), a body of cabinet level officials from each of NAFTA's signatories established under the treaty, is authorized to issue interpretations binding on tribunals established under NAFTA's investment chapter, North American Free Trade Agreement, 32 ILM 289, 605 (1993) Arts. 1131(2), 2001(1) & (2)(c).

44) See Tienhaara, *Third Party Participation in Investment-Environment Disputes: Recent Developments*, REV. EUR. COMMUNITY & INT'L ENVIL. L., 230, 16(2) (2007).

45) As an exception, beginning with Annex 1137.4 of NAFTA, which permits either party to publish the award when the parties are the United States or Canada, US treaties have generally contained provisions on the transparency of arbitral procedures. See US Model BIT, Art. 29, available at <http://www.state.gov/e/eb/afd/bit/index.htm>.

reasoning of awards.<sup>46)</sup> On the other hand the ICSID Center is forbidden from publishing the full award without the consent of both parties. And the ICSID Arbitration Rules provides that persons other than the parties, their agents, counsel and advocates, and of witnesses and experts may not be allowed to attend hearings without the consent of both parties.<sup>47)</sup> The UNCITRAL Rules for all treaties prior to January 2013, had similar limitations except that Article 34(5) of the UNCITRAL Arbitration Rules provided that “[a]n award may be made public with the consent of all parties or where and to the extent disclosure is required of a party by legal duty, to protect or pursue a legal right or in relation to legal proceedings before a court or other competent authority.”<sup>48)</sup>

### 3. Risk of Expensive Litigation Against the Public Sector

Another criticism of ISDS is that it exposes the public sector to the risk of expensive litigation. Moreover, when the respondent is a developing country, as in a large majority of the cases, ISDS can carry a trade off for human development, as the money earmarked for awards could be used to build schools, roads or hospitals. There is no doubt that the risk of facing an investment arbitration is escalating. A steep upward trend has prevailed since the year 2000.<sup>49)</sup> According to UNCTADs, most recent update on investor state arbitration cases against APEC members account for 102 of the 450 known ISDS cases.<sup>50)</sup> It should be noted, however, that so far the vast majority of these cases are based on bilateral investment treaties (63%) or investment contracts (21%) and not free trade agreements.<sup>51)</sup>

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46) ICSID Arbitration Rules, *supra* note 34, Rule 48(4).

47) *Id.*

48) United National Commission on International Trade Law, UNCITRAL Arbitration Rules (as revised in 2010), *available at* <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf>. Under the recently drafted Rules on Transparency in Investor State Dispute Resolution, the notice of arbitration and other key documents would be published through the ICSID registry. *See supra* note 7.

49) UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, April 2012, [http://unctad.org/en/PublicationsLibrary/webdiaeia2012d10\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaeia2012d10_en.pdf), at 3.

50) *Id.* at 15-18.

51) ICSID Caseload Statistics for 2011-12, <http://icsid.worldbank.org>, at 10.

In terms of overall costs, expenses for defending ISD cases can range from a few hundred thousand to hundreds of million dollars or even billions of dollars. Eighty percent of the costs account for attorneys fees.<sup>52)</sup> ISDS cases are longer than WTO cases – averaging three years, with annulment petitions lasting another three years.<sup>53)</sup> A third-party financing market has emerged, which critics say contributes to the demand for more litigation.<sup>54)</sup>

As treaties with ISDS multiply, the potential for forum and treaty shopping increases. Investors can treaty shop when treaties contain a definition of investor with standing that includes subsidiaries of national entities wherever located.<sup>55)</sup> To compensate for this, most recent APEC FTAs require incorporation in the participating State and a controlling interest in the participating State for investor standing or otherwise contain a “denial of benefits” clause.<sup>56)</sup> Investors have engaged in several attempts to forum-shop by taking advantage of the more favorable dispute settlement offered to investors of other countries through the MFN clause.<sup>57)</sup> Some Members have therefore expressly exempted dispute resolution from the scope of the MFN clause.<sup>58)</sup>

#### IV. Responses of the Member Economies

Although APEC publishes no model investment arbitration agreement, it has worked for decades through the Investment Expert Group to develop non-binding principles<sup>59)</sup> and other recommendations to guide policy

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52) *Supra* note 29, at 18-22.

53) *Id.*

54) *Id.* at 36-39.

55) Peter Mulchinski, *Corporations and Uses of Law: International Investment Arbitration as a “Multilateral Legal Order,”* 1 ONATI SOCIO-LEGAL SERIES 4 (2011).

56) *Supra* note 2, art.11.11.

57) See Emanuel Gaillard, *Establishing Jurisdiction through a Most-Favored Nation Clause*, 2 N.Y.L.J. 1,3. (2005).

58) Canada-Peru FTA Annex B.4, available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/peru-perou/peru-toc-perou-tdm.aspx>.

59) The most recent version of the project begun in 1994 may be found at <http://aimp>.

makers. Most recently APEC collaborated with UNCTAD to create a handbook to serve as an analytical guide for negotiators for investment agreements, with a menu of textual options based on common alternative approaches.<sup>60)</sup>

## 1. Bilateral and Multilateral Responses

### 1) Clarifications and Exceptions to Disciplines

In the wake of the initial ISD cases challenging regulation in the environmental area, Member Economies, led by the US, have amended their treaties to reserve more policy space, particularly in clauses clarifying the scope of expropriations and through the use of expanded exceptions.<sup>61)</sup> A recent OECD study on the treatment of environmental concerns in international investment agreements shows that only 8% of all investment agreements in existence contain a reference to the environment, while about 89% of treaties coming into existence contain reference to the environment.<sup>62)</sup> Beginning with the 2004 US Model BIT, the expropriation provisions have been modified to allow for the normal exercise of state police powers in most cases, clarifying that “Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”<sup>63)</sup> What rises to the level of expropriation must be determined on a case-by-case basis taking into consideration several factors, including the extent to which the action “interferes with the

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[apec.org/Documents/2011/MM/AMM/11\\_amm\\_014app04.doc](http://apec.org/Documents/2011/MM/AMM/11_amm_014app04.doc).

60) APEC, *APEC UNCTAD Handbook for Negotiators of International Investment Agreements*, available at <http://investmentpolicyhub.unctad.org/Views/Public/Document.aspx?sid=5>. APEC explains that it does “not aim to present any sort of consensus or international benchmarking,” and that the options are merely “indicative and could be considered by the negotiators as a useful element without prejudging national policy decisions.” The handbook contains language from treaties inside and outside of APEC.

61) See generally, Kathryn Gordon & Joachim Pohl, *Environmental Concerns in International Investment Agreements: a survey*, [www.oecd.org/daf/investment/workingpapers](http://www.oecd.org/daf/investment/workingpapers) at 16-22.

62) *Id.*

63) *Supra* note 2, art. 11.6.

investors' distinct, reasonable investment-backed expectations."<sup>64)</sup>

Although in general Bilateral Investment Treaties in the region have not<sup>65)</sup> contained general exceptions clauses such as GATT Art. XX to carve out regulatory space,<sup>66)</sup> a few recent APEC investment agreements have followed the approach of the Argentina-New Zealand BIT.<sup>67)</sup> More often, Members have used exclusion with regard to specific commitments, such as the environmental exception to the prohibition on performance requirements in the KORUS-FTA or with respect to mode 3 services investment.<sup>68)</sup> Korea, for example, has incorporated the exceptions clause of GATS Art. XIV(b)<sup>69)</sup> into service sector commitments, but not for the Agreement overall, in its FTAs with Singapore and Peru and in the

64) *Id.*

65) Many earlier BITs of the US have included a less inclusive "Non-Precluded Measures" (NPM) clause for measures concerning vital public interest in emergency situations See William Burke White & Andreas Von Stadten, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-precluded Measures in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307(2007)

66) One notable exception is the very wide exclusion in the Korea-Japan BIT Art. 16(1)(c), "Notwithstanding any other provisions in this Agreement <...> each Contracting Party <...> take any measure necessary to protect human, animal or plant life or health," available at [http://unctad.org/sections/dite/ia/docs/bits/korea\\_japan.pdf](http://unctad.org/sections/dite/ia/docs/bits/korea_japan.pdf). See also, the Korean ASEAN Investment Agreement Art. 20, available at <http://akfta.asean.org/index.php?page=investment-legal-text>.

67) Art. 5(3) states: "The provisions of this Agreement shall in no way limit the right of either Contracting Party to take any measures (including the destruction of plants and animals, confiscation of property or the imposition of restrictions on stock movement) necessary for the protection of natural and physical resources or human health, provided such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination," available at [http://unctad.org/sections/dite/ia/docs/bits/argentina\\_newzealand.pdf](http://unctad.org/sections/dite/ia/docs/bits/argentina_newzealand.pdf). See also the KOREA-ASEAN FTA Investment Agreement, Art. 20(1).

68) *Supra* note 2, art. 11.8(3)(c), "Notwithstanding any other provisions in this Agreement <...> each Contracting Party <...> take any measure necessary to protect human, animal or plant life or health."

69) "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures... (b) necessary to protect human, animal or plant life or health;" Agreement Establishing the World Trade Organization Annex 1B: General Agreement on Trade in Services and Annexes, 1869 U.N.T.S. 183, 1994.

KOREA-ASEAN FTA.<sup>70)</sup> Under the influence of such clarifications and exceptions, investment arbitration tribunals today may be moving toward perform balancing and proportionality tests when applying expropriation or fair and equitable treatment clauses in contrast to the more absolute approach of the early cases.<sup>71)</sup>

## 2) Sustainability Impact Assessments

Aside from changes in treaty drafting, some members have employed Trade Sustainability Impact Assessment (hereinafter 'SIA') to engage a variety of stakeholders to induce "buy in" for investment liberalization, particularly when in agreements with the EU.<sup>72)</sup> Trade SIA is a process undertaken during a trade negotiation which seeks to identify the potential economic, social and environmental impacts of a trade agreement. Trade SIAs aim to integrate sustainability into trade policy by informing negotiators of the possible social, environmental and economic consequences of a trade agreement and to make information on the potential impacts available to all actors.<sup>73)</sup> SIAs have attempted to engage a wide spectrum of interest groups on consultations about the impact of the investment agreement.<sup>74)</sup> There are particular problems with evaluating the impact of investment chapters since so much depends on the conduct and business plans of the investor that is ultimately approved, but this only underscores the necessity of conducting rigorous due diligence on individual investors through published project-based social and environmental impact statements.

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70) Korea Singapore FTA art. 21.2.(2)(c), available at <http://www.commonlii.org/sg/other/treaties/2005/2/>, and Korea Peru FTA art. 24.1 (2), available at [http://www.sice.oas.org/TPD/PER\\_KOR/PER\\_KOR\\_Texts\\_e/PER\\_KOR\\_ToC\\_e.asp](http://www.sice.oas.org/TPD/PER_KOR/PER_KOR_Texts_e/PER_KOR_ToC_e.asp)

71) Gordon, *supra* note 61, at 10.

72) See, for example the Korea-EU FTA Sustainability Impact Assessment, available at [http://trade.ec.europa.eu/doclib/docs/2008/december/tradoc\\_141660.pdf](http://trade.ec.europa.eu/doclib/docs/2008/december/tradoc_141660.pdf). See also Colin Kirkpatrick et al., *The Trade sustainability impact assessment (SIA) on the comprehensive economic and trade agreement (CETA) between the EU and Canada: Final report*, EUROPEAN COMMISSION TRADE ASSESSMENTS, (2012) available at <http://mpra.ub.uni-muenchen.de/28812/>.

73) European Commission, *Handbook for Trade Sustainability Impact Assessments*, 2006, at 7.

74) *Id.* at 23.

### 3) *Transparency Provisions*

Member Economies have also strengthened transparency provisions in recent treaties along many dimensions. Concerning ISDS procedures, a growing minority of the treaties in existence today follow an open approach using the wording of the 2004 Model US BIT requiring public hearings and public access to all the documents such as the notifications, pleadings, final award, allowing for non-disputing party, and *amicus curiae* submissions. If a party requests confidentiality on a particular matter for business reasons or because it is privileged under domestic law, the tribunal is mandated to arrange for confidentiality.<sup>75)</sup>

Foreign investment projects with unrealistic or inflated financial projections have been associated with corruption in the admission process, leading to conflicts with governments and the public.<sup>76)</sup> A few FTAs include clauses that foster good governance by focusing on the elimination of bribery through anti-corruption legislation, such as Article 21.6 in the KORUS-FTA transparency chapter.<sup>77)</sup>

### 4) *Negotiating for an Appellate Review Mechanism*

There have been three distinct approaches to address the demand for an appellate review mechanism. First, a single consolidated appeals facility could be created under the ICSID convention. This has been apparently been a US policy objective, thus the US 2012 Model BIT states, “In the event that an appellate mechanism for reviewing awards rendered by investor-

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75) US Model BIT art. 29, available at <http://www.state.gov/documents/organization/117601.pdf>.

76) The Dabhol Power Project in India was one such example, involving the failed US multinational Enron. See Gus Van Harten, *TWAIL and the Dabhol Arbitration*, TRADE, LAW AND DEVELOPMENT (2011). Arbitration claims were launched under investment contracts and a bilateral investment treaty

77) 1. The Parties reaffirm their resolve to eliminate bribery and corruption in international trade and investment.

2. Each Party shall adopt or maintain the necessary legislative or other measures to establish that it is a criminal offense under its law, in matters affecting international trade or investment, for:

(a) a public official of the Party or a person who performs public functions for the Party intentionally to solicit or accept, directly or indirectly, any article of monetary value or other benefit, such as a favor, promise, or advantage, for himself or for another person, in exchange for any act or omission in the performance of his public functions; .. *supra* note 2.

State dispute settlement tribunals is developed in the future under other institutional arrangements, the Parties shall consider whether awards rendered under Article 34 should be subject to that appellate mechanism.” The introduction of an appeals facility at ICSID would mean amending Art. 54 of the ICSID Convention guaranteeing the finality of the awards, which would require the agreement of 143 States. Alternatively, specific states could agree to a protocol to the ICSID convention. In 2004, the ICSID Secretariat released a “Discussion Paper on Possible Improvements of the Framework for ICSID Arbitration” with a detailed proposal in the Annex for an appeals facility. The Secretariat abandoned the idea in view of the difficult technical and policy issues raised.<sup>78)</sup>

A second approach has been to negotiate appeals mechanism for individual treaties. Thus CAFTA<sup>79)</sup> and the KORUS-FTA contain obligations to establish a negotiating group to develop an appellate body or similar mechanism linked to the treaty. However, if such appellate mechanisms came into existence, arguably they might worsen the problem of inconsistency and fragmentation in international investment law while increasing the length of proceedings. Under this reasoning, it would be better to wait for an appeals facility associated with a single multilateral investment treaty, which is the third approach. Currently the Transpacific Strategic Economic Partnership Agreement with eleven countries is one of a few multilateral investment agreement negotiations in the region with investor state dispute settlement at the moment,<sup>80)</sup> including Member Economies Chile, New Zealand, Singapore, Brunei Darussalam, the United States, Australia, Peru, Vietnam, Malaysia, Mexico, and Canada. Another is the Regional Comprehensive Economic Partnership which includes China

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78) International Centre for Settlement of Investment Disputes Secretariat, *Possible Improvements of the Framework for ICSID Arbitration*, Discussion Paper (Oct. 22, 2004), available at [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnouncePDF&AnnouncementType=archive&AnnounceNo=14\\_1.pdf](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnouncePDF&AnnouncementType=archive&AnnounceNo=14_1.pdf).

79) United States-Dominican Republic-Central American Free Trade Agreement Annex 10-F, , available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dominican-republic-central-america-fta/final-text>.

80) The main agreement is available at <http://www.mfat.govt.nz/downloads/trade-agreement/transpacific/main-agreement.pdf>. The investment chapter, which was leaked unofficially outside of negotiations, can be found at <http://www.citizenstrade.org/ctc/wp-content/uploads/2012/06/tppinvestment.pdf>.

but not the United States.<sup>81)</sup>

## 2. Pre-arbitration Strategies for Conflict Prevention by Individual Member Economies

### 1) Pre-establishment Treatment

In investment arbitration, since the actions of all the various agencies interacting with foreign investors are judged as a whole some Members have focused on interagency coordination to prevent disputes from occurring. The commitment of protection of the investors legitimate expectations necessarily takes into account all representations and undertakings made by the host state including those in legislation, treaties, decrees, licenses, and contracts. Unless the treaty specifies otherwise, conduct of a local government or other entity exercising government of authority will be attributed to the national government under international law.<sup>82)</sup> When drafting environmental and health legislation, the investment treaty commitments should always be taken into account. Tribunals will be more likely to recognize a public health or environmental exception closely linked to the implementation of an international environmental treaty or if it is backed up by a favorable cost-benefit analysis or proportionality analysis to support an argument of reasonableness.<sup>83)</sup>

Besides communicating with relevant agencies involved with foreign investments about investment treaty commitments, some Member Economies have created a central contact point to coordinate negotiations with aggrieved foreign investors and have designated an entity that has legal authority to represent the Member in settlement negotiations.<sup>84)</sup> Members have established formal, reconciliation institutions, such as conciliation or arbitration-mediation services<sup>85)</sup> and foreign investment

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81) See *Asian Leaders Push Regional Trade Pact*, WALL ST. J., NOV. 19, 2012, available at <http://online.wsj.com/article/SB10001424127887323622904578128650479355368.html>.

82) *Compania de Aguas del Aconquija S.A. v. Argentinian (Vivendi Annulment)*, ICSID Case No. ARB.97/3 (July. 3, 2002), 19 ICSID Rev. 89 (2004).

83) *Vinales*, *supra* note 24, at. 275-277, 313-314.

84) UNCTAD, *Investor State Disputes: Prevention and Alternatives to Arbitration*, at 88-93.

85) See, for example, International Bar Association et al., *The IBA Rules for Investor State Mediation*, available at [http://www.ibanet.org/LPD/Dispute\\_Resolution\\_Section/Mediation/](http://www.ibanet.org/LPD/Dispute_Resolution_Section/Mediation/)

ombudsman. An ombud has been defined as an “officer appointed by the legislature to handle complaints against administrative and judicial action,” serving as a “watchdog” over those actions while exercising independence, expertise, impartiality, accessibility and powers of persuasion rather than control.” In some cases, the Ombudsman office has been able to alert Member economies to emerging conflicts, as well as serve as a mediator between investors and the government agencies with which investors have grievances. Korea has had an Investment Ombudsman Office since 1998 reporting directly to the Prime Minister’s Office. Its Investment Aftercare team both assists companies in understanding and complying with regulations and resolves disputes. From 2000 to 2007, more than 3,200 grievances of foreign investors that were received by the OIO covered an array of issues pertaining to various industrial sectors. In 2007, 370 grievances were filed, of which 298 were resolved by the “home doctors,” constituting 80.5 per cent of all grievances in that year.<sup>86)</sup>

## 2) Contractual Approaches

Some Member economies have found innovative ways to accommodate the interests of local non-government stakeholders in individual contracts with investors. Such provisions are aimed at providing additional security to local populations most strongly affected by an investment project. Local populations can be given a role in monitoring environmental or health compliance as can be seen in the agreement between Canada, government of the Northwest Territories, and BHP Diamonds.<sup>87)</sup> When people are displaced physically by an investment project, the contracts may preserve the right to limited use of the land, or grant other means of economic compensation through the investment project, such as equity stakes. As another example, access and benefit sharing agreements grant foreign investors the right to bioprospect in return for some sort of benefits to

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State\_Mediation/Default.aspx.

86) *Supra* note 85.

87) Article VII of the Environmental Agreement between Her Majesty the Queen in Right of Canada as represented by the Minister of Indian Affairs and Northern Development and the Government of the Northwest Territories and BHP Diamonds, Inc., available at <http://www.monitoringagency.net/ResourceCentre/EnvironmentalAgreement/tabid/87/Default.aspx>.

indigenous populations, including a right to royalties from the drugs developed on the basis of samples obtained.<sup>88)</sup> Australia has drafted templates of such agreements; these and other model agreements are available from the World Intellectual Property Organization.<sup>89)</sup>

### 3. Approaches from Outside APEC

It is worthwhile for the APEC Members to consider some novel developments outside the region in incorporating the public interest. Although FTAs do not yet impose duties on investors as well as States, some agreements come very close. The EU-CARIFORUM Economic Partnership Agreement (2008) imposes an obligation on the participating States to ensure that investors do not commit bribery and that investors comply with International Labor Organization Standards, environmental and labor treaties to which the states are parties.<sup>90)</sup> Furthermore, the Contracting parties must insure that investors will establish community liaison processes in connection natural resource projects.<sup>91)</sup>

## V. Conclusion

The ISD clauses of international investment treaties have attracted national controversy in several of the Member Economies, prompting a reconsideration of treaty drafting and the adoption of pre-litigation strategies to increase communication between investors and host-country stakeholders in order to prevent or resolve disputes at an early stage. Concerning the objection that ISD infringes on the sovereign right of States

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88) Guidelines and model contractual clauses are presented in the Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising from their Utilization to the convention on Biological Diversity, available at <http://www.cbd.int/abs/text>.

89) WIPO's database of contracts is available at <http://www.wipo.int/tk/en/databases/contracts>.

90) EU-CARIFORUM Economic Partnership Agreement art.71, Council Decision 2008/805/EC, 2008 O.J. (L 289) 51.

91) *Id.*

to legislate for environmental health and welfare, Member Economies have mostly chosen to negotiate to carve out public policy exceptions to the pertinent investment disciplines, but seldom with the full breadth of the WTO GATT and GATS exceptions clause. Some recent APEC FTAs have followed the US approach of incorporating provisions on the transparency of investment arbitral proceedings in their treaties. While considerable harmonization in the wording of investment disciplines and ISD clauses appears to be taking place, the APEC Members have neither the unified approach to the question of an appellate mechanism to support consistency of outcomes, nor has the problem of conflict of interest among arbitrators been addressed in any substantive way in the treaties. This suggests that the overall consensus in favor of the current ISD institutional structure has not been disturbed.

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