

INVESTOR-STATE DISPUTE SETTLEMENT: THE EVOLVING BALANCE BETWEEN INVESTOR PROTECTION AND STATE SOVEREIGNTY

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This paper analyses the recent evolution of Investor-State Dispute Settlement ('ISDS') and asks whether it strikes an appropriate balance between investor protection and State sovereignty. The paper identifies three major points of contention on the impact of ISDS on State sovereignty – the legitimacy of the ISDS mechanism; the scope of obligations enforceable under ISDS; and the phenomenon of 'regulatory chill'. After analysing the evolution of ISDS provisions over three treaties, the paper concludes that the balance between investor protection and State sovereignty in the most recent treaty significantly improves on earlier treaties but that there is still room for improvement, particularly with the perceived legitimacy of the ISDS mechanism. The paper finishes by suggesting four reforms to address outstanding concerns.

INTRODUCTION

This paper analyses the recent evolution of Investor-State Dispute Settlement ('ISDS') and asks whether ISDS strikes an appropriate balance between investor protection and State sovereignty.

ISDS has recently been the subject of much attention from academics, politicians, interest groups and the media, partly due to the inclusion of ISDS provisions in the Trans-Pacific Partnership Agreement, a free trade agreement which could cover as much as 36% of the world economy if ratified by its negotiating parties.¹ The controversy surrounding ISDS has been such that Chief Justice Robert French of the High Court of Australia has voiced his

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¹ Department of Foreign Affairs and Trade, *Trans-Pacific Partnership* <<http://dfat.gov.au/trade/agreements/tpp/Pages/trans-pacific-partnership-agreement-tpp.aspx>>; Phillip Adams, 'Where are the TPP negotiations up to?' (Radio Interview, 3 March 2015) <<http://www.abc.net.au/radionational/programs/latenightlive/where-are-the-tpp-negotiations-up-to3f/6275624>>.

concerns about the mechanism² and the Australian Government announced its opposition to the inclusion of ISDS provisions in future treaties in 2011³ (since reversed with the election of the Coalition in 2013 – ISDS provisions are now included in treaties on a case-by-case basis).⁴

The inclusion of ISDS provisions in a treaty gives covered foreign investors standing to challenge a host State before an ISDS arbitral tribunal in the event that the host State violates its obligations under the treaty. The sorts of actions that an investor might challenge include outright takings (e.g. the State nationalising a foreign investor's mine) and denials of justice.

Critics' main concern, however, is that ISDS threatens States' abilities to implement public interest regulation, such as public health and environmental regulation.⁵ A good example of this is the one ISDS claim in which Australia has been a respondent. Australia legislated requirements for the plain packaging of tobacco through the *Tobacco Plain Packaging Act 2011* (Cth). Philip Morris Asia, a large tobacco company, challenged the constitutionality of the requirements in the High Court of Australia, failed, and is now in an ongoing ISDS dispute with Australia over the legislation.⁶ If Philip Morris Asia were to win and Australia were ordered to compensate Philip Morris Asia, critics would cite this as evidence that the balance between investor protection and State sovereignty in ISDS is skewed too far in favour of investor protection.

Proponents of ISDS argue that ISDS is necessary to address the need for investor protection. Investors are vulnerable to the arbitrary exercise of State power, especially by States with poor records of upholding the rule of law.⁷

² Chief Justice Robert French, 'Investor-State Dispute Settlement – A Cut Above the Courts?' (Paper presented at the Supreme and Federal Courts Judges' Conference, Darwin, 9 July 2014).

³ *Ibid* 13.

⁴ Australian Broadcasting Corporation, 'ISDS: The Devil in the Trade Deal', *Background Briefing*, 14 September 2014 (Jess Hill) <<http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490#transcript>>.

⁵ See e.g., Elizabeth Warren, 'The Trans-Pacific Partnership clause everyone should oppose', *Washington Post* (online) (25 February 2015) <http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html>; Claire Provost and Matt Kennard, 'The Obscure Legal System That Lets Corporations Sue States' *The Guardian* (online) (10 June 2015) <<http://www.theguardian.com/business/2015/jun/10/obscure-legal-system-lets-corporations-sue-states-ttip-icsid>>.

⁶ Attorney-General's Department, *Tobacco plain packaging – investor-state arbitration* <<http://www.ag.gov.au/Internationalrelations/InternationalLaw/Pages/Tobacoplainpackaging.aspx>>; Department of Foreign Affairs and Trade, *Investor-State Dispute Settlement* <<http://dfat.gov.au/trade/topics/Pages/isds.aspx>>; *JT International SA v Commonwealth* (2012) 250 CLR 1.

⁷ See e.g., Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879.

Proponents also argue that the changes to ISDS provisions and the obligations they enforce in newer treaties address critics' concerns about the impact of ISDS on States' abilities to implement public interest regulation.

This paper will weigh both sides of the argument to reach a conclusion on whether the balance between investor protection and State sovereignty in ISDS, as it currently stands, is appropriate.

The structure is as follows. Chapter One outlines both sides of the argument on three major points of contention about the impact of ISDS on State sovereignty – the legitimacy of the ISDS mechanism, the scope of obligations enforceable under ISDS, and the phenomenon of 'regulatory chill'. Chapter Two analyses the evolution of ISDS over three treaties, namely, the *Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investments* ('Hong Kong-Australia BIT'),⁸ the *North American Free Trade Agreement* ('NAFTA')⁹ and the *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea* ('KAFTA').¹⁰ Chapter Three concludes whether, in the author's opinion, ISDS strikes the right balance between investor protection and State sovereignty and suggests four reforms to address outstanding concerns.

I DEBATING THE IMPACT OF ISDS ON STATE SOVEREIGNTY

A Overview

This chapter examines the debate between critics and proponents of ISDS over the impact of ISDS on State sovereignty. Part A examines arguments concerning the legitimacy of the ISDS mechanism. Part B introduces the controversy surrounding the appropriate scope of obligations enforceable under ISDS. Part C examines the debate surrounding 'regulatory chill'.

Legitimacy of the ISDS Mechanism

Given the significant power and responsibility entrusted to ISDS tribunals, a lack of legitimacy in the ISDS mechanism could undermine both State sovereignty and investor protection.¹¹ Two key concerns about the legitimacy of

⁸ *Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investments*, signed 15 September 1993, 1748 UNTS 385, (entered into force 15 October 1993).

⁹ *North American Free Trade Agreement*, signed 17 December 1992, [1994] CTS 2 (entered into force 1 January 1994).

¹⁰ *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea*, signed 8 April 2014, [2014] ATS 43, (entered into force 12 December 2014).

¹¹ Eduardo Zuleta, 'The Challenges of Creating a Standing International Investment Court' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 409-413; Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The Appeal Proposal' in Jean E Kalicki and Anna Joubin-

ISDS relate to the method of appointment of arbitrators and the lack of consistency in ISDS tribunal decision-making.

1 *Appointment of Arbitrators*

The method of appointment of arbitrators in ISDS is critical to the legitimacy of ISDS. Redfern and Hunter note that

nothing is more important than choosing the right arbitral tribunal. It is an important choice, not only for the parties to the particular dispute, but also for the reputation and standing of the arbitral process itself. It is, above all, the quality of the arbitral tribunal that makes or breaks the process.¹²

ISDS arbitral tribunals are usually made up of three members, with a common practice being that each party to the dispute will nominate one arbitrator and the parties reach agreement on who will be the third arbitrator.¹³

Because of the ad hoc nature of ISDS arbitral tribunals, arbitrators depend on repeated appointments and have none of the security of tenure that a judge would typically enjoy. As some academics have argued, '[a]ny need for reappointment makes judges less independent – this is no different for arbitrators'.¹⁴

Further, the disputing parties' primary concern may not be to choose the most impartial, most independent arbitrator as their nominee for the tribunal. As Jan Paulsson writes,

[d]isputants tend to be interested in one thing only: winning. They exercise their right of unilateral appointment, like everything else, with that overriding objective in view. The result is speculation about ways and means to shape a favourable tribunal, or at least to avoid a tribunal favorable to the other side – which is logically assumed to be speculating with the same fervour, and toward the same end.¹⁵

Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 463-473.

¹² Cited in Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006), 1123/3.

¹³ See, e.g., *NAFTA* art 1123; *KAFTA* art 11.19.

¹⁴ Anne van Aaken 'Delegating Interpretative Authority in Investment Treaties: The Case of Joint Administrative Commissions' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 21, 33.

¹⁵ Extracted in Anne van Aaken 'Delegating Interpretative Authority in Investment Treaties: The Case of Joint Administrative Commissions' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 21, 35-36. See also, Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The

Some argue that such practices, known as ‘profiling’, have only become more prevalent as the number of ISDS cases has risen.¹⁶ If arbitrators are being chosen in order to ‘shape a favourable tribunal’, that has negative implications for the impartiality of the members of ISDS tribunals.

The other aspect of the appointment of arbitrators giving rise to concerns is the ‘double hat dilemma’.¹⁷ US Senator Elizabeth Warren, a high-profile critic of ISDS, recently wrote about this in an op-ed in the *Washington Post*:

ISDS could lead to gigantic fines, but it wouldn’t employ independent judges. Instead, highly paid corporate lawyers would go back and forth between representing corporations one day and sitting in judgment the next.¹⁸

This so-called ‘double hat dilemma’ raises similar concerns to those relating to arbitrators’ lack of secure tenure. If arbitrators are interchangeably representing parties and sitting on arbitral tribunals it raises doubts about their independence and impartiality when deciding matters in arbitrations.¹⁹

Proponents of ISDS argue that such criticisms are ‘not accurate but rather based on a generalized distrust and an unfounded presumption of bad faith of arbitrators’.²⁰ They offer rebuttals on both theoretical and empirical grounds.

It is beyond the scope of this paper to address in any detail the empirical arguments of whether or not the method of appointment of arbitrators results in arbitral tribunals which are not independent or impartial. Suffice it to note that some academics use empirical analysis to argue that ‘[s]uch assertions have

Appeal Proposal’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 470.

¹⁶ Gabriel Bottini, ‘Reform of the Investor-State Arbitration Regime: The Appeal Proposal’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 470.

¹⁷ Eduardo Zuleta, ‘The Challenges of Creating a Standing International Investment Court in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 411.

¹⁸ Elizabeth Warren, ‘The Trans-Pacific Partnership clause everyone should oppose’, *Washington Post* (online) (25 February 2015) <http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html>.

¹⁹ Eduardo Zuleta, ‘The Challenges of Creating a Standing International Investment Court in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 411; Elizabeth Warren, ‘The Trans-Pacific Partnership clause everyone should oppose’, *Washington Post* (online) (25 February 2015) <http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html>.

²⁰ Eduardo Zuleta, ‘The Challenges of Creating a Standing International Investment Court in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 409.

no discernible basis in reality'.²¹ However, doubts persist.

The theoretical rebuttal is that there are existing measures in place that 'tend to ensure the impartiality and independence of arbitrators'.²² This includes the ability of parties to challenge arbitrators chosen by the other side.²³ Further, the commonly used rules under which ISDS operates impose duties on arbitrators. The *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* ('ICSID Convention') and the *Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for the Settlement of Investment Disputes (Additional Facility Rules)* ('ICSID Arbitration (Additional Facility) Rules') each require arbitrators to be 'of high moral character and recognised competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment'.²⁴ The *Arbitration Rules of the United Nations Commission on International Trade Law* ('UNCITRAL Arbitration Rules') require arbitrators to be impartial, independent and to disclose anything likely to give rise to justifiable doubts as to the arbitrator's impartiality or independence.²⁵

Finally, proponents of ISDS note that it is in the interest of arbitrators to uphold a reputation of independence and impartiality:

the reputation of an arbitrator is his or her most valuable asset, and therefore, to be known as someone who rules not upon his or her legal judgment, but upon the interests of his appointer, will make him or her lose almost any chance of being appointed again.²⁶

Under this view, arbitrators' self-interest in maintaining a reputation of integrity which will allow them to be reappointed in the future is a check on their independence and impartiality.

²¹ Charles N Brower and Sadie Blanchard, 'What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States' (2014) 52 *Columbia Journal of Transnational Law* 689, 710; Liang-Ying Tan and Amal Bouchenaki, 'Limiting Investor Access to Investment Arbitration: A Solution without a Problem' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 252.

²² Eduardo Zuleta, 'The Challenges of Creating a Standing International Investment Court' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 409.

²³ See e.g., *NAFTA* art 1125; *KAFTA* art 11.19.4.

²⁴ *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, opened for signature 14 October 1966, 575 UNTS 159 (entered into force 14 October 1966) art 14; *ICSID Arbitration (Additional Facility) Rules* art 8.

²⁵ *UNCITRAL Arbitration Rules* arts 9–12.

²⁶ Eduardo Zuleta, 'The Challenges of Creating a Standing International Investment Court' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 410.

2 Consistency of Decisions

Consistency is also critical to the perceived legitimacy of ISDS. As Kaufmann-Kohler argues,

it is important to remember that the credibility of the entire dispute resolution system depends on consistency, because a dispute settlement process that produces unpredictable results will lose the confidence of the users in the long term and defeat its own purpose.²⁷

ISDS has been criticised as giving rise to ‘an erratic pattern of decisions, with reasoning often impressionistic and displaying a certain disregard for State regulatory prerogatives’.²⁸ There are a few factors that contribute to this: ISDS arbitral tribunals are created on an ad hoc basis, they are asked to resolve disputes based on differing provisions in different treaties, and the doctrine of precedent does not operate in international investment law. Critics argue that

[w]hile in some cases these diverging results are attributable to meaningful factual differences or differing treaty provisions, in a growing number of cases separate tribunals have reached contradictory results that cannot be explained by factual or legal differences in the claims.²⁹

This is a significant concern because it undermines States’ ability to predict how ISDS provisions will be interpreted when they are going through the process of drafting and negotiating IIA provisions.

Some argue that a small degree of inconsistency can even be beneficial. As Professor Susan Franck notes, ‘a minor degree of inconsistency may be useful, as it permits a challenge to the fundamental principles of the system and fosters the considered evolution of law’.³⁰ On this view, flexibility in interpretation between different ISDS arbitral tribunals contributes to experimentation and evolution in international investment law.

²⁷ Cited in Joshua Karton, ‘Lessons from International Uniform Law’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 48, 55.

²⁸ Liang-Ying Tan and Amal Bouchenaki, ‘Limiting Investor Access to Investment Arbitration: A Solution without a Problem?’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 250; Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press, 2009) xxi.

²⁹ Eun Young Park, ‘Appellate Review in Investor State Arbitration’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 443, 443.

³⁰ Gabriel Bottini, ‘Reform of the Investor-State Arbitration Regime: The Appeal Proposal’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 466; Susan D Franck, ‘The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions’ (2005) 73 *Fordham Law Review* 1521, 1613.

However, such counter-arguments are generally qualified. As Professor Franck argues, 'it is possible to have too much of a good thing... the stakes in investment arbitration are simply too great to sit by idly while issues of public international law are being decided inconsistently, in private.'³¹

3 *Overarching Rebuttal to Legitimacy Issues - ISDS is Better than the Alternatives*

Besides the specific rebuttals outlined above, another response ISDS proponents have to concerns about the legitimacy of the ISDS mechanism is to argue that, for all its flaws, ISDS is better than the traditional alternatives of diplomatic protection and pursuing local remedies.³²

Under diplomatic protection, an investor's home State pursues the investor's dispute against the host State on the investor's behalf.³³ However, diplomatic protection has serious drawbacks. From the home State's perspective, the politics and diplomacy involved in diplomatic protection can potentially result in irritation and discord between the home State and the host State.³⁴ From the investor's perspective, there are three main drawbacks. Firstly, diplomatic protection generally requires the prior exhaustion of local remedies, which can be time-consuming and expensive. Secondly, a home State's decision to provide diplomatic protection is entirely discretionary – it is dependent on the importance of the claim to the State, the investor's proximity to the State and the state of diplomatic relations between the home State and the host State. Finally, under diplomatic protection, the investor loses all control over its claim.³⁵

The other avenue for investors is to pursue local remedies. This will generally be through the host State's domestic legal system. However, not only do legal protections and standards vary greatly between countries, legal systems also differ in their independence, efficiency, competence and respect for the rule of law.³⁶ Further, even if an investor is successful in obtaining judgment in their favour, enforcement of any resulting award might prove challenging in the face of an obstructionist legal system. As Christoph Schreuer notes, '[i]t is a sad fact that many countries lack a truly independent judiciary'.³⁷ Jan Paulsson

³¹ Ibid.

³² See e.g. Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879.

³³ Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879, 881-882.

³⁴ Ibid 881.

³⁵ Ibid 883.

³⁶ Ibid 883-884.

³⁷ Ibid.

argues that 'it would be preposterous to imagine that even half of the world's population lives in countries that provide decent justice... [t]he rule of law is pure illusion for most of our fellow travellers on this planet.'³⁸ Whether or not these are overly pessimistic views, arguably it is fair to conclude that many legal systems do not guarantee fair treatment for foreign investors.

ISDS addresses the drawbacks of diplomatic protection and domestic remedies. Compared to diplomatic protection, ISDS affords investors greater control; it is potentially more efficient and less expensive due to there not being a need for local exhaustion; and it enables the 'removal of the dispute from the realm of politics and diplomacy into the realm of law'.³⁹ Compared to pursuing local remedies, ISDS is arguably more likely to be neutral and independent of the host State; it provides certainty by holding States to agreed-upon legal standards of treatment of investments; and arbitral awards are recognised and enforceable in many jurisdictions.⁴⁰ By highlighting its advantages over diplomatic protection and pursuing local remedies, proponents of ISDS argue that, despite its flaws, ISDS is still better a better mechanism for investor protection than its alternatives.

B *The Scope of Obligations Enforceable Under ISDS*

Some of the most significant concerns about the impact of ISDS on State sovereignty relate to the scope of States' obligations under international investment agreements ('IIAs'), for which ISDS is an enforcement mechanism. As noted in the United Nations Conference on Trade and Development's ('UNCTAD') World Investment Report 2015, because ISDS is an enforcement mechanism for the substantive provisions of IIAs, it 'cannot be looked at in isolation, but only together with the substantive investment protection rules embodied in IIAs'.⁴¹

When States' obligations are drafted too broadly or are open to overly wide interpretations, they can negatively impact on a State's ability to craft public policy in areas such as public health and the environment. Australia's ongoing dispute with Philip Morris over plain packaging of tobacco requirements under

³⁸ Jan Paulson, 'Enclaves of Justice' (2007) 5 *Transnational Dispute Management*; cited in Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879, 883-884.

³⁹ Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879, 882.

⁴⁰ See generally Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 879; Chapter Two, below.

⁴¹ United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015) 154-155.

the *Tobacco Plain Packaging Act 2011* (Cth) is an example.⁴² Critics feel that when ISDS allows investors to challenge public interest regulation, there is a real risk that it goes too far in impinging on State sovereignty.⁴³

Proponents of ISDS note that there is currently no multilateral ‘system’ governing investor protection or ISDS. There is no ‘ISDS “system” or “regime” that is capable of being reformed (let alone treated as a single entity)’.⁴⁴ Instead, there is a ‘fragmented collection of bilateral and regional treaties negotiated based on individualized circumstances over the span of several decades’.⁴⁵

Each IIA is the product of negotiations and the final text will have been shaped by ‘complex, philosophically fraught debates among a wide range of domestic players and interests’ in each State.⁴⁶ IIAs, ‘by definition, emanate from the policy choices of sovereign States’.⁴⁷ The tribunal in *Daimler Financial Services v Argentine Republic* enunciated this very point:

as international treaties, [bilateral investment treaties] constitute an exercise of sovereignty by which States strike a delicate balance among their various internal policy considerations... It is for States to decide how best to protect and promote investment. The texts of the treaties they conclude are the definitive guide as to how they have chosen to do so.⁴⁸

Just like State governments are referred to by US politicians as ‘laboratories of democracy’, the ‘atomized’ network of IIAs with its differing formulations of ISDS and investors’ substantive rights is an ongoing experiment in investor

⁴² Department of Foreign Affairs and Trade, *Trans-Pacific Partnership* <<http://dfat.gov.au/trade/agreements/tpp/Pages/trans-pacific-partnership-agreement-tpp.aspx>>; Phillip Adams, ‘Where are the TPP negotiations up to?’ (Radio Interview, 3 March 2015) <<http://www.abc.net.au/radionational/programs/latenightlive/where-are-the-tpp-negotiations-up-to3f/6275624>>.

⁴³ See e.g., Claire Provost and Matt Kennard, ‘The Obscure Legal System That Lets Corporations Sue States’ *The Guardian* (online) (10 June 2015) <<http://www.theguardian.com/business/2015/jun/10/obscure-legal-system-lets-corporations-sue-states-ttip-icsid>>.

⁴⁴ J J Saulino and Josh Kallmer, ‘The Emperor Has No Clothes: A Critique of the Debate Over Reform of the ISDS System’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 560, 560.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.* 563.

⁴⁷ *Ibid.* 560.

⁴⁸ *Daimler Financial Services v Argentine Republic*, ICSID Case No. ARB/05/1, Award, (22 August 2012) [164]; Liang-Ying Tan and Amal Bouchenaki, ‘Limiting Investor Access to Investment Arbitration: A Solution without a Problem?’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 309.

protection policymaking.⁴⁹ States negotiate IIAs with their 'sovereign interests in mind... making carefully considered trade-offs' and if they are unhappy with their current IIAs 'they can, should, and will negotiate new ones'.⁵⁰

Proponents of ISDS argue that to the extent that interpretation or drafting of ISDS provisions is unanticipated or overly broad, it can be seen as part of the experiment in these 'laboratories of democracy'. Future IIAs will benefit from the wisdom gained from such experimentation and adjust accordingly. This is why IIAs from the 2010's are evolved from their 1990's counterparts and even more so from their 1970's counterparts.⁵¹

C 'Regulatory Chill'

Another concern about ISDS is that the significant rise in recent years of the number of ISDS arbitrations, taken together with the significant claims and costs involved, can negatively impact State sovereignty. States might note the size and frequency of ISDS awards as well as the costs of the ISDS process and be deterred from regulating for fear of having to be respondents in ISDS claims. This phenomenon is known as 'regulatory chill'.⁵²

As noted in UNCTAD's World Investment Report 2015, there has been a very significant rise in the past two decades of the number of ISDS arbitrations.⁵³ Despite ISDS provisions having been in IIAs since the late 1960's, it was only in 1990 that the first treaty-based ISDS claim was submitted to arbitration. The number of claims has since accelerated and by 2008 there were 326 known cases which almost doubled to 608 known cases by the end of 2014.⁵⁴

Costs of ISDS can sometimes be so large as to significantly impact government budgets. For example, an award of US\$353 million against the Czech Republic was roughly equivalent to the Czech Republic's entire

⁴⁹ J J Saulino and Josh Kallmer, 'The Emperor Has No Clothes: A Critique of the Debate Over Reform of the ISDS System' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 560, 566.

⁵⁰ J J Saulino and Josh Kallmer, 'The Emperor Has No Clothes: A Critique of the Debate Over Reform of the ISDS System' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 560, 565; See e.g., Christopher Ryan, 'Meeting Expectations: Assessing the Long-Term Legitimacy and Stability of International Investment Law' (2008) 29(3) *University of Pennsylvania Journal of International Economic Law* 725, 747-749.

⁵¹ See Chapter Two, below; United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015) 121-125.

⁵² Charles N Brower and Sadie Blanchard, 'What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States' (2014) 52 *Columbia Journal of Transnational Law* 689, 749-50.

⁵³ United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015) 123-125.

⁵⁴ *Ibid* 124.

healthcare budget.⁵⁵

However, proponents argue that ‘arbitral tribunals have generally been careful to fend off unmeritorious claimants and claims’.⁵⁶ In explaining the rise in ISDS claims, proponents argue that the ‘most apparent reason for the rise in ISDS arbitration is the concurrent rise in the stock of foreign direct investment’ and increased globalisation over the last few decades.⁵⁷

Proponents also note that over 90 percent of the nearly 2,400 bilateral investment treaties in force have operated without a single investor claim of a treaty breach.⁵⁸ The US has been party to IIAs with ISDS provisions for three decades and has only had 13 ISDS cases brought to judgment against it and has not yet lost a single case.⁵⁹ Australia has only been a respondent in one instance, the ongoing Philip Morris dispute.⁶⁰

As for the costs of ISDS, proponents of ISDS argue that they need to be placed into perspective. Investors pour a lot of capital into investments and are vulnerable to heavy losses through the arbitrary exercise of sovereign power; and, in any case, States win about twice as often as investors, and when investors do win their awards are on average less than 10 percent of their initial claim.⁶¹

II THE EVOLUTION OF ISDS OVER THREE TREATIES

This chapter analyses the evolution of ISDS over three treaties: the *Hong Kong-Australia BIT*, *NAFTA* and *KAFTA*. Part A explains the significance of the chosen treaties. Part B examines the procedural aspects of ISDS. Part C evaluates the interpretative methodology employed by ISDS arbitral tribunals. Part D examines the scope of obligations enforceable under ISDS.

⁵⁵ Australian Broadcasting Corporation, ‘ISDS: The Devil in the Trade Deal’, *Background Briefing*, 14 September 2014 (Jess Hill) <<http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490#transcript>>.

⁵⁶ Liang-Ying Tan and Amal Bouchenaki, ‘Limiting Investor Access to Investment Arbitration: A Solution without a Problem’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 308.

⁵⁷ Scott Miller and Gregory N Hicks, ‘Investor-State Dispute Settlement: A Reality Check’ (Center for Strategic & International Studies, 2015) v, 6.

⁵⁸ *Ibid* v.

⁵⁹ Jeffrey Zients, *Investor-State Dispute Settlement (ISDS) Questions and Answers* (26 February 2015) White House <<https://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-answers>>.

⁶⁰ Department of Foreign Affairs and Trade, *Investor-State Dispute Settlement* <<http://dfat.gov.au/trade/topics/Pages/isds.aspx>>.

⁶¹ Scott Miller and Gregory N Hicks, ‘Investor-State Dispute Settlement: A Reality Check’ (Center for Strategic & International Studies, 2015) v.

A Significance of the Chosen Treaties

The three treaties examined in this Chapter are the *Hong Kong-Australia BIT*, *NAFTA* and *KAFTA*. They are each significant to the analysis of the evolution of ISDS in their own way.

From an Australian perspective, the *Hong Kong-Australia BIT* is a good baseline for an analysis of the recent evolution of ISDS. Not only is the *Hong Kong-Australia BIT* an older IIA, having entered into force in 1993, it is also the only treaty under which Australia has been a respondent in an ISDS claim - namely, the ongoing Philip Morris dispute over the introduction of the *Tobacco Plain Packaging Act 2011* (Cth).⁶²

NAFTA entered into force just one year after the *Hong Kong-Australia BIT* but its significance derives from its status as one of the most infamous and most widely litigated free trade agreements in the world, largely due to the ISDS provisions in Chapter 11 of *NAFTA*.⁶³ *NAFTA*'s Chapter 11 has been an influential model of ISDS and, as will be observed later in this Chapter, *KAFTA* incorporates many of the lessons learned from *NAFTA*.

The reason that *KAFTA* has been chosen as the end point is that, having entered into force in December 2014, it is one of the most recent IIAs concluded by Australia to include ISDS. As noted by the chief Australian negotiator on *KAFTA*, Jan Adams,

[t]he protections included in agreements to safeguard right to regulate have certainly been evolving, and we would see [*KAFTA*] as the latest, most evolved version of investor-state, which really does provide very good balance between the rights of sovereign governments to regulate and investor protection rights.⁶⁴

If Jan Adams is correct in describing *KAFTA* as 'the latest, most evolved version' of ISDS then, from an Australian perspective, it is a logical end point for an evaluation of the evolution of ISDS up to mid-2015. Future works should examine the ISDS provisions in the Trans-Pacific Partnership Agreement, which could cover as much as 36% of the world economy if ratified by its negotiating parties.⁶⁵

⁶² Department of Foreign Affairs and Trade, *Investor-State Dispute Settlement* <<http://dfat.gov.au/trade/topics/Pages/isds.aspx>>.

⁶³ See e.g., Charles N Brower and Sadie Blanchard, 'What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States' (2014) 52 *Columbia Journal of Transnational Law* 689, 722-726.

⁶⁴ Australian Broadcasting Corporation, 'ISDS: The Devil in the Trade Deal', *Background Briefing*, 14 September 2014 (Jan Adams) <<http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490#transcript>>.

⁶⁵ Department of Foreign Affairs and Trade, *Trans-Pacific Partnership*

B Procedural Aspects of ISDS

This Part analyses the evolution of procedural aspects of ISDS, including the following: alternative dispute resolution in ISDS, limitation periods on claims, applicable procedural rules, consolidation of claims, the method of appointment of arbitrators, the remedial powers of ISDS tribunals, and the prospects of an appellate mechanism in ISDS.

1 *Alternative Dispute Resolution*

As outlined in Chapter One, ISDS can be expensive in terms of both legal expenses and the awards rendered by tribunals. One way to diminish the burden of ISDS on States is to promote alternative dispute resolution ('ADR') between States and aggrieved investors.

Under the *Hong Kong-Australia BIT*, there is only an indirect reference to ADR. Article 10 provides that only a dispute 'which has not been settled amicably' after a period of three months from written notification of the claim may be submitted to procedures for settlement. Beyond providing for a cooling-off period of three months from written notification of claim, Article 10 places no imperative on the disputing parties to attempt to resolve their dispute through ADR.

NAFTA's Article 1118 insists that '[t]he disputing parties should first attempt to settle a claim through consultation or negotiation.' *KAFTA* runs along the same lines by providing that '[i]n the event of an investment dispute, the claimant and the respondent should initially seek to resolve the dispute through consultation and negotiation, which may include the use of non-binding, third party procedures.'⁶⁶ In addition, both *NAFTA* and *KAFTA* require an increased waiting period of six months from the time of the events giving rise to the claim before an aggrieved investor may submit the claim to arbitration.⁶⁷

Though neither makes ADR mandatory, *NAFTA* and *KAFTA* use more imperative language and increased cooling-off periods to push disputing parties more strongly than under the *Hong Kong-Australia BIT* to attempt to resolve their disputes through consultation and negotiation before pursuing arbitration.

<<http://dfat.gov.au/trade/agreements/tpp/Pages/trans-pacific-partnership-agreement-tpp.aspx>>; Phillip Adams, 'Where are the TPP negotiations up to?' (Radio Interview, 3 March 2015) <<http://www.abc.net.au/radionational/programs/latenightlive/where-are-the-tpp-negotiations-up-to3f/6275624>>.

⁶⁶ *KAFTA* art 11.15.

⁶⁷ *NAFTA* art 11.20; *KAFTA* art 11.16.3.

2 *Limitation Periods on Claims*

Another way to diminish the potential burden of ISDS on States is to introduce limitation periods on claims, which diminish States' exposure to claims arising from older grievances.

The *Hong Kong-Australia BIT* sets no limitation period on bringing an ISDS claim. Presumably, an aggrieved investor can submit a claim for arbitration as long as the circumstances giving rise to the claim occurred at any point in time following the entry into force of the *Hong Kong-Australia BIT* in 1993.

NAFTA and *KAFTA* both provide that an investor may not submit a claim for arbitration if more than three years have elapsed from the date on which the investor 'first acquired, or should have first acquired' knowledge of the alleged breach and knowledge that they have incurred loss or damage.⁶⁸ This significantly diminishes States' exposure to claims arising from older grievances, which is lacking from the *Hong Kong-Australia BIT*.

3 *Procedural Rules for ISDS*

NAFTA and *KAFTA* both delve into great detail in setting out various procedural requirements for ISDS.⁶⁹ In stark contrast, the *Hong Kong-Australia BIT* provides almost no detail at all.⁷⁰

The *Hong Kong-Australia BIT* provides that the disputing parties must either agree between themselves on the procedures for settling their dispute or use the *UNCITRAL Arbitration Rules*.⁷¹ *KAFTA* and *NAFTA* provide that a disputing investor has the choice to submit a claim to arbitration under the *ICSID Convention*, the *ICSID Arbitration (Additional Facility) Rules* or the *UNCITRAL Arbitration Rules*.⁷² However, whatever rules the aggrieved investor chooses, they will govern the procedure only to the extent they are not modified by the extensive provisions under *NAFTA* and *KAFTA* relating to ISDS procedure.⁷³

4 *Consolidation of Claims*

NAFTA and *KAFTA* both provide for consolidation of claims, a procedural innovation which is absent from the *Hong Kong-Australia BIT*.⁷⁴ Where two or

⁶⁸ *NAFTA* art 1116(2); *KAFTA* art 11.18.1.

⁶⁹ See e.g., *KAFTA* arts 11.15-11.27; *NAFTA* arts 1115-1138.

⁷⁰ The extent of the *Hong Kong-Australia BIT*'s treatment of ISDS is Article 10.

⁷¹ *Hong Kong-Australia BIT* art 10.

⁷² See also *KAFTA* art 11.16.3(d), 'if the claimant and respondent agree, to any other arbitration institution or under any other arbitration rules'.

⁷³ *KAFTA* art 11.16.5; *NAFTA* art 1120(2).

⁷⁴ *KAFTA* art 11.25; *NAFTA* art 1126.

more separate claims submitted to arbitration under *KAFTA* or *NAFTA* have a question of law or fact in common and arise out of the same events or circumstances, disputing parties may seek a consolidation order.⁷⁵ If granted, the claims are heard concurrently by the same arbitral tribunal.

Consolidation of claims allows for a more efficient use of resources in ISDS which can potentially save significant costs for both aggrieved investors and States.

5 *Appointment of Arbitrators*

As outlined in Chapter One, an aspect of ISDS which gives rise to concerns about legitimacy is the method of appointment of arbitrators. The *Hong Kong-Australia BIT* is silent on this point, leaving it to the disputing parties to decide.

In contrast, *NAFTA* and *KAFTA* both specify how arbitrators may be appointed. Unless the disputing parties otherwise agree, under both *NAFTA* and *KAFTA* an ISDS tribunal is made up of three arbitrators, with one arbitrator appointed by each of the disputing parties and the third arbitrator, the presiding arbitrator, appointed by agreement of the disputing parties.⁷⁶

Neither *KAFTA*, *NAFTA* nor the *Hong Kong-Australia BIT* address the concerns set out in Chapter One about the method of appointment of arbitrators in ISDS.

6 *Remedies Available to ISDS Tribunals*

The *Hong Kong-Australia BIT* is silent on the topic of remedies under ISDS besides mentioning that an 'arbitral tribunal shall have power to award interest'.⁷⁷ This silence means that, in its ongoing dispute with Australia over tobacco plain packaging legislation, Philip Morris Asia felt emboldened to seek an 'order for the suspension of enforcement of plain packaging legislation'.⁷⁸ If granted, such an order would be a direct challenge to Australia's regulatory power.

While the *Hong Kong-Australia BIT*'s silence on remedies would be highly unlikely to be interpreted as giving ISDS tribunals the authority to order the suspension of enforcement of Australian laws, the fact that Philip Morris Asia has sought such an order might concern the media and members of the general public. *NAFTA* and *KAFTA* make it clear that, in its final award, a tribunal may only award some combination of costs, monetary damages, any applicable

⁷⁵ *KAFTA* art 11.25; *NAFTA* art 1126.

⁷⁶ *NAFTA* arts 1123, 1126; *KAFTA* art 11.19.

⁷⁷ *Hong Kong-Australia BIT* art 10.

⁷⁸ *Philip Morris Asia Ltd Notice of Arbitration* (21 November 2011)

<<http://www.ag.gov.au/Internationalrelations/InternationalLaw/Documents/Philip%20Morris%20Asia%20Limited%20Notice%20of%20Arbitration%2021%20November%202011.pdf>> [8.2].

interest and restitution of property.⁷⁹ Further, *NAFTA* and *KAFTA* clarify that a tribunal may not order a Party to pay punitive damages.⁸⁰ These are sensible clarifications to make so that there is no doubt about ISDS arbitral tribunals' remedial powers.

7 Prospects of an Appellate Mechanism

An appellate mechanism in ISDS would be one way to address issues with inconsistent application of the law by arbitral tribunals. Neither the *Hong Kong-Australia BIT* nor *NAFTA* make any mention of an appellate mechanism.

KAFTA, on the other hand, signals some political movement towards establishing an appellate mechanism in ISDS. *KAFTA* provides that if Korea and Australia become parties to a multilateral agreement establishing an appellate body to hear investment disputes, then they 'shall strive to reach an agreement' so as to make ISDS arbitrations under *KAFTA* reviewable by the appellate body.⁸¹ *KAFTA* also requires Korea and Australia to consider whether to establish a bilateral appellate body or 'similar mechanism to review awards' within three years after the date of entry into force of *KAFTA*.⁸²

C ISDS Tribunals' Interpretative Methodology

This Part analyses the evolution of the interpretative methodology employed by ISDS arbitral tribunals. As noted in Chapter One, inconsistent applications of the law by ISDS tribunals, along with overly broad interpretations of State obligations, can raise serious concerns about the impact of ISDS on State sovereignty.

1 Hong Kong-Australia BIT

The *Hong Kong-Australia BIT* does not outline an interpretative methodology for its provisions. However, Hong Kong and Australia are both parties to the *Vienna Convention on the Law of Treaties* ('*Vienna Convention*'),⁸³ so the *Hong Kong-Australia BIT* will be interpreted in accordance with the principles laid out in that treaty.

While the *Hong Kong-Australia BIT* does not set out an interpretative methodology, it does provide in Article 9 that Australia and Hong Kong 'shall consult at the request of either of them on matters concerning the interpretation or application of this Agreement.' Article 9 does not make it

⁷⁹ *NAFTA* art 1135; *KAFTA* art 11.26.

⁸⁰ *NAFTA* art 1135; *KAFTA* art 11.26.

⁸¹ *KAFTA* art 11.20.13.

⁸² *KAFTA* annex 11-E.

⁸³ *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980).

clear what weight, if any, such ‘consultations’ should be accorded by tribunals interpreting the treaty.

The *Vienna Convention* provides that, together with context, ‘any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions’ should be taken into account in the interpretation of a treaty.⁸⁴ Accordingly, subsequent agreements between Hong Kong and Australia should be ‘taken into account’ in interpreting provisions of the *Hong Kong-Australia BIT*. Ewing-Chow and Losari note that

[n]ot many tribunals have referred to Article 31(3)(a) [of the *Vienna Convention*] when interpreting IIAs. Although some, in passing, have mentioned taking subsequent agreements into account, the real value of subsequent agreements by State parties of IIAs remains unclear.⁸⁵

Neither Article 9 of the *Hong Kong-Australia BIT* nor Article 31(3)(a) of the *Vienna Convention* indicate that ‘consultations’ or ‘subsequent agreements’ between Hong Kong and Australia regarding provisions of the *Hong Kong-Australia BIT* will be binding on tribunals.

2 NAFTA

Under *NAFTA*, an ISDS tribunal must decide issues in dispute ‘in accordance with [*NAFTA*] and applicable rules of international law’.⁸⁶ Article 102(2) of *NAFTA* requires that the ‘Parties shall interpret and apply the provisions of [*NAFTA*] in the light of its objectives... and in accordance with applicable rules of international law’. *NAFTA*’s objectives are set out in Article 102(1) and, relevantly, they include ‘increas[ing] substantially investment opportunities in the territories of the Parties’. As for the ‘applicable rules of international law’, both Canada and Mexico are parties to the *Vienna Convention*, and while the US has not ratified the *Vienna Convention* it ‘considers many of the provisions... to constitute customary international law on the law of treaties’.⁸⁷

NAFTA explicitly empowers States to issue binding interpretations of its provisions. Under Article 2001(1), *NAFTA* establishes a ‘Commission’ which ‘comprises cabinet-level representatives of the [State] Parties or their designees’. *NAFTA* grants the Commission the power to issue interpretations of *NAFTA* provisions and, once issued, these interpretations are binding on arbitral Tribunals.⁸⁸

⁸⁴ *Vienna Convention* art 31(3)(a).

⁸⁵ Michael Ewing-Chow and Junianto James Losari, ‘Which Is to Be Master? Extra-Arbitral Interpretative Procedures for IIAs’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 91, 104.

⁸⁶ *NAFTA* art 1131(1).

⁸⁷ United States Department of State, *Vienna Convention on the Law of Treaties* <<http://www.state.gov/s/l/treaty/faqs/70139.htm>>.

⁸⁸ *NAFTA* art 1131(2).

In addition to explicitly spelling out the binding nature of Commission interpretations, *NAFTA* makes it clear that the Commission has a role to play in ongoing arbitrations. Where a State asserts that ‘the measure alleged to be a breach is within the scope of a reservation or exception set out in [the Annexes], on request of the disputing Party, the Tribunal shall request the interpretation of the Commission on the issue’.⁸⁹ This explicitly gives the Commission the power to issue binding interpretations (in prescribed circumstances) in the midst of an ongoing arbitration – a strong assertion of States’ power at the expense of Tribunals.

There has been some controversy about the scope of the Commission’s power to issue binding interpretations. The Commission issued a Note of Interpretation on July 31 2001⁹⁰ (also discussed in Part D, below) which was a response to arbitral tribunals issuing awards with wide interpretations of the scope of the ‘fair and equitable treatment’ standard. The Note of Interpretation sought to clarify and narrow the scope of fair and equitable treatment under *NAFTA*.⁹¹

In *Pope & Talbot Inc v Canada*,⁹² the tribunal noted in relation to the Note of Interpretation that ‘were the Tribunal required to make a determination whether the Commission’s action is an interpretation or an amendment, it would choose the latter’.⁹³ The difference between an interpretation and an amendment is important because while the Commission has the power to issue binding interpretations, amendments to *NAFTA* are dealt with through an entirely separate mechanism.⁹⁴ The comments by the tribunal in *Pope & Talbot Inc v Canada* raised doubts about whether the Note of Interpretation was binding on tribunals because of the possibility that it was a *de facto* amendment rather than an interpretation.⁹⁵ Ultimately, tribunals appear to have accepted the Note of Interpretation as binding, being loathe to question the authoritative nature of interpretations issued by the Commission.⁹⁶

⁸⁹ Ibid art 1132(1).

⁹⁰ Note of Interpretation of Certain Chapter 11 Provisions, adopted by the *NAFTA* Free Trade Commission, July 31, 2001 (‘Note of Interpretation’).

⁹¹ See ‘Fair and Equitable Treatment’ in Part D, below.

⁹² *Pope & Talbot Inc v Canada*, (UNCITRAL) 9 (Award on Damages) (May 31, 2002).

⁹³ *Pope & Talbot Inc v Canada*, (UNCITRAL) 9 (Award on Damages) (May 31, 2002) 46-47; Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1131/16.

⁹⁴ See *NAFTA* art 2202.

⁹⁵ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/36. Claimants continued to raise this issue in ISDS disputes concerning *NAFTA* art 1105.

⁹⁶ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/36; *The Loewen Group Inc. and Raymond Loewen (Can.) v United States*, ICSID (W. Bank) ARB(AF)/98/3, (Award) (June 26, 2003) [128].

3 *KAFTA*

KAFTA does not provide an interpretative methodology for its provisions beyond requiring under Article 11.22.1 that an ISDS 'tribunal shall decide the issues in dispute in accordance with [*KAFTA*] and applicable rules of international law'. Both Korea and Australia are parties to the *Vienna Convention* so, as part of the 'applicable rules of international law', the interpretative principles under the *Vienna Convention* will apply.

However, the requirement under Article 11.22.1 that an ISDS tribunal decide issues in accordance with *KAFTA* and 'applicable rules of international law' is expressed to be subject to Article 11.22.3 which provides that a 'decision of the Joint Committee declaring interpretation of this Agreement under Article 21.3.3(c) shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that decision'. The Joint Committee is a body comprised of officials of each State party⁹⁷ and, under Article 21.3.3(c), may 'as appropriate, issue interpretations of the provisions of this Agreement'.

Also, similarly to what is provided under *NAFTA*, Article 11.23.1 of *KAFTA* provides that where a respondent 'asserts as a defence that the measure alleged to be a breach is within the scope of an entry set out in Annex I or Annex II, the tribunal shall, on request of the respondent, request the interpretation of the Joint Committee on the issue.' An interpretation by the Joint Committee 'shall be binding on the tribunal' and any decision or award issued by the tribunal 'must be consistent' with the interpretation.⁹⁸

The scope of the Joint Committee's authority to issue binding interpretations of *KAFTA* provisions appears to be equivalent to that of the Committee's relevant powers under *NAFTA*.

4 *Conclusion*

The most significant change to interpretative methodology in ISDS is the emergence under *NAFTA* and *KAFTA* of the power of States to issue binding interpretations of treaty provisions through Joint Commissions. This power allows States to safeguard themselves from overly wide interpretations of provisions by arbitral tribunals. It is a strong assertion by States of a significant measure of control over the interpretation of their rights and obligations in ISDS.

D *The Scope of Obligations Enforceable Under ISDS*

This Part examines the scope of the obligations enforceable under ISDS,

⁹⁷ *KAFTA* art 21.3.

⁹⁸ *KAFTA* art 11.23.2.

including the requirements in relation to ‘expropriation’, the ‘fair and equitable treatment’ standard, and general exclusions and regulatory carve-outs under each of the treaties.

1 *Expropriation*

IIAs typically provide that States may only ‘expropriate’ investments in limited circumstances.⁹⁹ The scope of what qualifies as an ‘expropriation’ has proved to be one of the more controversial questions arising out of ISDS and international investment law.¹⁰⁰ This section analyses the evolution of ‘expropriation’ from the *Hong Kong-Australia BIT* to *NAFTA* and *KAFTA*.

(a) *Hong Kong-Australia BIT*

Article 6 of the *Hong Kong-Australia BIT*, titled ‘Expropriation’, provides that investors ‘shall not be deprived of their investments nor subjected to measures having effect equivalent to such deprivation’. This is subject to the exception where such deprivation is ‘under due process of law, for a public purpose related to the internal needs of that Party, on a non-discriminatory basis, and against compensation’.¹⁰¹ The provision has only been utilized once - in the ongoing Philip Morris arbitration.¹⁰²

‘Deprived’ and ‘effect equivalent to such deprivation’ are not defined elsewhere in the treaty. The terms are vague and their scope is unclear. While the ‘deprivation’ of an investment might be obvious in a particular fact scenario, determining what is an ‘effect equivalent to deprivation’ is likely to be a more difficult exercise.

(b) *NAFTA*

NAFTA provides under Article 1110 that no Party ‘may directly or indirectly... expropriate an investment of an investor of another Party in its territory or take a measure tantamount to... expropriation of such an investment’. ‘Measure’ is defined in Article 201(1) and includes ‘any law, regulation, procedure, requirement or practice’.

Like the *Hong Kong-Australia BIT* in relation to ‘deprivation’, *NAFTA* does

⁹⁹ See e.g., *Hong Kong-Australia BIT* art 6; *NAFTA* art 1110; *KAFTA* art 11.7.

¹⁰⁰ Charles N Brower and Sadie Blanchard, ‘What’s in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States’ (2014) 52 *Columbia Journal of Transnational Law* 689, 727-728; United Nations Conference on Trade and Development, ‘World Investment Report 2015’ (United Nations, 2015) 138-140.

¹⁰¹ *Hong Kong-Australia BIT* art 6.

¹⁰² *Philip Morris Asia Ltd Notice of Arbitration* (21 November 2011)

<<http://www.ag.gov.au/Internationalrelations/InternationalLaw/Documents/Philip%20Morris%20Asia%20Limited%20Notice%20of%20Arbitration%2021%20November%202011.pdf>> [7.3], [7.5].

not define 'expropriation'. This leaves the scope as vague as under the *Hong Kong-Australia BIT*. As noted by the tribunal in *Marvin Roy Feldman Karpa v Mexico* ('*Feldman v Mexico*'),¹⁰³ 'NAFTA lacks a precise definition of expropriation'.¹⁰⁴

NAFTA does make it clear that both indirect and direct expropriation are covered by the provision, as well as measures which are 'tantamount to... expropriation'.¹⁰⁵ However, the difference between indirect expropriation and measures which are 'tantamount to expropriation' is unclear. A number of awards have suggested that the concepts are equivalent¹⁰⁶ but in at least one instance a tribunal has suggested that 'measures tantamount to expropriation' is a broader concept than 'indirect expropriation'.¹⁰⁷

There is also a lack of clarity in relation to 'indirect expropriation'. As noted in *Investment Disputes under NAFTA: an Annotated Guide to NAFTA*, 'NAFTA Chapter 11 tribunals have... struggled with defining the criteria required to find an indirect expropriation'.¹⁰⁸ The tribunal in *Feldman v Mexico* echoed this sentiment:

Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action... crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.¹⁰⁹

It is problematic that defining the scope of 'indirect expropriation' under NAFTA remains difficult. The majority of disputes under NAFTA concern 'indirect expropriations' rather than 'direct expropriations', which have become

¹⁰³ *Marvin Roy Feldman Karpa (U.S.) v Mexico*, ICSID (W. Bank) ARB(AF)/99/1, (Award) (Dec. 16, 2002).

¹⁰⁴ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/23; *Marvin Roy Feldman Karpa (U.S.) v Mexico*, ICSID (W. Bank) ARB(AF)/99/1, (Award) (Dec. 16, 2002) [97].

¹⁰⁵ NAFTA art 1110(1).

¹⁰⁶ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/28.

¹⁰⁷ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/29; *Waste Management, Inc. (U.S.) v Mexico*, ICSID (W. Bank) ARB(AF)/00/3 [143].

¹⁰⁸ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/16.

¹⁰⁹ *Feldman v Mexico* [100]; Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/23.

relatively infrequent in the last few decades.¹¹⁰

As for the criteria for when an expropriation will be acceptable, *NAFTA* uses almost equivalent terms to those in the *Hong Kong-Australia BIT*, with only minor differences that are unlikely to alter the scope of the exception in any significant way.¹¹¹ However, *NAFTA* does also provide for a carve-out in relation to the issuance of compulsory licenses and other actions in relation to intellectual property rights to the extent that they are consistent with the Intellectual Property chapter of *NAFTA*.¹¹²

All in all, *NAFTA* is not a significant improvement over the *Hong Kong-Australia BIT* in terms of the clarity with which States' obligations and regulatory space are demarcated.

(c) *KAFTA*

The formulation of 'expropriation' under *KAFTA*'s Article 11.7 is very similar to that under *NAFTA*. Article 11.7 provides that '[n]either Party shall expropriate... a covered investment either directly or indirectly through measures equivalent to expropriation'. The one obvious substantive change from *NAFTA* is that 'measures equivalent to expropriation' (i.e. the equivalent to 'measures tantamount to expropriation' under *NAFTA*) is not listed as a separate concept but is linked to indirect expropriation. The relevant exceptions are also substantially equivalent to those under *NAFTA*.¹¹³

KAFTA's Annex 11-B clarifies that expropriation requires an 'interference with a tangible or intangible property right in an investment' in one of two situations: direct expropriation or indirect expropriation. Annex 11-B defines direct expropriation as 'where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure'. Indirect expropriation is defined as when a Party achieves an 'effect equivalent to direct expropriation without formal transfer of title or outright seizure'.¹¹⁴

Determining whether there has been an indirect expropriation in a specific fact situation requires a 'case-by-case, fact-based inquiry' that considers all relevant factors relating to the investment, including: the economic impact of the government action; the extent to which the government action interferes with 'distinct, reasonable investment-backed expectations' and the character of the government action, including its objectives and context.¹¹⁵ The

¹¹⁰ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1110/12-1110/13.

¹¹¹ *NAFTA* art 1110(1); Cf *Hong Kong-Australia BIT* art 6(1).

¹¹² *NAFTA* art 1110(8).

¹¹³ *KAFTA* arts 11.7.1, 11.7.5; Cf *NAFTA* arts 1110(1), 1110(8).

¹¹⁴ *KAFTA* annex 11-B art 2.

¹¹⁵ *Ibid* annex 11-B art 4.

determination of what is a ‘reasonable investment-backed expectation’ may include ‘consideration of the nature and extent of governmental regulation in the relevant sector’.¹¹⁶

Annex 11-B sets out a much more detailed test for ‘indirect expropriation’ than *NAFTA* and also contains an important clarification 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.¹¹⁷

These ‘legitimate public welfare objectives’ are not exhaustive and may extend further than those listed.¹¹⁸ Annex 11-I goes further in making it clear that ‘the imposition of taxes does not generally constitute an expropriation’ and lists factors that would make it less likely for a particular tax to be an expropriation.

(d) *Conclusion*

KAFTA’s Annex 11-B and Annex 11-I are critical differentiators between expropriation under *KAFTA* and expropriation under *NAFTA* and the *Hong Kong-Australia BIT*. Indirect expropriation under those treaties is a vague, undefined concept of indeterminate scope. Annex 11-B and Annex 11-I, finalised after the commencement of Australia’s ISDS dispute with Philip Morris Asia, appear designed to safeguard public interest regulation by delineating more precisely what is meant by ‘direct expropriation’ and ‘indirect expropriation’ and by securing regulatory space for ‘legitimate public welfare objectives’.

2 *Fair and Equitable Treatment*

The ‘fair and equitable treatment’ standard (‘FET’) requires States to accord covered investments a certain minimum standard of treatment.¹¹⁹ The exact content of the standard has proven to be a controversial issue in ISDS.¹²⁰ This section examines the evolution of FET provisions and their interpretation from the *Hong Kong-Australia BIT* to *NAFTA* and *KAFTA*.

¹¹⁶ Ibid annex 11-B fn 52.

¹¹⁷ Ibid annex 11-B art 5.

¹¹⁸ Ibid annex 11-B fn 54.

¹¹⁹ Charles N Brower and Sadie Blanchard, ‘What’s in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States’ (2014) 52 *Columbia Journal of Transnational Law* 689, 737-748; United Nations Conference on Trade and Development, ‘World Investment Report 2015’ (United Nations, 2015) 137.

¹²⁰ Ibid.

(a) *Hong Kong-Australia BIT*

The *Hong Kong-Australia BIT* deals with FET in Article 2. Specifically, Article 2(2) provides that '[i]nvestments and returns of investors of each Contracting Party shall at all times be accorded fair and equitable treatment... in the area of the other Contracting Party'. 'Fair and equitable treatment' is not defined in the treaty and it is not entirely clear what the standard of treatment actually requires under the *Hong Kong-Australia BIT*.

The context in which the *Hong Kong-Australia BIT* was drafted makes the relationship between the vague concept of 'fair and equitable treatment' and international law unclear. Other treaties that entered into force around the same time as the *Hong Kong-Australia BIT* specify the relationship of 'fair and equitable treatment' to international law. A bilateral investment treaty between Canada and Argentina, entering into force in 1993, required 'fair and equitable treatment in accordance with principles of international law',¹²¹ subsuming 'fair and equitable treatment' under 'principles of international law'. In contrast, the United States' 1987 Model Bilateral Investment Treaty provides that '[i]nvestment shall at all times be accorded fair and equitable treatment... and shall in no case be accorded treatment less than that required by international law'.¹²² Here, 'fair and equitable treatment' is a separate concept to the treatment 'required by international law'.

(b) *NAFTA*

Article 1105 of *NAFTA* provides that '[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment'.

The treatment of FET in *NAFTA* is similar to that in the *Hong Kong-Australia BIT*. Both require States to accord investments 'fair and equitable treatment' without providing definitions of the term. The main difference is that *NAFTA* treats 'fair and equitable treatment' as a subset of 'treatment in accordance with international law'. The provision provides that 'treatment in accordance with international law' *includes* 'fair and equitable treatment'. However, this textual reading of the provision was challenged by the tribunal in *Pope & Talbot v Canada*, which, relying on a purposive interpretation of the

¹²¹ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/9; *Agreement Between the Government of Canada and the Government of the Republic of Argentina for the Promotion and Protection of Investments*, signed 5 November 1991, 2467 UNTS 97 (entered into force 29 April 1993) art II(4).

¹²² The January 11, 1982, Draft Treaty Between the United States and ____ Concerning the Reciprocal Encouragement and Protection of Investments, extracted in Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/8.

provision, stated that '[a]nother possible interpretation of the presence of the fairness elements in Article 1105 is that they are additive to the requirements of international law'.¹²³

Adding to the confusion, Article 1105 raises the additional question of what exactly is meant by 'international law'? 'International law' is not defined in the treaty, so it is not clear whether it refers to customary international law, to treaty law, or to any other sources of international law. This has been a source of considerable controversy in *NAFTA* arbitrations.¹²⁴ The tribunal in *S.D. Myers Inc v Canada* suggested that the term 'international law' was not limited to 'customary international law'.¹²⁵ *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* notes that an implicit conclusion of the tribunal is that the minimum standard of treatment under Article 1105 'encompasses the obligation to abide by other treaty obligations... A finding of breach of another provision of [NAFTA], or indeed of another [treaty] altogether, could form the basis for a claim under Article 1105 based on this logic'.¹²⁶

On July 31, 2001, in an attempt to deal with the lack of clarity surrounding Article 1105, the Commission under *NAFTA* issued a binding Note of Interpretation under the authority of Article 1131(2):

the Free Trade Commission hereby adopts the following interpretations of Chapter Eleven in order to clarify and reaffirm the meaning of certain of its provisions:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

¹²³ *Pope & Talbot Inc v Canada*, (UNCITRAL) (Award on the Merits of Phase 2) (Apr. 10, 2001) [110]; Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/23.

¹²⁴ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/24-1105/26.

¹²⁵ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/21-1105/22; *S.D. Myers Inc. v Canada*, (UNCITRAL) (Partial Award) (Nov. 13, 2000) [263]-[266].

¹²⁶ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/22.

3. A determination that there has been a breach of another provision of the *NAFTA*, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).¹²⁷

The Note of Interpretation clarified the scope of Article 1105, providing a narrower interpretation than that advanced by the tribunals in *S.D. Myers v Canada* and *Pope & Talbot*. The tribunal in *Loewen Group Inc v United States* summarised the effect of the Note of Interpretation:

The effect of the Commission's interpretation is that 'fair and equitable treatment' and 'full protection and security' are not free-standing obligations. They constitute obligations only to the extent that they are recognized by customary international law. Likewise, a breach of Article 1105(1) is not established by a breach of another provision of *NAFTA*. To the extent, if at all, that *NAFTA* tribunals... may have expressed contrary views, those views must be disregarded.¹²⁸

(c) *KAFTA*

Under Article 11.5 of *KAFTA*, '[e]ach Party shall accord to the covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment', which includes the obligation 'not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world'.

The immediate important change to note is the replacement of 'treatment in accordance with international law', as used under *NAFTA*, with 'treatment in accordance with the customary international law minimum standard of treatment of aliens'. The narrower view under *KAFTA* of the relevant 'international law' reflects the interpretation of *NAFTA* following the issuance of the Note of Interpretation.

KAFTA further elaborates that 'fair and equitable treatment' does not require treatment in addition to or beyond that which is required by 'treatment in accordance with the customary international law minimum standard of treatment of aliens' and does not create any additional substantive rights for investors.¹²⁹ Further, a breach of another provision of *KAFTA* does not establish a breach of Article 11.5.¹³⁰

¹²⁷ Note of Interpretation of Certain Chapter 11 Provisions, adopted by the *NAFTA* Free Trade Commission, July 31, 2001.

¹²⁸ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1105/36; *Loewen Group Inc v United States*, ICSID (W. Bank) ARB(AF)/98/3, (Award) (June 26, 2003) [128].

¹²⁹ *KAFTA* art 11.5.2.

¹³⁰ *Ibid* art 11.5.3.

(d) *Conclusion*

KAFTA defines FET as requiring nothing more of States than what is required under the ‘customary international law minimum standard of treatment to be afforded to covered investments’. *KAFTA* learns the lessons of *NAFTA* by incorporating the clarifications of the Note of Interpretation into its treaty text. *KAFTA* reduces the role of FET provisions in IIAs from their ambiguous role under the *Hong Kong-Australia BIT* to a mere codification of customary international law, allowing investors to rely on it in ISDS. By virtue of more clearly expressing what is meant by ‘fair and equitable treatment’, as compared to the *Hong Kong-Australia BIT*, FET under *KAFTA* is less of a risk to State sovereignty.

3 *General Exclusions*

The *Hong Kong-Australia BIT* contains no general carve-outs to the application of obligations enforceable under ISDS.¹³¹ In contrast, *NAFTA* contains a lot of exceptions designed to carve-out State regulatory space.¹³² For example, a decision by Canada following a review the *Investment Canada Act* ‘with respect to whether or not to permit an acquisition that is subject to review’ is not subject to dispute settlement.¹³³ Another example is Article 2103, which states that except as set out in that Article, ‘nothing in this Agreement shall apply to taxation measures’.¹³⁴ This is a significant carve-out (with some exceptions to its application to investment disputes, including to expropriation of investments under Article 1110).¹³⁵

KAFTA contains equivalent exceptions to most of those found under *NAFTA*¹³⁶ but, in some cases, it strengthens those exceptions. For example, *NAFTA* contains a national security exception allowing measures to be implemented in certain circumstances of national emergency.¹³⁷ At least one commentator has noted that while the exception ‘appears’ to be self-judging, it ‘remains to be seen’ whether a tribunal would interpret it as such.¹³⁸ *KAFTA* avoids any such uncertainty by explicitly making the equivalent national

¹³¹ The only significant exception is *Hong Kong-Australia BIT* art 7 but even this exception is limited to the operation of the Most-Favoured Nation in regards to preferences or privileges relating to various forms of economic union or economic integration or international agreements relating ‘wholly or mainly to taxation’.

¹³² See e.g., *NAFTA* arts 1101(2)-(4), 1108, 1112, 1113, 1114, 1138, 2102, 2103, 2104.

¹³³ *NAFTA* art 1138(2), annex 1138.2.

¹³⁴ *Ibid* art 2103(1).

¹³⁵ *Ibid* art 2103.

¹³⁶ See e.g., *KAFTA* arts 11.2.1, 11.2.3, 11.11, 11.2, 22.1, 22.2, 22.3, annex 11-C. Cf *NAFTA* arts 1101(2)-(4), 1108, 1112, 1113, 1114, 1138, 2102, 2103, 2104.

¹³⁷ *NAFTA* art 2102.

¹³⁸ Meg N Kinnear, Andrea K Bjorklund and John F G Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law International, 2006) 1138/5.

security exception self-judging.¹³⁹

The most significant evolution from *NAFTA* to *KAFTA*, however, is the addition of Article 22.1. Article 22.1 provides that, for the purposes of Chapter 11 (the investment chapter), ‘nothing in [*KAFTA*] shall be construed to prevent a Party from adopting or enforcing measures’ including those ‘necessary to protect human, animal or plant life or health’; imposed for the protection of ‘national treasures of artistic, historic or archaeological value’; or relating to the ‘conservation of living or non-living exhaustible natural resources’. Article 22.1 is similar in scope and effect to Article XX of the *General Agreement on Tariffs and Trade 1994* (*GATT*).¹⁴⁰ It is a broad and significant addition to *KAFTA*, securing State regulatory space in broad areas of public interest.

KAFTA goes further than both *NAFTA* and the *Hong Kong-Australia BIT* by both building on existing exceptions in *NAFTA* and adding Article 22.1, a broad-ranging general exception modelled after Article XX of *GATT*.

III THE BALANCE BETWEEN STATE SOVEREIGNTY & INVESTOR PROTECTION IN ISDS AND SUGGESTED REFORMS

This chapter evaluates the present balance between State sovereignty and investor protection in ISDS and suggests ways forward. Part A evaluates whether the present balance between State sovereignty and investor protection in ISDS is appropriate. Part B suggests four reforms to ISDS.

A *The Balance Between State Sovereignty & Investor Protection in ISDS*

Using the *Hong Kong-Australia BIT* as a baseline and *KAFTA* as a representation of the present state of ISDS, the following evaluation will assess the extent to which the concerns regarding State sovereignty, as outlined in Chapter One, have been addressed. This will be weighed against any significant erosion of investor protection to reach a conclusion on whether the present balance between investor protection and State sovereignty is appropriate.

1 *State Sovereignty*

(a) *Legitimacy of the ISDS Process*

As outlined in Chapter One, consistent application of law and appropriate appointment of arbitrators are critical to the perceived legitimacy of ISDS. If the ISDS mechanism is perceived as lacking legitimacy, then how can it be entrusted with claims having significant bearing on States’ regulatory power?

¹³⁹ *KAFTA* art 22.2, fn 92.

¹⁴⁰ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A (*GATT*).

While *KAFTA* provides far more detail on ISDS procedural matters than the *Hong Kong-Australia BIT*, the fundamental concerns about consistency and the method of appointment of arbitrators remain. Under *KAFTA*, it is still generally up to the disputing parties to appoint arbitrators to the tribunals. Also, there is no indication that ad hoc arbitral tribunals appointed under *KAFTA* are obliged to demonstrate any greater consistency in the application of the law than arbitral tribunals appointed under IIAs such as *NAFTA* or the *Hong Kong-Australia BIT*.

As noted in Chapter One, some empirical studies show no evidence of bias or impartiality in ISDS arbitral tribunals.¹⁴¹ Further, academics like Professor Franck note that a small degree flexibility in the application of law might even be beneficial.¹⁴² However, the public discourse surrounding ISDS suggests that, where State sovereignty is implicated, perceived legitimacy is a priority of the highest order.¹⁴³

The common law holds legal systems to a very high standard. In a highly influential statement of the law, Lord Chief Justice Hewart held in *R v Sussex Justices, Ex parte McCarthy* [1924] 1 K.B. 256 that it is 'of fundamental importance that justice should not only be done, but should manifestly and undoubtedly be seen to be done'.¹⁴⁴ Arguably, given the significant bearing that ISDS awards can have on State regulatory power, the legitimacy of ISDS is no less important than that of our domestic legal system.

As it currently stands under *KAFTA*, the ISDS mechanism still has issues with its perceived legitimacy which should be addressed through reform.

¹⁴¹ Charles N Brower and Sadie Blanchard, 'What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States' (2014) 52 *Columbia Journal of Transnational Law* 689, 710; Liang-Ying Tan and Amal Bouchenaki, 'Limiting Investor Access to Investment Arbitration: A Solution without a Problem' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 252.

¹⁴² Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73 *Fordham Law Review* 1521, 1613.

¹⁴³ See e.g., Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The Appeal Proposal' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 464; Elizabeth Warren, 'The Trans-Pacific Partnership clause everyone should oppose', *Washington Post* (online) (25 February 2015) <http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html>; Australian Broadcasting Corporation, 'ISDS: The Devil in the Trade Deal', *Background Briefing*, 14 September 2014 (Jess Hill) <<http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490#transcript>>.

¹⁴⁴ *R v Sussex Justices, Ex parte McCarthy* [1924] 1 K.B. 256, 259.

(b) *The Scope of Obligations Enforceable Under ISDS*

As noted in Chapter One, some of the most significant concerns about the impact of ISDS on State sovereignty relate to the scope of States' obligations under IIAs, for which ISDS is an enforcement mechanism. When States' obligations are drafted too broadly or are open to overly wide interpretations, they can negatively impact on a State's ability to craft public policy in areas such as health, the environment and education.

Chapter Two noted that, while it is unclear what significance subsequent State agreements and consultations have on the interpretation of State obligations under the *Hong Kong-Australia BIT*, *NAFTA* and *KAFTA* give States the power to issue binding interpretations of treaty provisions through Joint Commissions. This includes the ability to interpret certain exceptions and reservations after a dispute has commenced.¹⁴⁵ This power allows States to safeguard themselves from overly wide interpretations of provisions by arbitral tribunals. It is a strong assertion by States of a significant measure of control over the interpretation of their rights and obligations in ISDS.

Chapter Two also analysed the evolution of arguably the two most controversial State obligations commonly enforced under ISDS – the requirements in relation to 'expropriation' and the minimum standard of 'fair and equitable treatment'. In relation to expropriation, *KAFTA* significantly clarifies and refines the scope of the obligation over both the *Hong Kong-Australia BIT* and *NAFTA* and makes it clear that non-discriminatory regulatory actions designed to protect 'legitimate public welfare objectives' will only constitute expropriation in rare circumstances. In relation to fair and equitable treatment, *KAFTA* significantly improves upon the ambiguity of FET under the *Hong Kong-Australia BIT* and clarifies that FET under *KAFTA* is a mere codification of customary international law.

In addition, while the *Hong Kong-Australia BIT* has no general exceptions to the application of the obligations it places on States, *KAFTA* provides for a variety of general regulatory carve-outs and exceptions. *KAFTA* goes further than both *NAFTA* and the *Hong Kong-Australia BIT* by both building on existing exceptions in *NAFTA* and adding Article 22.1, a broad-ranging general exception modelled after Article XX of *GATT*.¹⁴⁶

Overall, the scope of obligations enforceable under ISDS, as it stands under *KAFTA*, to a significant degree addresses concerns about State sovereignty. However, regulatory impact assessment can be faulty and States need to remain vigilant about addressing unforeseen interpretations of State obligations that may arise in the future.

¹⁴⁵ See Part C of Chapter Two.

¹⁴⁶ See the section on General Exclusions in Part D of Chapter Two.

(c) 'Regulatory Chill'

The final concern about ISDS outlined in Chapter One is that of 'regulatory chill'. 'Regulatory chill' occurs if States take note of the size and frequency of ISDS awards as well as the costs of the ISDS process and are deterred from implementing public interest regulation.

Large companies like Philip Morris may be tempted to threaten smaller countries with ISDS to pressure them into not putting in place regulations that would affect their business interests. However, if there is greater certainty as to the precise delimitation of permissible regulatory power under IIAs and if there are clear exceptions and regulatory carve-outs in place for public interest regulation, then States will be more confident enacting appropriate regulation without fear of losing ISDS arbitral cases. *KAFTA* makes significant strides in this regard but there is always room for improvement.

KAFTA and *NAFTA* establish three-year limitation periods on bringing ISDS claims, allow for consolidation of claims, and place greater emphasis on settling claims amicably through ADR.¹⁴⁷ These kinds of changes can help make the overall ISDS burden more manageable for States. It should also be remembered that States with better records of upholding the rule of law, such as the United States and Australia, have been respondents in relatively few ISDS claims.¹⁴⁸ Further, some argue that 'arbitral tribunals have generally been careful to fend off unmeritorious claimants and claims'¹⁴⁹ and that the significant increase in globalisation and cross-border foreign direct investment to a great extent explains the increase in ISDS claims being brought.¹⁵⁰

While some concerns about 'regulatory chill' may well remain, the procedural innovations and the greater degree of clarity in the drafting of State obligations under *KAFTA* go a long way to addressing them.

2 *Investor Protection*

As observed in Chapter One, there is a real need for investor protection. Much of the controversy surrounding ISDS concerns its impact on State sovereignty but it is also important to consider whether such concerns can be addressed

¹⁴⁷ See Part B of Chapter Two.

¹⁴⁸ Jeffrey Zients, *Investor-State Dispute Settlement (ISDS) Questions and Answers* (26 February 2015) White House <[https://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-](https://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-answers)

[answers](http://dfat.gov.au/trade/topics/Pages/isds.aspx)>; Department of Foreign Affairs and Trade, *Investor-State Dispute Settlement* <<http://dfat.gov.au/trade/topics/Pages/isds.aspx>>; Scott Miller and Gregory N Hicks, 'Investor-State Dispute Settlement: A Reality Check' (Center for Strategic & International Studies, 2015) v.

¹⁴⁹ Liang-Ying Tan and Amal Bouchenaki, 'Limiting Investor Access to Investment Arbitration: A Solution without a Problem' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 250, 308.

¹⁵⁰ Scott Miller and Gregory N Hicks, 'Investor-State Dispute Settlement: A Reality Check' (Center for Strategic & International Studies, 2015) v.

without substantially eroding investor protection.

Broadly speaking, the evolution in ISDS outlined in Chapter Two has been towards more detail in relation to the obligations placed on States. The author has observed that more detail is good for State sovereignty as it makes clearer the scope of permissible State regulatory action as well as the scope of States' obligations. This greater clarity is good for investors also. Investors can be more certain of what standard of treatment they are entitled to, what recourse they have and the processes that are involved. Ambiguity is good for neither the State nor the investor. In this sense, *KAFTA*, while not perfect, is a significant step forward from the *Hong Kong-Australia BIT* and even *NAFTA*.

As noted above, *KAFTA* has also increased the degree to which there are carve-outs and exceptions to States' obligations and, by definition, these serve to narrow the circumstances in which investors will be entitled to an award in ISDS. However, arguably they are not of such sweeping scope as to seriously erode investor protection. Instead, these regulatory carve-outs reserve regulatory space for States in areas of significant public interest, such as public health and the environment.

However, there are some worrying changes where perhaps *KAFTA* and *NAFTA* have gone too far. States now have a role in issuing binding interpretations, through Joint Commissions, which extends to interpreting the scope of certain defences and exceptions after the dispute has already been brought to investment arbitration.¹⁵¹ This power is potentially open to abuse, which is concerning.

On balance, however, concerns about the interpretative power of Joint Commissions are not sufficient to support a conclusion that investor protection has been inappropriately eroded under *KAFTA* from the baseline of the *Hong Kong-Australia BIT*. ISDS under *KAFTA* is still a valuable tool for investor protection.

3 Conclusion – Is the Present Balance Satisfactory?

Overall, the present balance between investor protection and State sovereignty is reasonably appropriate but there is room for improvement. *KAFTA* has significantly refined the scope of obligations enforceable under ISDS, which is one of the major concerns surrounding ISDS. The greater certainty may have some flow-on effect on 'regulatory chill' and the costs associated with ISDS – although that does not mean that there is not more that can be achieved in terms of procedural efficiency. *KAFTA* has managed this without inappropriately eroding investor protection from the baseline of the *Hong*

¹⁵¹ See Part C of Chapter 2; Tomoko Ishikawa, 'Keeping Interpretation in Investment Treaty Arbitration 'on Track': The Role of State Parties' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 115, 141.

Kong-Australia BIT. However, more should be done to address concerns about the legitimacy of the ISDS mechanism.

B Suggested Reforms

This Part suggests four reforms to ISDS. Firstly, IIAs should be regularly reviewed and updated; secondly, developing States' should be supported in conducting thorough regulatory impact assessments; thirdly, a Standing International Investment Court should be established; and fourthly, an Appellate Court should be established.

1 Regularly Reviewing and Updating IIAs

The scope of obligations enforceable under ISDS should be refined over time. As discussed in Chapter One, IIAs may be regarded as experiments in international investment law policy-making. Only time will tell if the current balance, as represented by *KAFTA*, is suited to present and future public policy needs. States need to remain vigilant as unforeseen issues may arise.

The recent free trade agreement between the Swiss Confederation and the People's Republic of China requires biennial reviews of its provisions.¹⁵² States should incorporate similar provisions into all future IIAs, undertaking reviews through Joint Commissions of States every five years (or some other appropriate time period) to ensure that the drafting of obligations enforceable under ISDS remains appropriate. That way, any ambiguities or other issues may be identified and IIAs can be more responsive to developments in public policy needs.

The other issue is that, as discussed in Part A, older IIAs like the *Hong Kong-Australia BIT* lag behind newer generations of IIAs like *KAFTA*. States should be bringing older generations of IIAs in line with the evolutions in newer IIAs.

This could be done in a few different ways. Firstly, these treaties could be amended. Secondly, they could be terminated and renegotiated. Thirdly, where States have the power to issue binding interpretations through Joint Commissions, such as under *NAFTA*, binding interpretations could cover some of the necessary changes (e.g. the Note of Interpretation under *NAFTA*, discussed in Chapter Two). To avoid injustice, existing investors should be able to rely on the original wording for some appropriate period of time, perhaps three years (reflecting the limitation period on claims in treaties such as *NAFTA* and *KAFTA*).

Updating older IIAs would decrease the fragmentation of international investment law. It would be clearer for investors and States what rights and

¹⁵² See e.g., *Free Trade Agreement between the Swiss Confederation and the People's Republic of China*, signed 6 July 2013, (entered into force 30 April 2014) art 2.8.

obligations they have under various IIAs. The other benefit for States is that there would be less risk that ambiguities from older treaties would impose on their State sovereignty.

2 *Supporting Regulatory Impact Assessments*

On a related note, developing States should be assisted with the regulatory impact assessment process to help ensure that the scope of obligations they agree to under IIAs is appropriate to their policy needs.

Ambiguities in international investment law mean that the regulatory impact of IIAs is not always clearly foreseen, even with a thorough regulatory impact assessment process.¹⁵³ This can result in States not being fully aware of what they are negotiating and agreeing to under IIAs. This is particularly the case where developing States have insufficient resources to conduct thorough regulatory impact assessments. This may put developing States at a disadvantage during the negotiating process for IIAs and may lead them to agreeing to a wider scope of obligations enforceable under ISDS than is suitable for their circumstances.

Empirical studies show that it is less-developed States and those with weaker legal systems that are more likely to have ISDS claims brought against them.¹⁵⁴ This is all the more reason for them to be clear about what they are signing up for when concluding IIAs. Resources should be made available to developing States to help them conduct thorough regulatory impact assessments.¹⁵⁵ Not only would this assist developing States achieve an appropriate balance between investor protection and State sovereignty but it would also help developing States better observe their commitments under the IIAs they conclude.

3 *Establishing a Standing International Investment Court*

Establishing a Standing International Investment Court ('Investment Court') could enhance the legitimacy of the ISDS process.

(a) *Legitimacy*

In Chapter One, we identified three factors contributing to concerns about the independence and impartiality of ISDS arbitral tribunals – arbitrators' lack of secure tenure, 'profiling' of arbitrators, and the 'double hat dilemma'. An

¹⁵³ See United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015) 125-126.

¹⁵⁴ Scott Miller and Gregory N Hicks, 'Investor-State Dispute Settlement: A Reality Check' (Center for Strategic & International Studies, 2015) v.

¹⁵⁵ See United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015) 125-126.

Investment Court would address each of these factors.

The Investment Court should be made up of a relatively stable group of judges who will be chosen from the most respected of international investment law experts and assigned to cases through a rostering system.¹⁵⁶ This would eliminate the problem of ‘profiling’, where the disputing parties try to craft an arbitral tribunal sympathetic to their own side.

The judges should be appointed for a set period of time, subject to reappointment. This would give them security of tenure. As one academic notes, security of tenure

insulates the adjudicator from influence by powerful private interests, so as to ensure that no one can say that the judge was predisposed to decide a case or interpreted the law in a way that would increase his or her prospects for future income and career advancement.¹⁵⁷

Finally, there should be limitations on what other activities judges of the Investment Court can engage in while they remain judges of the Investment Court. They should not be able to appear as counsel before arbitral tribunals or any other activity that might give rise to a conflict of interest. This would address the ‘double hat dilemma’.

As for consistency in the application of legal principles, having a smaller, relatively stable group of highly respected international jurists making up the bench of the Investment Court is likely to result in greater consistency of decision-making than when ISDS is conducted by an ‘atomized network’ of ad hoc arbitral tribunals.¹⁵⁸

(b) *The Political Hurdle*

The challenge would be getting sufficient international consensus and political momentum for this reform. However, as one author notes, ‘the flaws and criticism of the current international system of settlement of investment disputes is creating the momentum for a consensual change where neutrality, independence, impartiality, transparency and consistency are not only

¹⁵⁶ Omar E Garcia-Bolivar, ‘Permanent Investment Tribunals: The Momentum is Building Up’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 394, 397.

¹⁵⁷ Eduardo Zuleta, ‘The Challenges of Creating a Standing International Investment Court’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 409.

¹⁵⁸ Omar E Garcia-Bolivar, ‘Permanent Investment Tribunals: The Momentum is Building Up’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 394, 397-398; J J Saulino and Josh Kallmer, ‘The Emperor Has No Clothes: A Critique of the Debate Over Reform of the ISDS System’ in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 560, 560.

permanently present, but also widely perceived'.¹⁵⁹

The composition of the proposed Investment Court should 'adequately reflect the interests of both developed and developing countries' to address any concerns about inappropriate country bias.¹⁶⁰ Also, the Investment Court should be presented as an opt-in mechanism, an additional option alongside the traditional ISDS arbitral mechanism. Making it optional would lessen the political difficulty in getting support for it.¹⁶¹ It would also encourage the Investment Court to prove its effectiveness as a dispute resolution mechanism in order to increase take-up.

A practical aspect that should be considered is the ongoing cost of running the Investment Court. This would include wages, leasing premises, administrative costs etc. However, there are also likely to be cost benefits as well, largely due to the economies of scale that would come with running a permanent Investment Court as opposed to setting up ad hoc arbitral tribunals.¹⁶² This might help reduce the marginal costs of ISDS arbitration. Covering the fixed cost of maintaining the Investment Court would be up to the States involved in setting up the Court. The fixed cost might be justified by the rapid increase in ISDS arbitrations since the 1990's.

4 *Establishing an Appellate Court*

Establishing an Appellate Court in ISDS would enhance the legitimacy of the ISDS mechanism in many of the same ways as establishing an Investment Court would. However, arguably it would promote an even greater level of consistency in ISDS decision-making than what would be achieved by only establishing an Investment Court.

(a) *Legitimacy*

The same considerations apply for an Appellate Court as for an Investment Court – an Appellate Court would enhance both the independence and impartiality of ISDS dispute resolution as well as the consistency of decisions.

However, arguably even more so than an Investment Court, an Appellate

¹⁵⁹ Omar E Garcia-Bolivar, 'Permanent Investment Tribunals: The Momentum is Building Up' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 394, 402.

¹⁶⁰ Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The Appeal Proposal' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 462.

¹⁶¹ Omar E Garcia-Bolivar, 'Permanent Investment Tribunals: The Momentum is Building Up' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 394, 398-399.

¹⁶² Eduardo Zuleta, 'The Challenges of Creating a Standing International Investment Court' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 417-418.

Court would 'be able to facilitate and foster the "rule of law" in international investment arbitration by accumulating and spreading consistent jurisprudence in the international community'.¹⁶³ It would do so by clarifying ambiguities in the law and also by creating an avenue of appeal from inconsistent decisions. The decisions of an Appellate Court should carry with them the weight of persuasive precedent, which would pressure tribunals to ensure a high quality of reasoning by leaving their awards open to appeal if they contradict or fail to sufficiently distinguish precedent established by the Appellate Court.¹⁶⁴

A disadvantage of having an Appellate Court is that it could contribute to greater costs in ISDS by undermining the finality of ISDS arbitral tribunals' awards, giving disputing parties a chance to appeal and prolong disputes.¹⁶⁵ On the other hand, as discussed above, a successful Appellate Court would help spread consistent international investment law jurisprudence. If there is greater consistency and clarity in international investment law, investors and States would better understand the content of their rights and obligations. Better understood rights and obligations could lead to less disputes being triggered and also less time spent in disputes arguing over matters of legal principle already settled by the Appellate Court.

(b) *The Political Hurdle*

More so than establishing an Investment Court, establishing an Appellate Court would be a significant political challenge, given the substantial power that the Appellate Court would wield through its ability to overturn awards and establish persuasive precedent. However, IIAs are starting to show signs of movement in that direction.¹⁶⁶ This is encouraging for the prospects of the reform as it hints at a building momentum for change. Also, similarly to what was said above about the Investment Court, the composition of an Appellate Court should 'adequately reflect the interests of both developed and developing countries'.¹⁶⁷

¹⁶³ Jaemin Lee, 'Introduction of an Appellate Review Mechanism for International Investment Disputes: Expected Benefits and Remaining Tasks' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 474, 477.

¹⁶⁴ See Eduardo Zuleta, 'The Challenges of Creating a Standing International Investment Court' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 403, 416.

¹⁶⁵ Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The Appeal Proposal' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 471.

¹⁶⁶ See e.g., *KAFTA* art 11.20.13, annex 11-E.

¹⁶⁷ Gabriel Bottini, 'Reform of the Investor-State Arbitration Regime: The Appeal Proposal' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System – Journeys for the 21st Century* (Brill, 2015) 455, 462.

CONCLUSION

This paper set out to answer the question of whether there is an appropriate balance between investor protection and State sovereignty in ISDS.

Chapter One outlined three main points of contention between critics and proponents of ISDS in relation to the impact of ISDS on State sovereignty – the legitimacy of the ISDS mechanism; the scope of obligations enforceable under ISDS; and the phenomenon of ‘regulatory chill’.

Chapter Two analysed the evolution of ISDS over three treaties, namely, the *Hong Kong-Australia BIT*, *NAFTA* and *KAFTA*. Specifically, Chapter Two examined the evolution of procedural aspects of ISDS, the interpretative methodology in ISDS and the substantive scope of obligations under ISDS.

Chapter Three concluded that ISDS has made significant strides in the right direction from the baseline of the *Hong Kong-Australia BIT* to *KAFTA*. In the author’s opinion, the current balance between investor protection and State sovereignty is reasonably appropriate, with some room for improvement. In particular, issues with the legitimacy of the ISDS mechanism remain and States also need to remain vigilant to ensure that ISDS keeps up with evolving public policy needs. Four reforms are suggested to address these outstanding concerns. Firstly, IIAs should be regularly reviewed and updated; secondly, developing States’ should be supported in conducting thorough regulatory impact assessments; thirdly, a Standing International Investment Court should be established; and fourthly, an Appellate Court should be established.

Increasing globalisation and levels of foreign direct investment mean that, in the 21st century, States’ economies are interconnected and interdependent like never before. Free-flowing capital crosses State borders with a speed and magnitude that would have been unimaginable even a century ago. Against this background, it is important to have in place a framework for investor protection which is both robust enough to offer real protection to investors and flexible enough to enable States to implement public interest regulation and govern effectively. With a little tweaking, ISDS is up to the task.