APPROPRIATE TREATY-BASED DISPUTE RESOLUTION FOR ASIA-PACIFIC COMMERCE IN THE 21ST CENTURY

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I INTRODUCTION

Australia and Japan have been negotiating a Free Trade Agreement ('FTA') since 2007. Along with Mexico and Canada, Japan also now wishes to join Australia and eight other countries already negotiating an expanded Trans-Pacific Partnership Agreement ('TPPA') – the first major Asia-Pacific FTA. Both developments are proving controversial.[1] On the one hand, free trade advocates argue that bilateral and even regional FTAs can often detract from the preferred options of multilateral trade and investment liberalisation, and unilateral deregulation. This stance is illustrated by the majority view expressed in the December 2010 Report of the Productivity Commission ('PC'), mostly adopted by the April 2011 *Gillard Government Trade Policy Statement* ('TPS').[2] At the other extreme, free trade critics now complain that all FTAs – including multilateral agreements such as the *General Agreement on Trade in Services* ('GATS') under the World Trade Organization ('WTO') regime – entrench

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1 Jane Kelsey (ed), *No Ordinary Deal: Unmasking the Trans-Pacific Partnership* (Allen & Unwin, 2011); Deborah Elms and C L Lim, 'The Trans-Pacific Partnership Agreement (TPP) Negotiations: Overview and Prospects' (Working Paper No 232, S Rajaratnam School of International Studies, 21 February 2012) <http://www.rsis.edu.sg/publications/WorkingPapers/WP232.pdf>; Open Letter from Lawyers to the Negotiators of the Trans-Pacific Partnership Urging the Rejection of Investor–State Dispute Settlement, 8 May 2012 <http://canadians.org/trade/documents/TPP-Jurists-letter-0512.pdf>; Luke Nottage, 'Australia–Japan Business Cooperation: The Last 50 Years and a New FTA?' on Luke Nottage, *Japanese Law and the Asia-Pacific* (20 October 2012) <http://www.blogs.usyd.edu.au/japaneselaw/2012/10/australia-japan_business.html>.

2 Productivity Commission, *Bilateral and Regional Trade Agreements: Research Report* (13 December 2010) cited in Department of Foreign Affairs and Trade, Australian Government, *Gillard Government Trade Policy Statement: Trading our Way to More Jobs and Prosperity* (April 2011) <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>.

institutional features and underlying assumptions related to deregulation and free market access that often have been proven inadequate by the Global Financial Crisis of 2008.[3]

However, many policy-makers and commentators are seeking a middle way. Some, like the dissenting Commissioner in the PC's Report, maintain that bilateral and regional agreements represent the most realistic way forward for further liberalisation of cross-border trade and investment.[4] They provide more scope, for example, for agreement on novel 'behind the border' measures not typically found in WTO and earlier FTAs, which the free trade advocates also often seek. Others argue that agreement on such measures, and other features of 'next generation' FTAs, must take more seriously the lessons from large-scale market failures epitomised by the Global Financial Crisis and find novel ways to bolster inter-state cooperation and minimum standards of protection for consumers and other vulnerable groups.[5]

This debate is led mainly by politicians and officials charged with international trade policy, as well as economists in think-tanks, academic institutions and international organisations, together with a few specialists in international economic law (especially WTO law). This short article cannot resolve the entire debate. But we propose to add new perspectives by drawing on insights across several business law sub-fields, particularly international arbitration and tax law, to suggest novel treaty-based mechanisms for resolving and minimising cross-border commercial disputes. These innovations should be widely acceptable even among various groups with their disparate views on how to proceed with FTA negotiations, albeit perhaps for different reasons.

In particular, we focus on measures to address a growing common concern about the delays and costs involved in international disputes between states that indirectly affect traders, investors or taxpayers; and in disputes resolved directly between investors and host states, particularly in investor–state arbitration

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3 Jane Kelsey, 'How the Trans-Pacific Partnership Agreement Could Heighten Financial Instability and Foreclose Government's Regulatory Space' (2010) 8 *New Zealand Yearbook of International Law* 3.

4 Productivity Commission, above n 2, app A. See also Richard Baldwin, 'Sequencing Regionalism: Theory, European Practice, and Lessons for Asia' (Working Paper No 80, ADB Working Paper Series on Regional Economic Integration, Asian Development Bank, May 2011) <http://aric.adb.org/archives.php?section=0&subsection=workingpapers>.

5 Luke Nottage, 'Asia-Pacific Regional Architecture and Consumer Product Safety Regulation for a Post-FTA Era' (Legal Studies Research Paper No 09/125, University of Sydney Law School, November 2009) <http://ssrn.com/abstract=1509810> with a revised and updated version forthcoming in Meredith Kolsky Lewis and Susy Frankel (eds), *Trade Agreements at the Crossroads* (Routledge, 2013) (forthcoming) ; Luke Nottage, 'Free Trade Agreements and Investment Treaty Innovations to Promote More Sustainable Financial Markets for Consumers' (Working Paper No 31, Sydney Centre for International Law, June 2012) <http://sydney.edu.au/law/scil/documents/2012/SCIL_WP31_Nottage_ILAbook.pdf>. See also Luke Nottage, 'Open Letter – Assessing Treaty-Based Investor–State Dispute Settlement': Open Letter from Lawyers to the Negotiators of the Trans-Pacific Partnership Urging the Rejection of Investor–State Dispute Settlement (8 May 2012) <http://canadians.org/trade/documents/TPP-Jurists-letter-0512.pdf>; Luke Nottage, 'Treaty Based Investor–State Dispute Settlement Mechanisms Not All Bad', *East Asia Forum* (online), 17 August 2012 <http://www.eastasiaforum.org/2012/08/17/treaty-based-investor-state-dispute-settlement-mechanisms-not-all-bad/>.

('ISA').[6] Our analysis also draws inspiration and analogies from even more acute concerns and possible counter-measures regarding delays and costs in international commercial arbitration ('ICA'), used to resolve purely commercial disputes directly between firms from different states.[7]

Specifically, we outline several novel mechanisms that could be entrenched in FTAs (Part II), investment treaties (Part III) and double-tax avoidance treaties ('DTTs': Part IV) to resolve disputes earlier or more cost-effectively – in other words, more appropriately. The article also suggests, somewhat counter-intuitively, that reducing costs and delays in these ways can often be achieved by making the respective processes more transparent in various ways. Although not a panacea and itself the topic of ongoing debate,[8] greater transparency in international dispute resolution does appear to hold considerable scope for enhancing both cost-efficiencies and democratic values. Nonetheless, the different degrees and types of public interests involved in these various dispute resolution categories sometimes make it important to keep at least some aspects confidential in order to avoid disputes or settle them earlier or more cost-effectively.

Lastly, although our arguments focus on the Australia–Japan context, several observations and recommendations are likely to apply to other bilateral relationships (such as the *Australia–Korea FTA*, also under negotiation).[9] They may also impact on emerging regional agreements for economic cooperation,

6 See, eg, David Gaukrodger and Kathryn Gordon, 'Investor–State Dispute Settlement Public Consultation: 16 May – 23 July 2012' (Scoping Paper, Organization for Economic Cooperation and Development, May 2012) 19–24 <http://www.oecd.org/daf/internationalinvestment/internationalinvestmentagreements/50291642.pdf >; see also several Public Comments responding to concerns about delays and costs in ISA: OECD, 'Investor–State Dispute Settlement Public Consultation: 16 May – 23 July 2012: Comments Received as of 30 August 2012' (Organization for Economic Cooperation and Development, 30 August 2012) <http://www.oecd.org/daf/internationalinvestment/internationalinvestmentagreements/ISDSconsultationcomments_web.pdf>.

7 Luke Nottage, 'Addressing International Arbitration's Ambivalence: Hard Lessons from Australia' in Vijay K Bhatia, Christopher N Candlin and Maurizio Gotti (eds), *Discourse and Practice in International Commercial Arbitration* (Ashgate, 2012) 11; Luke Nottage, 'Drafting Arbitration Clauses to Minimise Costs and Delays in ICA: An Asia-Pacific Perspective' (Working Paper No 28, Sydney Centre for International Law, June 2011) <http://sydney.edu.au/law/scil/documents/2011/WP28_Nottage_DraftingArbitrationClauses_APC.pdf>.

8 See especially, the exhaustive deliberations underway since October 2010 at the United Nations Commission for International Trade Law ('UNCITRAL') regarding transparency in treaty-based ISA: UNCITRAL, *Working Group II, 2000 to Present: Arbitration and Conciliation* (2012) <http://www.uncitral.org/uncitral/en/commission/working_groups/2Arbitration.html>. For helpful summaries, see: *UNCITRAL Working Group II Blog*, Moot Alumni Association <http://www.maa.net/index.php?option=com_content&view=category&layout=blog&id=70&Itemid=182>.

9 For a listing and introduction to Australia's FTAs in force and under negotiation, see Department of Foreign Affairs and Trade, Australian Government, *Australia's Trade Agreements*, <http://www.dfat.gov.au/fta/index.html>. For a listing and the texts of Japan's FTAs and investment treaties, see Ministry of Economy Trade and Industry, *FTA/EPA/IIA* <http://www.meti.go.jp/english/policy/external_economy/trade/FTA_EPA/index.html>.

such as the TPPA, and indeed ongoing discussions about reforming the Dispute Settlement Understanding ('DSU') within the WTO system.[10]

II INTER-STATE TRADE (AND SERVICES INVESTMENT) DISPUTE RESOLUTION

Provisions in most bilateral or regional FTAs for dealing with inter-state dispute settlement have a similar structure to the WTO's DSU.[11] A party can complain about another party allegedly violating the agreement by requesting the establishment of a panel (or other adjudicator, however described).[12] If the panel finds a violation, it can rule that the respondent country should remove the violation.[13] If the respondent fails to remove the violation, the complainant can retaliate, meaning it can suspend obligations that it would otherwise owe to the respondent.[14] In the WTO, the complainant must seek permission before being able to impose retaliation.[15] Most FTAs also have a provision to deal with the situation in which the respondent believes the complainant wants to apply or actually is applying retaliation out of proportion to the injury caused by the original violation. This point can also go to a third-party adjudicator.[16] In WTO disputes, the rule applied is that the retaliation should be equivalent to the extent

10 *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 2. See, eg, Dencho Georgiev and Kim van der Borght (eds), *Reform and Development of the WTO Dispute Settlement System* (Cameron May, 2006); Faisal A S A Albashar and A F M Maniruzzaman, 'Reforming the WTO Dispute Settlement System: A Rethink of the Third Party Right of Access to Panel and Appeal Processes from Developing Countries' Perspectives' (2010) 11 *Journal of World Investment and Trade* 311. For a helpful outline of the DSU system, see also World Trade Organization, *The Process – Stages in a Typical WTO Dispute Settlement Case* (2012) <http://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s1p1_e.htm>.

11 There are far too many FTAs, containing slightly different dispute settlement provisions, to cite them all – or even to cite to all variations of such provisions. To compare and contrast with the DSU, two useful examples are the *Agreement on Comprehensive Economic Partnership among Japan and Member States of the Association of South East Asian Nations*, signed 14 April 2008 (entered into force 1 December 2008) <http://www.meti.go.jp/english/policy/external_economy/trade/FTA_EPA/asean.html> ('*Japan–ASEAN FTA*') and the *Agreement Establishing the ASEAN–Australia–New Zealand Free Trade Area*, signed 27 February 2009, [2010] ATS 1 (entered into force 1 October 2010) <http://www.dfat.gov.au/fta/aanzfta/contents.html> ('*AANZFTA*').

12 See, eg, *Japan–ASEAN FTA* art 62; *AANZFTA* ch 17 art 8; cf DSU art 4.

13 See, eg, *Japan–ASEAN FTA* art 69 (the making of an award); *AANZFTA* ch 17 arts 13(16), 15(1); cf DSU art 19(1).

14 See, eg, *Japan–ASEAN FTA* art 72(3); *AANZFTA* ch 17 art 17.3 (which notably requires an intermediate step of requesting a review of the purported implementation before imposition of retaliation).

15 DSU art 22(2).

16 See, eg, *Japan–ASEAN FTA* arts 71(2), 71(2), 72(5); *AANZFTA* ch 17 art 17(8); DSU art 22(6) (providing for an arbitration on the permissible extent of retaliation).

of the impairment of benefits caused by the initial violation.[17] FTAs also usually have rules worded in terms of equivalence or proportionality.[18]

In general, FTAs (like the WTO's DSU) do exhibit a preference for negotiated solutions.[19] Other provisions usually require the state parties to consult with each other to try to reach a negotiated solution and remove the need to go through the procedures for adjudication. The parties may raise various points during that stage of negotiations. They will exchange information to establish the facts. They will make legal arguments. The complainant may try to establish that the violation is quantitatively significant, affecting a large value of trade, and may use that to make the point that if an adjudication were to find a violation then the respondent will be faced with retaliation affecting a large value of its exports unless it removes the violation. Sometimes, this might be enough to coax the respondent to remove the impugned measure. In effect, the consultations process might be enough to focus the minds of the political decision makers in the respondent state upon the costs and benefits of continuing with the measure. However, in other instances, it is not until the whole course of the dispute settlement procedures has run that the decision makers finally evaluate those costs and benefits and remove the violation. Of course, in some rare instances, not even the actual application of retaliation – let alone the threat – is sufficient to induce compliance.

Of course, the decision whether or not to withdraw a violating measure is, like any other decision of a state, made by political decision makers. Those political decision makers may make that decision by evaluating what is best for the citizens within the state. However, politicians' consideration of what is best for the citizens may be swamped by politicians' evaluation of the political costs and benefits to themselves of different courses of action. Indeed, the 'public choice' school of economics has generated models to explain and predict political decisions on trade policy by concentrating on political costs and benefits to politicians.[20] Trade agreements have also been modeled in terms of the way that they impact on the levels of political support and opposition accruing to political decision makers.

While economists have used quantitative models to assess the feasibility of a given trade agreement,[21] jurists like Schwartz and Sykes have utilised a qualitative description of the same political forces to explain the way that States

17 DSU art 22(4).

18 See, eg, *Japan–ASEAN FTA* art 72(4), which provides that retaliation is 'restricted to the same level of nullification or impairment that is attributable to the failure to comply with the Award'; and *AANZFTA* ch 17 arts 17(7), 17(10), which uses a standard of 'equivalence'.

19 See, eg, *Japan–ASEAN FTA* arts 62–3; *AANZFTA* ch 17 arts 6–7; cf DSU arts 4–5.

20 The leading work is Gene M Grossman and Elhanan Helpman, 'Protection for Sale' (1994) 84 *American Economic Review* 833. It is subject to testing in Pinelopi Koujianou Goldberg and Giovanni Maggi, 'Protection for Sale: An Empirical Investigation' (1999) 89 *American Economic Review* 1135; Kishore Gawande and Usree Bandyopadhyay, 'Is Protection for Sale? Evidence on the Grossman-Helpman Theory of Endogenous Protection' (2000) 82 *Review of Economics and Statistics* 139.

21 Wilfred J Ethier, 'Political Externalities, Nondiscrimination, and a Multilateral World' (2004) 12 *Review of International Economics* 303.

behave in using provisions to renegotiate their trade liberalisation commitments or in making decisions within the framework of dispute provisions on whether to impose retaliation or to agree on compensatory liberalisation.[22] Schwartz and Sykes see a respondent in dispute settlement calculating the political payoffs and deciding to remove a violation if the political support gained from maintaining the violating measure is exceeded by the political opposition from exporters who are harmed by the complainant's retaliation. They took their explanation a step further by controversially introducing the concept of 'efficient breach' into analysis of trade law. On their view, the system allows the respondent to choose not to withdraw a violating measure in a situation in which the political position of the complainant government, having implemented retaliatory protection, is no worse off than it would have been had the respondent complied, and the political position of the respondent government is improved even after allowing for the loss of political support caused by suffering retaliation. The trade agreement serves a function of making it much more difficult, but not impossible, for a government to use the grant of trade protection as a way of increasing political support. In essence, the final stage of the dispute settlement system under a trade agreement, when the implementation of retaliation becomes possible and both the extent of permissible retaliation and the likely subject matter of retaliation become known, serves in most cases to convince the government of the respondent country that they are not in an 'efficient breach' situation and that their political position will be better if they comply with the ruling.

The question asked here is whether any additional mechanisms could be added to FTA dispute settlement provisions to bring forward the point at which decision makers do that weighing of the costs and benefits of bringing measures into compliance. Such mechanisms might shorten the lifespan of illegal measures, benefiting affected private traders and reducing the resources expended on dealing with trade disputes. Two suggestions made here start by focusing on the factors that weigh upon those decisions by political decision makers.[23]

First, dispute settlement provisions could bind the parties in advance to a procedure for quantifying what is at stake, at a stage in the process much earlier than would otherwise be the case if the question were not considered until a violation is found and the respondent fails to comply. A respondent could agree in advance that whenever a dispute commences, the complainant can have an expert appointed to answer the question: if the complainant is correct about the measure being a treaty violation, how much trade is affected and what would be the quantum of retaliation that the complainant could ultimately impose? The

22 Warren F Schwartz and Alan O Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization' (2002) 31 *Journal of Legal Studies* S179. See also Kenneth W Abbott, 'The Trading Nation's Dilemma: The Functions of the Law of International Trade' (1985) 26 *Harvard International Law Journal* 501.

23 For a more detailed exposition of these two suggested mechanisms and the theoretical basis for them, see Brett G Williams, 'Innovative Mechanisms for Resolving or Avoiding Inter-State Trade Disputes in an Asia-Pacific Regional Free Trade Agreement' (2011) 18 *Australian International Law Journal* 141.

respondent's political decision makers then have an earlier opportunity to evaluate whether it is worthwhile to persist with the measure at issue. In clear political terms, they can evaluate the extent to which removing the protectionist measure in dispute would attract political opposition from the affected import-competing producers, and can also evaluate the extent to which retaliation might cause affected exporters to manifest political opposition to the government. The early quantification and focus on the political calculus may lead to earlier resolution of the dispute. Of course, this would depend on how strongly the respondent believes it will be found not to be in violation. At least in some cases, however, the early quantification may lead to an earlier realisation that persisting with a violating measure in the face of retaliation will not be the best political choice.

Secondly, consider another factor that might affect the level of political support for or opposition to political decision makers: the general public perception of whether a particular measure is in the overall national interest. One could justifiably be skeptical about the extent to which assessments of the national interest impact on politicians' decisions. Often, politicians will be heavily influenced by more direct and immediate manifestations of political support or opposition arising from those directly affected by trade measures, rather than assessments of the broad impact on a diffuse community which may take effect over a relatively long time period. However, it is possible that the weight of the assessment of the national interest in the politician's calculus of political support can be raised to a more significant level through increased transparency. It may be that there is not a widespread or high level of awareness and understanding by the public or the electorate of the economy-wide effects of a particular protective measure. It is also possible that the measure has been implemented in response to particular political pressures, without a process involving any objective economic assessment of the costs associated with the protective measure. In such circumstances, it could then be beneficial to have FTA provisions whereby the respondent has consented in advance to an objective economic assessment by an appropriate expert, whose report is made available publicly and uncensored in the respondent state. Such a public economic evaluation of overall economic impact may not have as significant a bearing on politicians' decisions as a clear and relatively immediate loss of political support from a particular group of exporters. Nonetheless, exposure of the economic report to public consumption and debate may carry some weight with politicians.

Of course, in some cases, the report may find net economic gains. In other cases, the report may find that a particular gain that is difficult to quantity is being achieved at a quantifiable cost by a measure which is higher than the quantifiable cost of achieving the same gain by another policy measure. The assessment would depend on the particular measure and the facts of each situation. However, there would be some instances where the report would serve a function of publicising that the measure is imposing a net cost on the citizens in the respondent state. It may be that raising the transparency of those costs could lead to that factor having an appreciable impact on political decision makers. It could induce removal of violating measure more quickly than would otherwise

be the case. Sometimes, the mere fact that the dispute settlement provision contains this proposed mechanism for transparent evaluation of the economic impact of a policy may lead to better decisions about adoption of policies in the first place, avoiding any dispute ever arising at all.

Both mechanisms would need to be set out in ways that could work in practice, given also the paucity of support for the mechanisms within existing FTAs (including those concluded respectively by Australia and Japan). These novel provisions would need to give the complainant the right to set the additional process in motion without the respondent being able to block it. Thus, the provisions would need to specify a clear mechanism for resolving disputes about whom should be appointed as the provider of the expert report. The provision should facilitate the completion of the choice of expert and commencement of the process quickly, so that the process can actually be completed in a time frame so as to provide extra information to the parties at an early stage of the principal dispute settlement procedures.

Further, regarding the mechanism for pre-estimating retaliation, the provision would need to require the complainant to state the precise assumptions that should guide the expert determination. The quantification of retaliation at the end of the ordinary dispute process depends on the precise violation that is found to exist. This pre-estimate mechanism therefore cannot tell the parties exactly how much retaliation could be permitted at the end of the dispute. It can only tell the parties how much retaliation could be permitted if the adjudicator makes particular findings about the existence of a violation and the respondent fails to modify the measure. For the second mechanism, facilitating public dissemination of a report on economic impact, the states should agree on particular publication media in advance. The parties could agree that both parties can publish the report on a government website, and that the other will not obstruct public access to that website.

For both mechanisms, it might be appropriate for the expert to ensure that submissions of the parties are taken into account. It may be appropriate to place the cost of invoking the procedure on the complainant party invoking it. Finally, both of these mechanisms would still achieve the intended impact on political decision making even if the expert reports were explicitly non-binding and even if the members remained completely free to publicly contest the findings in the expert report. Some other practicalities are explored in a separate paper,[24] as well as below (Part III(B)(1)) in the context of ISA proceedings, where both novel mechanisms suggested here are also worth exploring.

24 Ibid.

III INVESTOR–STATE ARBITRATION

A Background to (Asia-Pacific) ISA

Investor–state arbitration needs more introduction as it still tends to be less well known than inter-state dispute resolution under the WTO Agreements or FTAs. Yet treaty-based ISA claims have proliferated, especially over the last decade,[25] due to the confluence of two trends since the 1990s. First, even in developing countries and the Asian region, host states have increasingly liberalised their regimes for foreign direct investment ('FDI') both unilaterally or voluntarily and via treaties. Second, increasingly comprehensive ISA provisions have been added to bilateral investment treaties ('BITs') or now FTA Investment Chapters. These allow a home state's investors to bring direct claims – before any international arbitral institution specified in the treaty – regarding a host state's violation of substantive protections or liberalisation commitments agreed under the treaty (and sometimes even customary international law).[26]

However, Asian respondent states and especially Asian claimant investors appear to be disproportionately under-represented in formal ISA filings.[27] It seems unlikely that the main reason for this phenomenon is an 'Asian culture' broadly inimical to formal dispute resolution procedures, as Asian state parties are well-represented nowadays in WTO as well as other international law disputes, and in ICA filings.[28] Instead, the relative paucity of ISA filings involving Asian parties seems to be due mostly to numerous economic factors that create disproportionately high 'institutional barriers' to proceeding with ISA cases, including various costs involved. These range from direct costs, such as engaging increasingly expensive international law firms to represent a party (especially if hitherto unfamiliar with actual proceedings) through to many indirect costs. The latter include lost management time, but also the risk of permanently alienating a host state or even a large investor in the now highly integrated Asia-Pacific regional economy.[29]

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25 By the end of 2011, 450 known ISA claims had been filed: United Nations Conference on Trade and Development ('UNCTAD'), 'Latest Developments in Investor–State Dispute Settlement' (IIA Issues Note No 1, UNCTAD, April 2012) 3 <http://unctad.org/en/Pages/Home.aspx>.

26 Vivienne Bath and Luke Nottage, 'Foreign Investment and Dispute Resolution Law and Practice in Asia: An Overview' in Vivienne Bath and Luke Nottage (eds), *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge, 2011) 1.

27 See, respectively, Erik Voeten, 'Regional Judicial Institutions and Economic Cooperation: Lessons for Asia?' (Working Paper No 65, ADB Working Paper Series on Regional Economic Integration, Asian Development Bank, November 2010) <http://aric.adb.org/archives.php?section=0&subsection=workingpapers>; Luke Nottage and J Romesh Weeramantry, 'Investment Arbitration in Asia: Five Perspectives on Law and Practice' (2012) 28 *Arbitration International* 19.

28 Luke Nottage and Richard Garnett, 'Introduction' in Luke Nottage and Richard Garnett (eds), *International Arbitration in Australia* (Federation Press, 2010) 1, 32–3; Simon Greenberg, Christopher Kee and J Romesh Weeramantry, *International Commercial Arbitration: An Asia-Pacific Perspective* (Cambridge University Press, 2011) 33–43.

29 Nottage and Weeramantry, above n 27, 44.

Such concerns are particularly acute in the case of Japan, although similar issues arise among other Asian states that are also now large investors abroad.[30] No Japanese investor has yet filed a claim directly against a host state, despite almost all Japan's BITs and FTAs containing mostly pro-investor and increasingly elaborate ISA provisions.[31] Engaging outside lawyers to pursue arbitration claims still often seems like 'throwing good money after bad', although attitudes and practices related to ICA and court-based dispute resolution may be slowly changing[32] in line with some gradual transformations in Japan's legal profession and justice system.[33] Japan's investors and traders are also desperate to secure and import stable supplies of energy and natural resources,[34] especially after the 'triple disasters' that devastated the Tohoku region on 4 March 2011.[35] More generally, they have extensive and highly integrated production chains throughout the Asian region, nurtured through large-scale outbound FDI since the mid-1980s.[36] These are highly susceptible to a loss of competitive advantage should a Japanese firm get offside with a host state due to the escalation of disputes over an investment.

The Japanese government also seems sensitive to the risks of ripple-on effects for other firms that could arise should one Japanese firm become embroiled in formal ISA proceedings with one of the nation's treaty partners. Japan therefore works actively through inter-governmental 'investment committees' established under its FTAs and 'new-generation' investment treaties, involving industry groups, to manage and avoid investment disputes.[37]

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30 See, eg, Joongi Kim, 'A Pivot to Asia in Investor–State Arbitration' (2012) 27(2) *ICSID Review* (forthcoming). Seemingly for similar reasons, Korean investors also have not filed any ISA proceedings despite Korea having concluded significantly more investment treaties than Japan, including ISA provisions: see generally Bath and Nottage, above n 26, 11–12.

31 Shotaro Hamamoto and Luke Nottage, 'Foreign Investment In and Out of Japan: Economic Backdrop, Domestic Law, and International Treaty-Based Investor–State Dispute Resolution' (Sydney Law School Research Paper No 10/145, University of Sydney Law School, 2010) <http://ssrn.com/abstract=1724999>. See generally Koichi Miki, 'Investment Treaties and Investor–State Arbitration: The Japanese Perspective' (2008) 19 *American Review of International Arbitration* 301; Yoshimi Ohara and Shuji Yanase, 'Japan' in Michael Moser and John Choong (eds), *Asia Arbitration Handbook* (Oxford University Press, 2012) 1, 42–50.

32 M A Richter, 'Attitudes and Practices of Japanese Companies with Respect to International Commercial Arbitration: Testing Perceptions with Empirical Evidence' (2011) 8(5) *Transnational Dispute Management Journal* 1.

33 Luke Nottage and Stephen Green, 'Who Defends Japan?: Government Lawyers and Judicial System Reform in Japan' (2011) 13(1) *Asian-Pacific Law and Policy Journal* 129.

34 See, eg, the Mitsui/Mitsubishi involvement in the Sakhalin Island oil and gas development: Shotaro Hamamoto, 'A Passive Player in International Investment Law: Typically Japanese?' in Vivienne Bath and Luke Nottage (eds), *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge, 2011) 53, 60–1.

35 Luke Nottage, 'After the Disasters, Can We Revive a Free Trade Agreement with Japan?', *The Conversation* (online), 28 July 2011 <http://theconversation.edu.au/after-the-disasters-can-we-revive-a-free-trade-agreement-with-japan-2272>.

36 Peter Drysdale, 'Australia and Japan: A New Economic Partnership in Asia' (Report, Austrade, September 2009) <http://www.austrade.gov.au/default.aspx?FolderID=2147>.

37 Hamamoto and Nottage, above n 31.

Nonetheless, the incorporation of both substantive protections and ISA provisions in Japan's investment treaties provides potential leverage to Japanese firms in informal negotiations with a host state aimed at managing an investment dispute. This appears to represent one reason why Japan's peak business association, *Nippon Keidanren*, has pressed the government for over a decade to include these features in its investment treaties.[38] They also provide additional muscle for the Japanese government if and when it attempts informal inter-state dispute resolution with the host state. Like most Asian countries, Japan has never initiated an inter-state claim under a BIT or bilateral FTA due to a host state's measure affecting a home state investor. But having ISA provisions in almost all its treaties does allow the government to point out informally that if the dispute is not resolved amicably, then ultimately the investor may well directly initiate formal arbitration proceedings. For this tactic to operate effectively, however, the threat of a Japanese or Asian investor filing an ISA claim must be credible.

B Reducing Costs and Delays in ISA (including via 'Arb-Med')

One way to make ISA more credible is to incorporate provisions into future investment treaties, or at least tailored arbitration rules provided as an option for investors within the treaties, which are directly designed to reduce uncertainties, costs and delays in proceedings. Many of these features would likely appeal to critics of ISA in treaties, often concerned about host states' burden from defending claims, as well as to investors and others who favour ISA rights. Innovations explored elsewhere[39] include novel approaches regarding:

- arbitrator appointment and remuneration;
- time limits for resolving ISA claims;
- capacity to resolve threshold issues at an early stage of proceedings;[40]

38 Saadia Pekkanen, 'Investment Regionalism in Asia: New Directions in Law and Policy?' (2012) 11 *World Trade Review* 119; Saadia M Pekkanen, *Japan's Aggressive Legalism: Law and Foreign Trade Politics beyond the WTO* (Stanford University Press, 2008).

39 Luke Nottage and Kate Miles, '"Back to the Future" for Investor–State Arbitrations: Revising Rules in Australia and Japan to Meet Public Interests' (2009) 26(1) *Journal of International Arbitration* 25.

40 See generally Chester Brown and Sergio Puig, 'The Power of ICSID Tribunals to Dismiss Proceedings Summarily: An Analysis of Rule 41(5) of the ICSID Arbitration Rules' (2011) 10 *Law and Practice of International Courts and Tribunals* 227 <http://ssrn.com/abstract=1859446>. In a recent Asia-related decision, *Rafat Ali Rizvi v Republic of Indonesia (Decision on Preliminary Objections)* (ICSID Arbitral Tribunal, Case No ARB/11/13, 4 April 2012), the tribunal declined to throw out the claim as 'manifestly without legal merit' pursuant to the *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, opened for signature 18 March 1965, 8359 UNTS 160 ('ICSID Convention'), Rules of Procedure for Arbitration Proceedings, rule 41(5) ('ICSID Arbitration Rules'), ruling that the question was too complex to resolve at a preliminary stage. For similar language, see also *Australia–Chile Free Trade Agreement*, signed 30 July 2008, [2009] ATS 6 (entered into force 6 March 2009) art 10.20(3) ('*Australia–Chile FTA*'). By contrast, states may add treaty provisions containing language that arguably sets a lower threshold for rejecting claims, as suggested by *Agreement between Japan and the Republic of Chile for a Strategic Economic Partnership*, signed 27 March 2007 (entered into force 3 September 2007) art 79(1)(a) (whether the claim fails 'as a matter of law').

- arbitrators' powers to issue interim measures; and
- voting procedures for arbitrators.

Particularly in the context of Japan,[41] as well as other Asian countries (like the People's Republic of China[42]) where arbitrators also still appear relatively open to actively helping commercial parties to settle their disputes during ICA proceedings ('Arb-Med'), new investment treaty provisions encouraging settlement could significantly reduce costs and delays in ISA.

There is growing interest in such hybrid processes and in extending other alternative dispute resolution practices to enhance the capacity of the ISA system to resolve or prevent investment disputes.[43] The growing volume and backlog of ISA filings, as well as increased costs and delays,[44] are creating pressures to rethink the traditional 'all or nothing' approach to treaty-based investment dispute resolution – whereby investors either abandon or settle claims outside any formal procedure, or pursue arbitration to the bitter end. Admittedly, formal treaty-based conciliation procedures have rarely been used – even by Asian parties[45] – partly because investors have tended to choose the arbitration process generating an outcome binding on the host state. The latter may also find even an adverse decision rendered by international arbitrators easier to justify to its citizens, as opposed to a settlement agreed through a formal conciliation process – which may generate further legislative or political difficulties for the host state. A hybrid Arb-Med process could therefore present an attractive middle way forward, especially as practitioners become more familiar with this possibility in other spheres of contemporary cross-border dispute resolution.

In ICA practice, arbitration rules and national legislation, there is already increasing recognition – even among practitioners and commentators from the English common law tradition – that it can be acceptable and often even

41 Luke Nottage, 'Arb-Med and New International Commercial Mediation Rules in Japan' on Luke Nottage, *Japanese Law in Asia-Pacific Socio-Economic Context* (21 July 2009) <http://blogs.usyd.edu.au/japaneselaw/2009/07/arbmed_and_new_international_c_1.html> (responding to Professor Tatsuya Nakamura's empirical analysis of JCAA cases).

42 Shahla F Ali, *Resolving Disputes in the Asia-Pacific Region: International Arbitration and Mediation in East Asia and the West* (Routledge, 2011); Mark Goodrich, 'Arb-Med: Ideal Solution or Dangerous Heresy?' (2012) 15(1) *International Arbitration Law Review* 12.

43 See generally Susan D Franck, 'Challenges Facing Investment Disputes: Reconsidering Dispute Resolution in International Investment Agreements' in Karl P Sauvant (ed), *Appeals Mechanism in International Investment Disputes* (Oxford University Press, 2008) 143; Joint Symposium, 'International Investment and ADR' (2010) *Washington and Lee University School of Law and UNCTAD* <http://investmentadr.wlu.edu/symposium/>; UNCTAD, above n 25 (referring also to UNCTAD, 'Best Practices in Investment for Development, Case Studies in FDI, How to Prevent and Manage Investor–State Disputes: Lessons from Peru' (Investment Advisory Series B, UNCTAD, 2011) <http://archive.unctad.org/en/docs/webdiaepcb2011d9_en.pdf>).

44 UNCTAD, above n 25; OECD, above n 6.

45 Nottage and Weeramantry, above n 27, 37–8.

desirable for arbitrators to facilitate settlement.[46] However, ongoing concerns within some legal traditions about Arb-Med suggest that such settlement facilitation generally should be conducted without the arbitrators meeting separately or ex parte (caucusing) with each party.[47] This protection is designed to minimise (perceptions of) arbitrator bias or complaints that one party is not being treated equally, which are otherwise usually mandatory provisions of ICA law.[48] However, there may well be appropriate cultural or psychological reasons for parties to provide (informed) consent to caucusing by arbitrators to further encourage settlement, as still seems to occur quite often for example in Japan.[49]

In ISA proceedings, which involve greater and more diverse public interests than ICA proceedings, there may be even greater risks involved in allowing arbitrators to meet parties ex parte in order to facilitate early settlement. Under the International Centre for the Settlement of Investment Disputes ('ICSID') Arbitration Rules, there may also be challenges regarding lack of impartiality, and a party unhappy with an award rendered (after failed Arb-Med attempts) may allege annulment particularly on the basis of a 'serious departure from a fundamental rule of procedure'.[50]

In non-ICSID arbitrations, say under the UNCITRAL Rules, the law of the seat may also create difficulties. If it is based on the UNCITRAL Model Law, apart from requirements regarding arbitrator impartiality and equal treatment of parties, art 24(3) is arguably mandatory – requiring that all 'information supplied to the arbitral tribunal by one party shall be communicated to the other party'.[51]

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46 Gabrielle Kaufmann-Kohler, 'When Arbitrators Facilitate Settlement: Towards a Transnational Standard' (2009) 25 *Arbitration International* 187; Luke Nottage and Richard Garnett, 'The Top 20 Things to Change in or Around the Australia's International Arbitration Act' in Luke Nottage and Richard Garnett (eds), *International Arbitration in Australia* (Federation Press, 2010) 149, 179–84; Friven Yeoh and Desmond Ang, 'Reflections on *Gao Haiyan* – Of "Arb-Med", "Waivers", and Cultural Contextualisation of Public Policy Arguments' (2012) 29 *Journal of International Arbitration* 285.

47 See, eg, Centre for Effective Dispute Resolution (CEDR), *The CEDR Commission on Settlement in International Arbitration* (2012) <http://www.cedr.com/about_us/arbitration_commission/>. This project was directed by leading practitioners within both the common law tradition (Lord Harry Woolf from the UK) and the civil law tradition (Professor Gabrielle Kaufmann-Kohler from Switzerland). For recent litigation where ex parte attempts to facilitate settlement of arbitral proceedings (in China) resulted in difficulties when enforcing the award (in Hong Kong), see: Goodrich, above n 42; Yeoh and Ang, above n 46. In *Gao Haiyan v Keeneye Holdings Ltd* [2011] HKCA 459 (2 December 2011) enforcement of an award was allowed even after Arb-Med by caucusing, but only on appeal and largely because (a) parties had clearly consented to this procedure and (b) the award had not been set aside at the seat (in China).

48 See, eg, UNCITRAL Model Law on ICA, arts 12(1), 18 (given force of law in Australia by the *International Arbitration Act 1974* (Cth), as amended by *International Arbitration Amendment Act 2010* (Cth)); see generally Greenberg, Kee and Weeramantry, above n 28, 92–3.

49 Especially where the parties and/or lawyers come from Japan or another civil or Asian law jurisdiction: Hamamoto and Nottage, above n 31; Yeoh and Ang, above n 46. See also more generally: Sophie Nappert and Dieter Flader, 'A Psychological Perspective on the Facilitation of Settlement in International Arbitration – Examining the CEDR Rules' (2011) 2 *Journal of International Dispute Settlement* 459.

50 *ICSID Convention* art 52(1)(d). See generally Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) 283–4.

51 Greenberg, Kee and Weeramantry, above n 28, 93, citing Aaron Broches, 'UNCITRAL - Commentary on the Model Law' in Jan Paulsson (ed), *International Handbook on Commercial Arbitration (Supplement No 11)* (Kluwer, 1990) 92.

This rule, also found in the UNCITRAL Rules themselves,[52] could seriously reduce the attractiveness and effectiveness of Arb-Med involving caucusing. Of course, a state adopting the Model Law may vary its provisions to allow for caucusing, as in legislation enacted in Hong Kong, followed by Singapore.[53] Interestingly, however, that still requires arbitrators to disclose to the other party information obtained in confidence from one party when caucusing – albeit only after the mediation attempts have failed. Perhaps partly for this reason, these Arb-Med provisions have not been used much in practice in either jurisdiction.

Nonetheless, so far there have been very few challenges to awards either at the seat, or even in a state where enforcement is sought (usually now under the 1958 New York Convention),[54] in the context of failed Arb-Med. This may be because the usual practice (outside some states like China or Japan) is for Arb-Med to be conducted in open session, ie, without caucusing by the arbitrators. Such Arb-Med is quite often and effectively carried out in ICA proceedings especially by arbitrators from or familiar with the civil law tradition.[55]

To encourage greater use of mediation in investment disputes, including Arb-Med, on 30 March 2012 the International Bar Association ('IBA') released for public comment draft 'IBA Rules for Investor–State Mediation'.[56] If parties adopt these Rules, either before or after a dispute arises (art 1(1)(a)), mediation can occur even when (investor–state) arbitration proceedings have been initiated (art 2(4)).[57] The person authorised to attempt mediation 'can conduct meetings with one party only' (art 7(3)); but 'no information provided orally by a party to the mediator during a separate meeting may be disclosed to any other party by the mediator, unless the party explicitly authorizes the mediator to do so' (art 7(4)).

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52 *UNCITRAL Arbitration Rules 1976*, GA Res 31/98, UN GAOR, 31st sess, 99th plen mtg, Supp No 17, UN DOC A/31/17 (15 December 1976) art 15(3) ('*UNCITRAL Arbitration Rules 1976*'); *UNCITRAL Arbitration Rules (as revised in 2010)*, GA Res 65/22, UN GAOR, 65th sess, 57th plen mtg, Agenda Item 77, UN DOC A/Res/65/22 (6 December 2010) art 17(4) ('*UNCITRAL Arbitration Rules 2010*').

53 *Arbitration Ordinance 1989* (Hong Kong) cap 609, s 2B (reproduced in s 33 of the 2011 Ordinance: <http://www.hklii.hk/eng/hk/legis/ord/609/>); *International Arbitration Act* (Singapore, 1995) s 17. For revised versions of the Act, see <http://statutes.agc.gov.sg/aol/home.w3p>. Unfortunately, Australia's 2010 amendments to the *International Arbitration Act 1974* (Cth) fail to address this issue at all.

54 *Convention on the Recognition and Enforcement of Foreign Arbitral Awards,* opened for signature 10 June 1958, 330 UNTS 38 (entered into force 7 June 1959).

55 See Kaufmann-Kohler, above n 46; Gabrielle Kaufmann-Kohler, 'The Arbitrator as Conciliator: A Statistical Study of the Relation between an Arbitrator's Role and Legal Background' (2007) 18(2) *ICC Bulletin* 81. But see the *Keeneye* litigation in Hong Kong described in: Goodrich, above n 42.

56 *IBA Rules for Investor–State Mediation* (International Bar Association, Consolidated Draft of 30 March 2012) <http://www.ibanet.org/LPD/Dispute_Resolution_Section/Mediation/Default.aspx>. See also Luke Nottage, 'TPP negotiations and the IBA's Draft Rules on Investor–State Mediation' on Luke Nottage, *Japanese Law in Asia-Pacific Socio-Economic Context* (14 May 2012) <http://blogs.usyd.edu.au/japaneselaw/2012/05/tpp_negotiations_and_the_ibas.html>.

57 The appointed mediator may not serve as arbitrator for disputes subject to the mediation 'unless the parties explicitly agree otherwise' (art 8.5). Such agreement can presumably be given up-front, when the parties commit to mediation under these Rules. This is consistent with approach adopted in CEDR and common in ICA proceedings. It is preferable to the requirement under s 27D(1) of the *Commercial Arbitration Act 2010* (NSW) which requires a further agreement by the parties (allowing the mediator to continue as arbitrator) if Arb-Med fails. See Nottage and Garnett, above n 46, 184.

This confidentiality obligation therefore differs from Arb-Med provisions under Hong Kong and Singapore legislation, and the draft IBA Rules are expressly subjected to any contrary 'provision of law from which the parties or a party cannot derogate' (art 1(3)), although it is not completely clear that the disclosure obligations in Arb-Med under Hong Kong and Singaporean statutes are in fact mandatory. Parties considering adopting the draft IBA Rules, including states entering into investment treaties,[58] will need always to check carefully for any mandatory provisions especially regarding possibilities and procedures for ex parte Arb-Med which may be required under the arbitration law of the seat (which may be specified as a third country), or under the ICSID regime. A safe and still quite effective compromise would be for the parties to ISA proceedings to agree to vary the IBA Rules (as permitted under art 1(2)) by excluding the power for the mediator to caucus, at least until mediation commences and the need for caucusing arises (in which case further agreement can be recorded).

The draft IBA Rules also provide a helpful guide to 'qualifications for mediator[s]' (set out in Appendix B) that parties '*may* wish to take into account, but are not bound by' (art 4(3)). If they cannot agree and a Designating Authority makes the appointment (pursuant to arts 4(6)–(7)), then Appendix C states that the Authority '*shall* take into account, but not be bound by, the recommended qualifications set out in Appendix B' (emphasis added). A useful amendment to the IBA Rules, if and when finalised and adopted by Asia-Pacific parties, might be to add as another recommended qualification a nomination to a regional panel of mediators, with acknowledged expertise in investment disputes and the particular circumstances of Asia-Pacific state and business practice.

More generally, Asia-Pacific states and regional organisations[59] could develop regional panels of arbitrators, mediators, and those particularly familiar with Arb-Med, which states and investors might commit to consulting in making their appointments. Such a panel is found and used under the 1993 *North American Free Trade Agreement* ('NAFTA'),[60] and was also provided in the 2004 *Japan–Mexico FTA* – but no nominations have been made.[61] Recently, beyond the regional level, ICSID has acknowledged that somewhat different skills may be required for those helping to resolve investment disputes by

58 If states are reluctant to commit in their treaties to have arbitrators follow these IBA Rules, given their novelty and origins in a private rather than international organisation, one solution would be to add a provision requiring arbitrators and parties at least to 'consider' adopting them after commencement of ISA proceedings. For a similar approach regarding another set of IBA Rules (on evidence-taking), see: *Arbitration Rules of the Australian Centre for International Commercial Arbitration* art 27.2 ('ACICA').

59 Such as the Asia-Pacific Regional Arbitration Group: <http://www.aprag.org/>.

60 *North American Free Trade Agreement,* opened for signature 17 December 1992, 32 ILM 605 (1993) (entered into force 1 January 1994).

61 Hamamoto and Nottage, above n 31, 37.

mediation, rather than arbitration, by establishing separate Panels of Arbitrators and of Conciliators listing designees of the World Bank's President.[62]

C Enhancing ISA through Greater Transparency

Another indirect means of rendering treaty-based ISA claims more credible, especially involving Japan or other Asian nations whose investors have never or hardly ever filed ISA claims, is to add various additional transparency obligations into treaties. Such obligations are typically advocated on behalf of host states, based on their interests (indeed, often their domestic law obligations) related to disclosure of important official information to their citizenry.[63] More detailed transparency rules are already therefore being added to many investment treaties, including several recent ones concluded by Australia and Japan.[64] Yet greater transparency obligations regarding the filing and progression of ISA claims can also benefit foreign investors in various ways,[65] including expanding the potential for amicable settlement of investment disputes.

1 Estimating Likely Compensation or Welfare Loss if ISA Claim Succeeds

One innovation would involve parties to investment treaties agreeing to appoint an independent expert to make public an estimate of (i) the likely compensation or other relief owed by the host state if the ISA claim turns out to be successful, and/or (ii) the broader welfare loss to the host state being caused by the impugned measure. This parallels the suggestions made above (Part II) in the case of inter-state trade disputes. Likewise, although the states could agree to such an appointment for an investment claim that has already been filed, it would be preferable for this to occur prior to the dispute arising by means of commitments added to investment treaties. States could agree in advance that the estimates disclosed by the expert would be binding, but some calculations may be quite complex and highly sensitive to the assumptions provided to the

62 See International Centre for Settlement of Investment Disputes, 'Designations to the ICSID Panels of Conciliators and of Arbitrators by the Chairman of the ICSID Administrative Council' (News Release, International Centre for Settlement of Investment Disputes, 15 September 2011) <http://icsid.worldbank.org/ICSID>.

63 Nottage and Miles, above n 39, 235–7. See also the ongoing efforts at UNCITRAL to craft transparency provisions to incorporate into or alongside their Arbitration Rules, frequently adopted in investment treaties (as well as commercial contracts): UNCITRAL, *Working Group II, 2000 to Present: Arbitration and Conciliation* (2012) <http://www.uncitral.org/uncitral/commission/working_groups/2Arbitration.html> (see, eg, A/CN.9/WG.II/WP.169).

64 See, eg, AANZFTA and especially the *Australia–Chile FTA* (2009): Mark Mangan, 'Australia's Investment Treaty Program and Investor–State Arbitration' in Luke Nottage and Richard Garnett (eds), *International Arbitration in Australia* (Federation Press, 2010) 191; see also the *Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership*, signed 17 September 2004 (entered into force 1 April 2005): Hamamoto and Nottage, above n 31, 41.

65 Another advantage for foreign investors derives from research in social psychology suggesting that, if a process is perceived as fairer or more legitimate (eg due to greater transparency), parties overall will generally be more satisfied even if one side must inevitably lose on the substantive merits. See, eg, Tom R Tyler, 'Psychological Perspectives on Legitimacy and Legitimation' (2006) 57 *Annual Review of Psychology* 375, 379–80.

expert.[66] Anyway, it may often instead be sufficient for the estimates to be non-binding and advisory – the key is that they be made public. This would help to highlight for directly and indirectly affected groups within the host state the likely financial and other losses that flow from the state persisting with the impugned measure.[67]

After all, political economists have pointed out that 'the political economy of investment policy is not fundamentally different [to] … the formation of trade policy', with the latter also potentially subject to distortive capture by groups urging their home states to adopt barriers to foreign market entrants.[68] As further noted recently by Jürgen Kurtz, the 'national treatment' obligation commonly found in investment treaties as well as trade agreements, guaranteeing equal competitive opportunity between foreign and domestic firms, is particularly important in this respect:

> Without such a guarantee, the most efficient and innovative ([eg] foreign) producers could be precluded from serving customers in the host state's market where there is successful protectionist lobbying of regulators by competing domestic industry in the host state. Consumers would suffer as a result when denied the benefits of lower prices, greater product variety and/or higher service quality where provided by foreign investors. In fact, in a recent article that assesses BITs from the perspective of modern economic theory, Joseph Stiglitz … argued that: 'If countries must sign investment agreements, they should be narrowly focused on the issue of discrimination'. [69]

Admittedly, Stiglitz does argue that investment treaties prohibiting discrimination should be limited to direct discrimination, where that is the primary purpose of the host state's legislation (rather than its effect), and he also objects (on both efficiency and justice grounds) to broader treaty protections such

66 Generally, the assumptions provided should be agreed by the investor and the host state as well as perhaps the investor's home state (as a 'reality check' for the investor). If agreement cannot be reached, the assumptions could be provided by the investor (and its home state), but with the host state also permitted to provide its own assumptions for the same or a separately appointed expert. Provisions could also be added to allow the parties an opportunity to comment on the expert's draft estimates before public disclosure, as with draft panel decisions in WTO proceedings. Without such safeguards, there is the risk that the investor may provide unrealistic assumptions and estimates that would overly skew political dynamics in the host state regarding its measures subject to challenge.

67 One compromise might be for the expert's estimates generally to be advisory only, but binding if the arbitral tribunal has been formed and agrees to engage an expert. Another possibility is for states to pre-commit to binding estimates for certain types of more straightforward disputes, such as direct expropriation discriminating against foreign investors.

68 Jürgen Kurtz, 'Australia's Rejection of Investor–State Arbitration: Causation, Omission and Implication' (2012) 27 *ICSID Review* 65, 74, going on to cite Gene M Grossman and Elhanan Helpman, 'Foreign Investment with Endogenous Protection' in Robert C Feenstra et al (eds), *The Political Economy of Trade Policy: Papers in Honor of Jagdish Bhagwati* (MIT Press, 1996) 199, 216.

69 Kurtz, above n 68, 11, citing Joseph E Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities' (2007) 23 *American University International Law Review* 451, 548. See also Luke Nottage, 'The Rise and Possible Fall of Investor–State Arbitration in Asia: A Skeptic's View of Australia's "Gillard Government Trade Policy Statement"' (Legal Studies Research Paper No 11/32, University of Sydney Law School, June 2011) pt III <http://ssrn.com/abstract=1860505>, pointing out that protectionist impulses may explain why at least some firms in Australia may not have wished to lobby the PC to recommend the inclusion of ISA protections in future treaties.

as 'fair and equitable treatment'.[70] For our present purposes, particularly in regard to appointing an expert to estimate and disclose likely welfare losses from the host state measure impugned by the foreign investor, it may certainly be more straightforward and compelling if the expert's mandate is limited to claims of direct discrimination. Recent developments in Indonesia affecting foreign mining companies, for example, show that such disputes do still arise – even where the host state has a pressing need for FDI[71] and even though a growing number of investment disputes do instead allege discriminatory effect or indirect expropriation.[72]

Also related to the expert's mandate, care must be given to ensure that she or he is given sufficient scope, via treaties or arbitration rules, to provide estimates of likely compensation payable by the host state or its welfare loss from the disputed measure. Some treaties, like the *Australia–Chile FTA* signed in 2009, only provide for appointment of an expert to provide evidence on scientific or technical matters.[73] But even under such treaties, the arbitration rules selected by the investor may allow for experts to be appointed with a broader mandate. The disputing parties anyway might reach an ad hoc agreement to appoint an expert empowered to give evidence on broader issues, such as (i) the likely scope of compensation or (ii) broader welfare losses being incurred by the host state, on the assumption that a treaty violation is made out.

Agreement during proceedings or beforehand (via treaties etc) would also usually be needed to overcome limits on privacy and confidentiality related to the arbitration, if the expert is engaged after its commencement, as a key aspect of our proposal is that the expert's estimates be made public. By contrast, arbitration rules commonly used in ISA proceedings generally insist on privacy (excluding

70 Stiglitz, above n 69, 549.

71 See, eg, Simon Butt and Luke Nottage, 'Divestment of Foreign Mining Interests in Indonesia Meets the "Gillard Government Trade Policy Statement"' *Japanese Law in Asia-Pacific Socio-Economic Context* (1 April 2012) <http://blogs.usyd.edu.au/japaneselaw/2012/04/divestment_of_foreign_mining_i.html>; Simon Butt, Luke Nottage and Brett Williams, 'Renegotiating Indonesian Investments in the Shadow of International Treaty Law' on Luke Nottage, *Japanese Law in Asia-Pacific Socio-Economic Context* (2 April 2012) <http://blogs.usyd.edu.au/japaneselaw/2012/04/renegotiating_indonesian_inves.html>; with edited versions also at Simon Butt, Luke Nottage and Brett Williams, *Divestment of Foreign Mining Interests in Indonesia* (13 May 2012) East Asia Forum <http://www.eastasiaforum.org/2012/05/13/divestment-of-foreign-mining-interests-in-indonesia> and Simon Butt, Luke Nottage and Brett Williams, *Indonesian Investments and International Treaty Law* (14 May 2012) East Asia Forum <http://www.eastasiaforum.org/2012/05/14/indonesian-investments-and-international-treaty-law>.

72 Nick Gallus, 'The "Fair and Equitable Treatment" Standard and the Circumstances of the Host State' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 223; Suzanne A Spears, 'Making Way for the Public Interest in International Investment Agreements' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 271.

73 See art 10.25: 'Without prejudice to the appointment of other kinds of experts where authorised by the applicable arbitration rules, a tribunal, at the request of a disputing party or, unless the disputing parties disapprove, on its own initiative, may appoint one or more experts to report to it in writing on any *factual issue concerning environmental, health, safety or other scientific matters* raised by a disputing party in a proceeding, subject to such terms and conditions as the disputing parties may agree' (emphasis added). On similar Japanese investment treaty provisions related to appointment of experts, compare: Hamamoto and Nottage, above n 31, 41.

access for non-parties) as well as confidentiality (of information generated by the arbitration, especially the award). However, rules and/or treaties are increasingly adding transparency obligations in recognition of the greater public interests involved compared for example to ICA proceedings.[74] Note for example that article 37(2) of the ICSID Arbitration Rules as revised in 2006, largely replicated in the *Australia–Chile FTA* (even therefore for non-ICSID claims), does provide for written submissions by a 'non-disputing party'. But this person must have a 'significant interest in the proceeding' (such as the home state of the foreign investor, or an NGO seeking to intervene as an amicus curiae), unlike an expert as envisaged in this paper.

Another issue to consider is who will appoint the expert and how. This is more complicated than for inter-state trade (and some investment) disputes, as outlined in Part II above, due to the potential or actual direct involvement of a foreign investor in dispute with the host state. If an ISA claim has not yet been filed, then it seems appropriate for the home and host state to have the opportunity and responsibility of appointing the expert, although the home state may be allowed (or even required) to consult with its potentially affected investor regarding its proposed nominee. But once the ISA claim is filed, the foreign investor should play a greater role in appointment as the estimates produced by the expert can be expected to a have major impact on settlement or other resolution of the dispute to which the foreign investor is now formally a party. Yet its home state still typically has an interest in the ongoing dispute. One solution is therefore for the expert to be appointed by joint agreement of both states and the foreign investor, unless either of the states waives its right to be involved.

If no agreement can be reached on appointment, moreover, there needs to be a default appointment mechanism. If no ISA claim has yet been filed, then it cannot be the arbitral tribunal itself, as is sometimes envisaged under arbitration rules.[75] Anyway, the primary background of such arbitrators is unlikely to be in economics, and therefore they would not be well placed to identify and appoint an expert capable of estimating welfare losses. A better solution is to nominate a permanent institution, preferably with experience in both law and economics, as the default appointing authority. The WTO, or possibly the Asia-Pacific Economic Co-operation forum ('APEC') for Asia-Pacific parties to investment treaties, seem more likely candidates than institutions that primarily specialise in arbitration and/or other commercial law, such as UNCITRAL or the Permanent Court of Arbitration. Of course, this assumes that states choose to pre-commit (via treaties) to appointment of an expert. If instead they do so ad hoc after a dispute arises, they may be able to appoint a different institution as the default appointment authority in the event they cannot agree themselves on an expert.

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74 Nottage and Miles, above n 39, 235–7; Christina Knahr, 'The New Rules on Participation of Non-Disputing Parties in ICSID Arbitration: Blessing or Curse?' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 319.

75 Cf, eg, *UNCITRAL Arbitration Rules 1976* art 27; *UNCITRAL Arbitration Rules 2010* art 29(1), adding a requirement first for the tribunal to consult with the disputing parties.

Agreement would also be needed on other rights and obligations of the expert. To maximise potential for earlier resolution of investment disputes, the expert would need to be appointed and publicise the estimates within a reasonable period. This could draw on experience from WTO proceedings, such as arbitrations (under art 22 of the DSU) concerning the scope of permitted retaliation for treaty violations, but time limits could also be set based on the amount and type of dispute.[76] If this is considered too difficult to determine, in advance through specific treaty provisions, timeframes could be set through the same mechanism as provided for appointment of the expert.

The fees and expenses chargeable by the expert could initially be split equally between the investor and the host state, but be reallocated to the unsuccessful party if the dispute generates a final award (or, if the case is resolved earlier thanks to the estimates being provided, costs could be reallocated by agreement as part of the settlement). Although such expert opinions may not come cheap, they should be assessed in a context where average arbitration and legal fees for ISA proceedings amount to several million dollars – and sometimes much more.[77] The expert should also be expressly protected against liability claims, particularly from a host state that might find its attractiveness to investors diminished or even its credit rating downgraded following disclosure of the expert's estimates,[78] provided they are made in good faith based on given assumptions.

More generally, however, what happens if the expert's estimate reveals that the impugned measure's net impact on the host state's economic welfare is positive, rather than negative? This outcome seems unlikely in cases of discrimination violating national treatment commitments, but perhaps more plausible if expert estimates were introduced for example in the context of claims of expropriation (especially indirect expropriation).[79] Such a situation could well result in greater intransigence on the part of the host state in regard to settling the dispute, and indeed lead to more chances of host states being prepared to introduce measures violating treaty obligations. An economist's response,

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76 For example, Energy Charter investment arbitrations take on average almost 3 years: OECD, above n 6, 14.

77 Gaukrodger and Gordon, above n 6, 19.

78 Anyway, rating agencies and foreign investors should consider not just the expert's estimates, but also the chances of the treaty violations being actually proven. Particular caution is required where pleadings and other formal documentation on those aspects are not publically available.

79 It may be a factor, for instance, behind Australia's strong stance against the tobacco industry in introducing plain packaging legislation, and defending the *Philip Morris Asia v Australia* arbitration subsequently initiated under the 1993 Australia–Hong Kong BIT. The Australian government may be calculating that even if it loses the case and has to pay compensation, there will be a net economic benefit from the new regulatory framework due to reduced long-term health costs incurred from tobacco-related illnesses. However, there may also be other political factors at play, including the short-term political benefits of introducing a popular measure in a context where any adverse arbitration award may only be forthcoming after the government has lost an upcoming general election. See generally Luke Nottage, 'Consumer Product Safety Regulation and Investor–State Arbitration Policy and Practice after *Philip Morris Asia v Australia*' in Leon Trakman and Nick Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) (forthcoming).

however, might be that such 'efficient breach' of treaty commitments can represent a desirable 'Pareto' improvement: even after fully compensating the claimant for the violation, the respondent host state makes a net gain, so both states benefit.[80] If violations occur too often and international law is brought into broader disrepute, however, it may be better to provide that if the expert determines that the net economic welfare impact on the host state is positive, that estimate is not made public after all. Another possibility would be to limit the expert's estimates, in all cases, to the amount of compensation payable to the foreign investor on the assumption that treaty violations are proven.

2 Investor's Disclosure to the Home State about its ISA Claim

Alternatively, or in addition, states should consider adding provisions in their investment treaties that a foreign investor should notify its home state when (or even before) the investor initiates an ISA claim. This happens anyway if the investor elects ICSID Arbitration Rules, but only as to the fact that the case has been filed; the Statement of Claim or other specifics are not disclosed via the ICSID website.[81] There is also no notification procedure under other Rules commonly permitted under investment treaties, such as the UNCITRAL Arbitration Rules, although sometimes the investor or the host state makes public the fact that the ISA claim has been filed and indeed some other documentation filed in the proceedings.[82]

States have only recently started to add provisions to investment treaties that require disclosure to the home state about the fact or an ISA claim and certain other information. One example is art 10.21 of the *Australia–Chile FTA*, although the obligation to disclose extensive documentation to the home state (the 'non-disputing state') is imposed on the host state (respondent) – along with an obligation on the host state (under art 10.22) generally to disclose such information publically as well.

Adding such disclosure obligations on the host state and/or the foreign investor is a useful mechanism to ensure involvement by the investor's home state, even at an early stage. Other investors may also realise the potential for similar claims, thus creating further incentive for the home state to take up the matter as well with the host state. Investors from third countries having treaties

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80 The structure of trade agreement dispute settlement already provides for such breaches (as mentioned in Part II above, especially at n 22); all our proposal does is bring forward and highlight the dynamics involved and extend them to investment treaty dispute resolution. See also generally Eric A Posner and Alan O Sykes, 'Efficient Breach of International Law: Optimal Remedies, "Legalized Noncompliance" and Related Issues' (John M Olin Law & Economics Working Paper No 546, Chicago Law School, 23 February 2011) <http://ssrn.com/abstract=1780463>.

81 See *ICSID* <http://icsid.worldbank.org/ICSID>.

82 A recent example is the *Philip Morris Asia v Australia* arbitration: see Attorney-General's Department, Australian Government, *Investor–State Arbitration – Tobacco Plain Packaging* (30 May 2012) <http://www.ag.gov.au/Internationallaw/Pages/Investor-State-Arbitration---Tobacco-Plain-Packaging.aspx>; Nottage, above n 79. Developments and documentation in many other ISA proceedings, including non-ICSID arbitrations but only when in the public domain, can also be found for example at: *Investment Treaty Arbitration* <http://italaw.com>.

with that host state, and those third-country governments, may also become involved. Credible opportunities for settlement can emerge along with clarification of key facts and legal arguments determining any likely host state liability for the impugned measures, as well as the probable duration and costs of proceedings. Further expert opinions could be obtained on such matters, and disclosed publically or at least to the home state, to focus the minds of the disputing parties on the real issues and thus generate further potential for settlement.

Admittedly, enhancing transparency provisions in these ways could backfire and instead *reduce* chances of settlement, if they bring in too many potential claimants and even states not directly party to the investment treaty generating the initial claim. However, this risk can be reduced by adding more powers under bilateral treaties to consolidate substantively similar claims before a single tribunal. NAFTA expressly provides for consolidation of closely related proceedings (art 1126), and several cases have been subjected to these procedures. And if substantively similar disputes arise under different treaties and therefore potentially different arbitral tribunals, states can agree in advance (even informally) to try to appoint to those tribunals all or most of the same individual arbitrators who have been already appointed to resolve the other disputes.[83] This too will reduce costs and foster greater predictability of outcomes, helping to facilitate settlement even when multiple claims arise.

Another innovation useful to enhance potential for settlement is to require a host state to suspend enactment or implementation of actual or planned measures which have generated a notice of claim, triggering a 'cooling off period' where host state and the foreign investor (and potentially its home state) can undertake good faith negotiations aimed at amicable settlement. If the host state proceeds to implement the measure despite the cooling-off period, for example through its normal parliamentary process, the measure may become very difficult to undo.[84] This forces the arbitrators to proceed to a final award rather than appointing experts or engaging directly in Arb-Med to facilitate early settlement.

Treaties already typically set periods for amicable settlement and/or cooling-off periods before the arbitration can be commenced.[85] However, the consequences of non-compliance remain quite uncertain, compared to the effect usually given to 'multi-tiered dispute resolution clauses' in ICA and domestic

83 See examples of both approaches provided in: Dolzer and Schreuer, above n 50, 236, especially in several claims brought against Argentina (eg, *Pan American Energy and others v Argentina* (ICSID Arbitral Tribunal, Case No ARB/03/13, 27 July 2006)). NAFTA-like provisions on consolidation can also be found in the recent investment treaty practice of Japan (eg its FTAs with Mexico and with Chile: Hamamoto and Nottage, n 31, 41) and Australia (*Australia–Chile FTA* art 10.26).

84 Arguably this was one factor exacerbating the first-ever claim against Australia under an investment treaty (with Hong Kong, concluded in 1993), initiated by Philip Morris Asia in 2011 in reaction to Australia's proposed tobacco plain packaging law: Nottage, above n 79. Even under existing 'cooling off provisions', treaties do not always clearly state that good faith negotiations must be attempted before the ISA claim can be initiated; Hamamoto and Nottage, above n 31, 34.

85 Gaukrodger and Gordon, above n 6, 13–14; Nottage and Miles, above n 39, 48–51; Hamamoto and Nottage, above n 31, 34.

resolution contexts.[86] To allow more chances for earlier or more cost-effective resolution of investment disputes, particular attention should be paid to the question of whether and how the state should delay or suspend at least some types of measures challenged through treaty-based ISA proceedings, as provided already for example under some domestic public law regimes.[87]

3 Inter-state Agreement to Suspend Foreign Investor's ISA Claim

In addition, more scope for settling disputes within an ISA framework can be created by extending a feature already found in some treaties, which also presumes greater transparency relating to the proceedings. In the sensitive area of taxation policy, where states have long been concerned to retain a greater degree of national sovereignty and discretionary power (as elaborated in Part IV below), investment treaties quite often have special provisions relating to possible claims by foreign investors that a host state's tax measures amount to expropriation. Specifically, if an investor initiates such a claim its home state can agree with the impugned host state that the latter's measures are *not* expropriatory, thus suspending the investor's ISA claim.[88] Such an agreement might anyway be sought and obtained between states even after the investor has filed a claim, because they created the investor's ISA rights in the first place. But it seems fairer to put investors clearly on notice, through treaty provisions included prior to any disputes arising, that their claims are subjected to this sort of state control.[89]

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86 For example, some tribunals have held that periods specified in investment treaties are not intended to be jurisdictional pre-requisites to proceeding to arbitration: Dolzer and Schreuer, above n 50, 247–50. See also the decision of the Tokyo High Court (*X Co and Y,* 2116 Hanrei Jiho 64, Tokyo High Court (22 June 2011)), declining to enforce a multi-tiered dispute resolution clause: Tatsuya Nakamura, 'The Recent Japanese Court Decisions on Arbitration' (2012) 28 *JCAA Newsletter* 4, 9–10. But compare, in Australia and elsewhere, Simon Chapman, 'Multi-tiered Dispute Resolution Clauses: Enforcing Obligations to Negotiate in Good Faith' (2010) 27 *Journal of International Arbitration* 89.

87 Cf Gaukrodger and Gordon, above n 6, 26–9. The Scoping Paper notes that most discussion so far about non-pecuniary remedies has concerned provisional remedies; but that the European Commission has broader questions about possible repeal or reversal of the measure concerned: at 28–9. In the present article, we focus on the possibility of treaties suspending the measure's implementation in order to facilitate settlement of the dispute.

88 See, eg, *Agreement between Japan and the Republic of Indonesia for an Economic Partnership*, signed 20 August 2007 (entered into force 1 July 2008) art 73(4). A watered-down variant can be found in Chapter 11 of AANZFTA, which provides in art 25(6) (emphasis added):

> Where an investor claims that the disputing Party has breached Article 9 (Expropriation and Compensation) by the adoption or enforcement of a taxation measure, the disputing Party and the non-disputing Party shall, upon request from the disputing Party, hold consultations with a view to determining whether the taxation measure in question has an effect equivalent to expropriation or nationalisation. Any tribunal that may be established pursuant to this Section shall accord *serious consideration* to the decision of both Parties under this Paragraph.

89 Rather similarly, domestic and international contract law protects 'third party beneficiaries' of agreements between parties who subsequently wish to alter rights accorded to such third parties. See, eg, *UNIDROIT Principles of International Commercial Contracts 2010* art 5.2.5 ('The parties may modify or revoke the rights conferred by the contract on the beneficiary until the beneficiary has accepted them or reasonably acted in reliance on them'); *Property Law Act 1969* (WA) s 11(3), *Property Law Act 1974* (Qld) s 55(3)(d); Draft Proposal [3.2.16.09] of the Japanese Civil Code (Law of Obligations) Reform Commission, <http://www.shojihomu.or.jp/saikenhou/English/draftproposals.html#Book3ch6>.

Such provisions encourage both states to negotiate and cooperate with a view to agreeing on whether the tax measure is appropriate. However, this does assume that the host state is notified and kept informed (by the investor and/or the host state) about the ISA claim. Also, if the home state agrees with the host state that the measure (like an additional mining tax) is not expropriatory, it may expect a reciprocal acknowledgement should it introduce a similar measure in its own jurisdiction which generates an ISA claim by investors from the other state. An express reciprocity commitment could therefore be added to such treaties. If one state (A) agrees with the other (B) that an ISA claim initiated by an investor of A, over a measure (X) introduced by B, should be suspended because X does not violate the treaty, then an investor of B should be expressly precluded from initiating a similar claim if A then also introduces a measure substantively identical to X.

In addition, states should consider extending this type of provision first to encompass other types of measures (for example, public health measures) as well as other types of claims (for example, alleged breaches of the 'fair and equitable treatment' obligation commonly found in investment treaties).[90] One reason why claims of 'expropriatory taxation' have rarely generated inter-state agreements to suspend such claims may well be that these cases also nowadays tend to involve claims that the relevant treaty has been violated in other ways.

This approach thereby generates another mechanism that can result in states 'trading up' to higher agreed regulatory standards, rather than the 'race to the bottom' often feared by critics of FTAs and BITs.[91] If managed well, greater transparency by involving the host state can effectively 'mediate' the bilateral dispute between its investor and the host state. Admittedly, for the investor this risks 're-politicising' the dispute because its home state may 'block' its claim, whereas one of the major benefits of a treaty-based right to bring direct ISA proceedings against the host state has been seen as the 'de-politicisation' of the dispute by cutting out the investor's home state as gatekeeper to claims against the host state. But at least under our proposed approach the foreign investor can initiate the ISA claim; its home state only becomes formally involved after that, in dealings with the home state. Further, the treaty can add requirements for the home state to consult formally with the foreign investor before agreeing with the host state that a measure does not breach protections against expropriation or other substantive rights. This requirement can draw inspiration from the tax treaty arbitration system detailed below in Part IV.

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90 Micah Burch and Luke Nottage, 'Novel Treaty-Based Approaches to Resolving International Investment and Tax Disputes in the Asia-Pacific Region' (2011) 18 *Australian International Law Journal* 127; Nottage and Garnett, above n 46. By contrast, for example, both the *Australia–Chile FTA* art 10.24 and the *Japan–Chile FTA* art 94 allow an inter-governmental Committee to impose joint interpretations on the arbitral tribunal only regarding certain 'non-conforming measures' listed in Annexes to those respective treaties. On FET, see generally Gallus, above n 72.

91 Cf generally David Vogel, *Trading Up: Consumer and Environmental Regulation in a Global Economy* (Harvard University Press, 1995).

Investors may still not be happy with this compromise, compared to standard ISA protections, but it may be one useful way forward. After all, certain developing countries (particularly in South America) but also resource-rich developed countries (especially now Australia) are otherwise now disengaging from treaty-based ISA altogether.

D Obstacles to Improving ISA Due to Australia's Trade Policy Statement

Unfortunately, the Gillard Government's TPS undermines even such compromise solutions for ISA rights, which attempt to balance concerns for both efficiency and democratic legitimacy in Australia's investment treaties. When announced in April 2011, it seemed possible to read the Government's policy stance on ISA as still allowing at least some forms of ISA protections in future treaties at least with developing countries, consistently with Australia's practice over the last twenty years and in line with one interpretation of the recommendation contained in the 2010 PC Report.[92] But the Gillard Government subsequently made it clear that the TPS intended to eschew all forms of ISA in all future treaties (albeit apparently without abrogating or renegotiating existing investment treaties containing ISA protections).[93] The TPS also rejects all forms of treaty-based 'investor–state dispute settlement'. The Gillard Government is thereby refusing to commit even to separate investor–state mediation procedures (as under ICSID or UNCITRAL Conciliation Rules, and/or the draft IBA Rules outlined in Part III.B above in the context of 'Arb-Med' during ISA proceedings).

Perhaps a new Government or even the Gillard Government itself will eventually amend the TPS regarding ISA rights. Contrary to the assumptions made by the PC, for example, it now seems that Australian investors do in fact value treaty-based ISA rights to manage the risks of cross-border investment – especially in the Asian region.[94] Australia's recent policy shift also adds another

92 Leon E Trakman, 'Investor State Arbitration or Local Courts: Will Australia Set a New Trend?' (2012) 46 *Journal of World Trade* 83; Kurtz, above n 68; Nottage, above n 69.

93 Nottage, above n 69. For example, the *Malaysia–Australia Free Trade Agreement*, signed 22 May 2012 (not yet in force; anticipated entry into force 1 January 2013) <http://www.dfat.gov.au/fta/mafta> is the first concluded by Australia with any low-to-middle-income treaty partner that completely omits any form of investor–state dispute settlement. However, investors from each state are anyway protected by ISA through *AANZFTA*.

94 See, eg, Donald Robertson, *Protecting Your Investments in Foreign Courts – An Australian Mining Company Secures Bilateral Investment Treaty Remedy for Local Court Delays* (6 March 2012) Freehills <http://www.freehills.com/7902.aspx>; Butt and Nottage, above n 71; Australian Chamber of Commerce and Industry, 'Australian Foreign Investment Requires Rights to Sue Foreign Governments' (Media Release, MR262/121, 9 August 2012) <http://acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement/>. The latter generated extensive media coverage from early August 2012: see, eg, Kyla Tienhaara, 'ACCI's Right to Sue Campaign Not Supported by the Facts' *The Conversation* (online), 13 August 2012 <http://theconversation.edu.au/accis-right-to-sue-campaign-not-supported-by-the-facts-8800>; Nottage, *Treaty Based Investor–State Dispute Settlement Mechanisms Not All Bad*, above n 5.

impediment to successfully completing TPPA negotiations,[95] particularly given the longstanding preferences for ISA protections that are evident on the part of Singapore, the US and (to a lesser extent) Japan.

Meanwhile, however, Australia's TPS undercuts all our recommendations above aimed at tailoring the treaty-based ISA framework towards appropriate dispute resolution of contemporary investment disputes. Nonetheless, some suggestions to reduce costs and delays or to expand transparency of ISA proceedings can still be agreed in bilateral disputes that may arise between investors and host states under Australia's *existing* investment treaties – many of which have many years to run before their original or renewed terms expire.[96] Secondly, some recommendations – such as encouraging tribunals to engage in more Arb-Med (Part III.B), or agreeing on an independent expert to estimate damages and welfare costs (Part III.C.1) – can be extended to *inter-state* arbitration provisions. Those are invariably included in investment treaties, and appear to remain unaffected by the TPS position. Thirdly, for future investments into or out of Australia, an investor and the host state can also agree to ISA under one-off investment contracts, and these contractual provisions can also include some of our recommendations above. However, the transaction costs in negotiating such deals will be significant. Australia may also be unlikely to agree to such ISA protections if it is the host state, given the concerns about ISA expressed briefly in the TPS and in some greater detail in the underlying PC Report.

Finally, even under the current TPS, a novel hybrid treaty-based mechanism for investment dispute resolution can also be envisaged. An investment treaty could provide that a home state *must* initiate an inter-state arbitration claim against the host state if the home state's fulfills certain criteria, which may be set out even in the home state's legislation rather than the treaty itself. One analogue is section 301 of the US *Trade Act of 1974* 19 USC § 2411, which requires the government to initiate a WTO claim if the US firm meets certain statutory

95 See, eg, Australian Chamber of Commerce and Industry, 'ACCI Welcomes TPP Negotiations' (Media Release, MR186/12, 5 March 2012) <http://www.acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement >. See also Leon Trakman, 'Resolving Investor Disputes under a TPPA: What Lies Ahead?' (Paper presented at the Trans-Pacific Partnership Agreement Conference, University of Melbourne, 17 August 2012) available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2153623>.

96 For example, the 1993 *Australia–Indonesia Treaty* was renewed in 2003 for another 15 years, and prior (unilateral) termination triggers a sunset provision protecting existing investments for 15 years: *Agreement between the Government of Australia and the Government of the Republic of Indonesia Concerning the Promotion and Protection of Investments,* signed 17 November 1992, [1993] ATS 19 (entered into force 29 July 1993) art 15 <http://www.austlii.edu.au/au/other/dfat/treaties/ATS/1993/19.html>.

conditions.[97] Such legislation can also add certain procedural provisions not only for the applicant firm but also the broader public to enhance transparency and other values. A second analogue comes from contemporary developments in double tax dispute resolution under DTTs, explained next in Part IV.

IV TAX TREATY ARBITRATION AND DISPUTE RESOLUTION

Evolving mechanisms for the resolution of treaty-based international tax disputes offer some interesting and controversial approaches to the issue of commercial dispute resolution, and at the same time illustrate the complexity of finding a one-size-fits-all mechanism. A particular complicating feature of the tax area is the heightened sensitivity regarding sovereignty and confidentiality. Thus, as with investment and trade, the goal is to reduce the cost and delay associated with dispute resolution, but in the tax area the issue of transparency must be approached more carefully. Nonetheless, the change wrought by the introduction of mandatory arbitration pursuant to DTTs suggests some possibilities for, and some pitfalls of, improving commercial dispute resolution in the Asia-Pacific and elsewhere.

The network of thousands of DTTs (the basis for international tax law, such as it is) has as its main goal the elimination of double taxation of international trade and investment activity. They are widely found throughout Asia.[98] Each bilateral DTT is individually negotiated and unique, but considerable harmonisation is provided by the *Model Tax Convention on Income and on Capital* published by the Organisation for Economic Co-operation and Development ('OECD'). This is the primary template for a large number of treaties, including the majority of those between developed nations, and it is broadly representative of trends and practice in international taxation.[99] The *OECD Model Tax Convention*, in addition to its substantive provisions, sets forth procedures for resolving taxpayer-initiated, treaty-based disputes.

In particular, article 25 of the *OECD Model Tax Convention* provides for a 'mutual agreement procedure' ('MAP') whereby a taxpayer who alleges taxation not in accordance with the treaty can compel the two relevant competent

97 See, eg, Richard Sherman and Johan Eliasson, 'Trade Disputes and Non-State Actors: New Institutional Arrangements and the Privatisation of Commercial Diplomacy' (2006) 29 *World Economy* 473. Also, moving *away* from a purely inter-state dispute settlement mechanism, a recent proposal calls for an independent prosecution department to be established within the WTO Secretariat, with a right to initiate proceedings: Claus D Zimmerman, 'Rethinking the Right to Initiate WTO Dispute Settlement Proceedings' (2011) 45(5) *Journal of World Trade* 1057. This would arguably generate more credible commitments by states to resisting domestic lobbying from politically powerful, import-competing industries.

98 See generally Sunita Jogarajan, 'A Multilateral Tax Treaty for ASEAN – Lessons from the Andean, Caribbean, Nordic and South Asian Nations' (2011) 6 *Asian Journal of Comparative Law* 145.

99 OECD, *Model Tax Convention on Income and on Capital 2010* (OECD Publishing, 2010) ('*OECD Model Tax Convention*').

authorities to 'endeavor' to resolve the dispute through bilateral negotiation.[100] This provision is common in contemporary DTTs and in most cases, facilitated by cooperative institutional and personal links between tax officials and other experts,[101] it works very effectively.

However, the international business community (especially multinational enterprises) has long lobbied for a more forceful backstop to these essentially voluntary negotiations. It claims that the basic MAP denies meaningful taxpayer involvement, can be cumbersome and wasteful, allows for a potential 'joint audit' by the competent authorities, and potentially subjects the taxpayer's case to intergovernmental horse-trading. Evidence suggests that the need for more appropriate dispute resolution mechanisms in this area is real. Among OECD countries, the number of new taxpayer-initiated MAP cases has increased 60 per cent between 2006 and 2009, which saw almost 1600 new such cases reported; during the same time, the inventory of outstanding unresolved cases increased by 50 per cent to over 3400.[102] To take an important regional example, Japan's number of MAP cases has nearly quadrupled in the last decade.[103]

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100 Article 25 of the *OECD Model Tax Convention* reads:

> Where:
>
> a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the action of one or both of the Contracting States have resulted for the person in taxation not in accordance with the provision of this Convention, and
>
> b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issue arising from the case shall be submitted to arbitration if the person so requests. These unresolved issue shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic law of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph[.]

101 For example, an official from Japan's National Tax Agency is regularly seconded to the Australian Tax Office to maintain and develop cooperative relationships between the tax authorities particularly in cross-border tax matters. More broadly on such transgovernmentalism, see, eg, Internal Revenue Service, *Pacific Association of Tax Administrators (PATA) Transfer Pricing Documentation Package* (6 September 2012) Internal Revenue Service United States Department of Treasury <http://www.irs.gov/Businesses/International-Businesses/Pacific-Association-of-Tax-Aministrators-(PATA)-Transfer-Pricing-Documentation-Package >, a set of principles agreed by the member nations of the PATA (Australia, Canada, Japan and the US) under which taxpayers can create uniformly accepted transfer pricing documentation.

102 Centre for Tax Policy and Administration, *Dispute Resolution: Country Mutual Agreement Procedure Statistics of 2008 and 2009*, OECD <http://www.oecd.org/document/25/0,3746,en_2649_37989739_46501785_1_1_1_1,00.html>.

103 National Tax Agency, Japan, 'National Tax Agency Report 2011' (Report, National Tax Agency, Japan, September 2011) 42–3 <http://www.nta.go.jp/foreign_language/Report_pdf/2011e.pdf>. A significant proportion involve the US and Australia, as well as disputes with China.

In response to this trend, the OECD made big news in 2008 when it introduced new article 25(5) into the *OECD Model Tax Convention*.[104] While arbitration is a generally accepted facet of international commercial dispute resolution worldwide, and now throughout Asia,[105] dispute resolution under bilateral tax treaties has only slowly and begrudgingly started to gain acceptance – given the strong public interests and 'epistemic community' involved in the international tax field.[106] The new provision requires states to arbitrate treaty-based disputes if they remain unresolved after two years of negotiation between the competent tax authorities pursuant to the basic MAP. However, the 'mandatory' arbitration provision has some important limitations on both the taxpayer and the taxing authorities. The taxpayer initiates the proceedings and ultimately the taxpayer may reject the mutual agreement implementing the arbitration, but otherwise the competent authorities have significant notional control over the proceedings – reflecting state sovereignty concerns greater than those evident in commercial or even investor–state arbitration.[107] The competent authorities appoint the arbitrators and delimit the arbitral jurisdiction. For example, article 25(7) of the Australia–New Zealand treaty limits arbitrable disputes to those involving 'issues of fact'.[108]

The somewhat counterintuitive conventional wisdom regarding the likely practical effect of the new provision – yet to produce a reported dispute that has progressed through the MAP to arbitration – is that states are so averse to submitting tax policy matters to arbitration that the mere threat of arbitration will cause them to earnestly endeavor to negotiate a resolution within the two years allowed by article 25(5).[109] In the same vein, such a threat could lead to greater reliance on ex ante mechanisms, such as Advance Pricing Agreements. The latter involve tax authorities pre-approving the method for calculating arm's length transfer prices, and they are being increasingly relied upon in this regard.[110]

If adding tax treaty arbitration provisions is mainly aimed at – and encourages – earlier settlement of tax disputes, this can help explain the fact that

104 Centre for Tax Policy and Administration, 'The 2008 Update to the OECD Model Tax Convention' (Report, OECD, 18 July 2008) <http://www.oecd.org/dataoecd/20/34/41032078.pdf>.

105 Nottage and Garnett, above n 28, 27; Greenberg, Kee and Weeramantry above n 28; Nottage and Weeramantry, above n 27.

106 See, eg, Allison Christians, 'Networks, Norms, and National Tax Policy' (2010) 9 *Washington University Global Studies Law Review* 1.

107 See, eg, Marcus Desax and Marc Veit, 'Arbitration of Tax Treaty Disputes: The OECD Proposal' (2007) 23 *Arbitration International* 405.

108 *Convention between Australia and New Zealand for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion*, signed 26 June 2009, [2009] ATNIF 18 (not yet in force).

109 The US Department of Treasury International Tax Counsel testified before US Congress, shortly before the adoption of the OECD report that led to the inclusion of article 25(5), that 'the prospect of impending mandatory arbitration creates a significant incentive to compromise': Testimony to Senate Committee on Foreign Relations on Pending Income Tax Agreements, United States Senate, 17 July 2007, HP-494 (John Harrington, Department of Treasury International Tax Counsel). A Dutch official, in typically less formal European fashion, echoed the sentiment: 'We love arbitration but we will never use it': Marlies de Ruiter, 'Supplementary Dispute Resolution' (2008) 9 *European Taxation* 493.

110 National Tax Agency, Japan, above n 103, 41.

early adopters of such provisions are generally trading partners with a close existing relationship (such as Australia–New Zealand, Japan–New Zealand, US–Canada, Japan–Netherlands and Japan–Hong Kong). Additionally, as a result of corporate globalisation, the large majority of MAP cases involve transfer pricing disputes where the taxpayer is a large multinational enterprise.[111] Combined with the initiation and veto rights granted to taxpayers, this aspect of tax treaty arbitration has drawn criticism on the grounds that it is an unacceptable transfer of power to such enterprises and a giveaway to international business interests.[112]

However, in the context of relationships between developed nations whose trade and investment relationships are well-established and balanced, mandatory arbitration could strike the right balance between empowering taxpayers (mainly multinational enterprises) to have their proliferating disputes heard and permitting competent authorities to retain the requisite amount of sovereignty and process control. Thus, for countries such as Australia and Japan (whose bilateral treaty has not been renegotiated since the introduction of article 25(5)), mandatory tax treaty arbitration could very well be an appropriate step forward. But even so, the competent authorities are likely to be wary of transparency for fear of setting a precedent and limiting its tax policy options in the future.

By contrast, considering the Asia-Pacific broadly and including also developing countries, there remain some real concerns about mandatory arbitration. In the context of a relationship between a developed and a developing nation, mandatory arbitration pitting a developing country against not only a developed trading partner, but also a taxpayer that is likely to be a large multinational corporation, seems likely to doubly stack the deck against the developing nation. Indeed, for such relationships the United Nations publishes a model DTT as an alternative to the predominant OECD one. In the general, the *United Nations Model Double Taxation Convention* aims to exhibit provisions that are more appropriate and fair in light of the relationship between developed and developing countries (for example, by favouring retention of source country taxation rights). In March 2012, the *United Nations Model Double Tax Convention* added mandatory arbitration to its MAP as well.[113] While the United Nations version of the provision further protects national sovereignty (for example, by allowing the competent authorities as well as the taxpayer to opt out of the arbitral decision), its very inclusion could generally weaken a developing country's negotiating position vis-à-vis both trading partners and taxpayers.[114]

111 See generally Zvi D Altman, *Dispute Resolution under Tax Treaties* (PhD Thesis, Harvard University, 2005).

112 See, eg, Michael J McIntyre, 'Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes' (2006) 7 *Florida Tax Review* 622.

113 *United Nations Model Double Taxation Convention between Developed and Developing Countries* (2011 update) art 25, available at <http://www.un.org/esa/ffd/tax/unmodel.htm>.

114 Allison Christians, 'Putting Arbitration on the MAP: Thoughts on the New UN Model Tax Convention' (23 April 2012) 66 *Tax Notes International* 351 <http://www.taxanalysts.com/www/features.nsf/Articles/3C785AE8BA33A7BB852579ED005419E3?OpenDocument>.

While the mandatory arbitration provision that is gaining acceptance in DTTs worldwide is neither perfect nor appropriate for all situations, it is a step in the right direction toward further reducing double taxation of cross-border trade and investment among developed nations. It also provides some possibilities for more effectively resolving commercial disputes generally, while adequately balancing the interests of the sovereigns involved as well as the affected private party.

V CONCLUSION

International treaty-making to promote sustainable trade and investment stands at a crossroads after the Global Financial Crisis, particularly for Australia as it rethinks its approach to both trade policy and the Asia-Pacific region.[115] One way forward is to develop novel treaty-based dispute resolution mechanisms that more effectively balance public and private interests. This article has identified several mechanisms across fields of treaty-making activity that have tended to develop their own sub-disciplines. One common theme is their potential to promote earlier settlement of disputes, saving time and hopefully costs. Greater transparency can enhance this potential, to varying extents depending on the area of law. This is clearest for the dispute settlement mechanisms we propose for international trade agreements, arguably also in the context of international investment treaties, but much more debatable in the field of international tax treaty dispute resolution. Heightened transparency may also help address concerns that treaty-based ISA provisions, in particular, undermine core democratic values and a variety of public interests.

115 Productivity Commission, above n 2; The Australian Government has commissioned a White Paper, 'Australia in the Asian Century', see: Australian Government, *Australia in the Asian Century* (2012) <http://asiancentury.dpmc.gov.au>.