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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"

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The Rise and Possible Fall of Investor-State Arbitration in Asia: A Sceptic's View of Australia's "Gillard Government Trade Policy Statement"

Luke Nottage[#]

ABSTRACT:

International commercial arbitration has grown rapidly in Asia – especially in arbitration centres in Singapore, Hong Kong and China – to resolve cross-border commercial disputes mainly between private firms {Nottage and Garnett 2010}. The stage has also been set for increased claims involving investor-state arbitration ("ISA"). Most Asian countries have acceded to the framework 1965 Convention on the Settlement of Investment Disputes between States and Nationals of other States ("ICSID Convention"), promoted by the World Bank. It provides a largely supranational regime for administering arbitration proceedings and especially for readily enforcing awards resulting from investors claiming illegal interference (such as nationalization or expropriation) by host states. Asian countries have also increasingly added the further "consent" needed under the ICSID Convention to initiate such arbitral proceedings, by concluding treaties with the home countries of foreign investors– initially BITs, but now also Investment Chapters in FTAs – which include ISA provisions (Dolzer and Schreuer 2008).

One possible interpretation of this phenomenon is that home states are being mobilized on behalf of their private investors, to secure ISA protections for them all through treaties with existing or potential host states. This incurs short-term costs for governments, including delays in reaching agreement or trade-offs in other respects (eg lower liberalization of tariffs on goods imported into the host state), as well as long-term risks (especially, of a host state having to pay out potentially large amounts in compensation following foreign investors' ISA claims).

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"Politics is not an exact science."

*"Laws are like sausages — it is best not to see them being made."***

Introduction

However, governments also save costs by agreeing to ISA provisions in their treaties. They can tell their own investors to make direct ISA claims against the home state, rather than feeling obliged to take up grievances on their behalf with the host state (under inter-state "diplomatic protection" processes, derived from customary international law but often restated nowadays in treaties in addition to ISA provisions). Governments also don't need to support as much the (often state-linked) political risk insurers, which can provide investors with insurance against at least some forms of illegal action taken by host states. In addition, states that insist on ISA provisions may be able to save on "legal technical assistance" overseas development assistance (ODA) aimed at improving the host state's judicial system and investment law framework, which anyway allows investors from third countries to "free ride" on such initiatives. As well as such savings, there is also the possibility that offering ISA protections will significantly increase inbound investment – although, at an aggregated level, there now appears to be little clear empirical support for this possibility.

Yet, arguably linked to the colonial legacy in the region, many Asian countries have traditionally been quite sceptical about inbound FDI generally, and ISA in particular (Sornarajah 2011). China did not include full-scale ISA provisions in its investment treaties until quite recently – partly, as China itself emerged as a major capital exporter {Bath 2011}. The assumption was that foreign investors would flock to China anyway, for other economic reasons. The Philippines managed to have ISA omitted in its FTA signed with Japan in 2006, which otherwise has included ISA in almost all its investment treaties (Hamamoto and Nottage 2010; Hamamoto 2010). This rather haphazard or belated uptake of investment treaties with expansive ISA provisions is a factor, but not the only one, behind a comparatively low level of formal ISA claims involving Asian parties (Nottage and Weeramantry 2011).

This resistance to treaty-based ISA in Asia appeared to be slowly dissipating, in line with the dramatic increase in inbound FDI into the region since the 1990s – despite the Asian Financial Crisis of 1997 and the Global Financial Crisis of 2008 (Bath and Nottage 2011). This can be inferred not only from the growth in bilateral investment treaties and FTA investment chapters. ISA provisions were also included in the ASEAN Comprehensive Investment Treaty, signed in 2009 (but not yet in force) with the aim of

** Quotes often attributed to Otto von Bismarck (1815-1898), Germany's "Iron Chancellor". The former from a speech to Prussia's Upper House (18 December 1863). See *Otto von Bismarck*, WIKIQUOTE, [http://en.wikiquote.org/wiki/Otto_von_Bismarck_\(last_modified_Apr._2._2011\)](http://en.wikiquote.org/wiki/Otto_von_Bismarck_(last_modified_Apr._2._2011)). But the latter quote attributed to Bismarck only from the 1930s, with the original possibly from the lawyer-poet John Godfrey Saxe – quoted in the Daily Cleveland Herald (29 March 1869). See Fred R. Shapiro, *On Language – Quote...Misquote*, NEW YORK TIMES, Jul. 21, 2008, <http://www.nytimes.com/2008/07/21/magazine/27wwwl-guestsafire-t.html> and his YALE BOOK OF QUOTATIONS 86 (2006).

further liberalizing as well as protecting intra-ASEAN investment {Maxwell and Wegner 2009}; and in other treaties concluded by ASEAN extending ISA protections to investors from bilateral partners (such as Australia and New Zealand under AANZFTA, signed in 2009 and binding also on the Philippines) (Mangan 2010; Bath and Nottage 2012).

However, the situation may change again in ASEAN and other parts of Asia. As part of the “Gillard Government Trade Policy Statement” announced in April 2010, Australia decided not to include ISA provisions if this would give foreign investors better procedural or substantive rights than local investors.¹ This can be seen as viewed as one state pushing back against a broader world-wide tendency towards “privatizing international law” – the growing production and enforcement of international law by private actors, not traditional political authorities. Aspects of this tendency have been criticized by some political economists (Stephan 2011), but especially by political scientists keen to restore greater democracy into international rule making (Vibert 2011). Australia’s attempt to rebalance the public and private interests involved in the ISA system is laudable in principle, as nothing is ever perfect and the ISA regime certainly has flaws. However, its specific new policy stance leaves many difficulties, from both procedural and substantive law perspectives, especially in a regional context.

First, Australia’s position means no ICSID Arbitration Rules option can be included for investors under any future treaty concluded by Australia, even though it is party to the framework ICSID Convention. At most, if ISA provisions were included, they could only allow non-ICSID arbitration, as under the UNCITRAL Arbitration Rules or any rules tailored more specifically for ISA by institutions such as the Australian Centre for International Commercial Arbitration (ACICA: see (Nottage and Miles 2009)). Awards under such Rules would have to be enforced against the host state by any successful foreign investor under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which provides greater – albeit still limited – scope for review by national courts. In theory, that regime is closer (but still not identical!) to that available for enforcing awards by an Australian investor which might have negotiated an investment contract with the Australian government, incorporating an arbitration agreement, in order to protect its own investment.²

¹ See DEPARTMENT OF FOREIGN AFFAIRS AND TRADE, AUSTRALIA, *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity* (2011), available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>.

² Cf. e.g. New Convention Art V with ss35-36 of the *Commercial Arbitration Act 2010* (NSW). The latter is largely based on Art 34 of the UNCITRAL Model Law on International Commercial Arbitration, in turn inspired by New York Convention Art V, and constitutes new uniform law for domestic arbitration on a template that other States and Territories have agreed upon (Garnett and Nottage 2011).

However, the Act also allows the losing party to an arbitration to apply to a local court to have the award set aside before any enforcement proceedings, on grounds that are more expansive than those set out in Art V of the Convention (largely reproduced in s 34 of the Act) – including especially a serious error of law by the arbitrators (s 34A). For many foreign investors conducting a non-ICSID investment arbitration with the seat outside Australia (e.g. in Japan), the applicable arbitration law (Japan’s Arbitration Act of 2003) will not allow local courts (in Japan) this extra ground for review. More limited review is arguably a benefit for foreign investors, so would the Australian government consider this situation to create “greater rights for foreign investors” compared to local investors conducting arbitration in Australia? Its policy position would then demand that any ISA provisions in the Australia-Japan FTA, presently under negotiation, should allow only non-ICSID arbitration (a) with more expansive review by Japanese courts (matching those in s34A) in arbitrations involving claims against the Australian government, and (b) a requirement that the seat of such arbitrations be Japan (or Australia) – otherwise an investor might seek to commence an arbitration with the seat elsewhere where court review is more restricted (e.g. Singapore). It seems extremely unlikely that Japan would ever agree to such unusual provisions in any treaty with Australia.

An alternative might be for Australia to enact domestic legislation allowing any local investor to claim against the government (even without an arbitration clause) with grounds for setting aside the award limited only to s 34 of the Act – i.e. excluding the s 34A ground, so that local and foreign investors achieve the same rights. But even then, to be consistent in its policy

Second, Australia's policy implies no ISA in treaties with any country that has a *higher* level of domestic substantive law protection for (all) investors (eg perhaps the USA) than protection under Australian domestic law protection, *if* that country seeks to extend its higher level of protection abroad by entrenching it through ISA in a treaty with Australia. (Under Australia's new policy, ISA can only be included if the substantive protections in the treaty are instead capped at the lower, Australian domestic law level – but the other country will have little incentive to press for that, especially if ICSID Arbitration is no longer an option, because it can get that level of protection through Australian courts anyway.) Third, it means no ISA in treaties with any country that has a *lower* level of domestic law protections for all investors (eg possibly Chile or even Singapore, or very probably Vietnam: (Dang 2011)) compared to Australia's domestic law, *if* the former adopts a similar approach to Australia's recent policy statement. Other countries may well mimic Australia's policy stance, which seems to be underpinned by the reality that foreign investors are increasingly desperate for its rich energy and natural resources anyway, if those countries begin to believe that offering ISA will not materially increase inbound investment given their own particular economic circumstances.

So how will this policy position play out in current negotiations, for example, to add an investment chapter and more countries (including Vietnam, Australia, the US, and possibly Japan) to the Trans-Pacific Partnership Agreement ("TPPA", including already Chile, NZ, Singapore and Brunei)?³ Will there be multiple bilateral carve-outs, as under AANZFTA – where Australia and New Zealand excluded the application of that regional treaty's investment chapter altogether in their bilateral context⁴ – following a very complicated exercise including attempts to compare levels of protection offered anyway to all investors under domestic legal systems? Will the problem become so intractable that the TPPA ends up omitting an investment chapter or some of these countries

stance, the Australian government would need to prevent Japanese investors invoking ISA under any Australia-Japan FTA involving arbitration in a third state with even more restricted rights of local court review.

³ See generally *Trans-Pacific Partnership*, EAST ASIA FORUM, <http://eastasiaforum.org/tag/trans-pacific-partnership/>; and, on the delay announced by Japan regarding possibly joining the negotiations, following its devastating natural disaster on Mar. 11 2011, see Rick Wallace, *Fears for FTA as Japan stalls on Pacific bloc: a US-backed trade group is heading for the 'too hard' basket*, AUSTRALIAN, May 18, 2011, <http://www.theaustralian.com.au/business/fears-for-fta-as-japan-stalls-on-pacific-bloc-a-us-backed-trade-group-is-heading-for-the-too-hard-basket/story-e6fmg8zx-1226057801458>.

⁴ The public explanation given for that carve-out (via an Exchange of Notes) was that Australia and New Zealand were then negotiating the addition of an Investment Protocol in their bilateral 'Closer Economic Relations' FTA dating back to 1983. That Protocol was subsequently signed on 16 February 2011 and omitted ISA – or indeed provisions for inter-state diplomatic protection claims to resolve disputes over cross-border investment – leaving only provisions for political "consultations" aimed at a mutually agreed solution (Art 25: see also Daniel Kaldermis, *CER Investment Protocol – a bit more extensive than one might think?*, CHAPMAN TRIPP (Mar. 1, 2001), <http://www.chapmantripp.com/publications/Pages/CER-Investment-Protocol-a-bit-more-extensive-than-one-might-think.aspx>).

The omission of ISA was not publically explained by government leaders or officials, but a New Zealand parliamentary committee (recommending adoption of the signed treaty, so it can come into force) has stated:

"Consistent with our practice in other CER instruments, the Protocol does not include a formal dispute settlement mechanism for resolving disputes between states or between investors and states.

This reflects the strong and unique nature of the CER relationship, including the all-encompassing arrangements under the TTMRA, and the high level of dialogue between Ministers and officials on both sides of the Tasman. Therefore disputes between the parties are more likely to be satisfactorily resolved by consultations than by formal arbitration. Similarly, the absence of any compulsory investor-state dispute settlement provisions¹⁴ in the Protocol is also reflective of the unique and longstanding nature of the CER relationship and the high level of mutual recognition of each other's well established judicial systems."

See FOREIGN AFFAIRS, DEFENCE AND TRADE COMMITTEE (NZ), *International treaty examination of the Protocol on Investment to the New Zealand-Australia Closer Economic Relations Trade Agreement*, 25 (2001) http://www.parliament.nz/NR/rdonlyres/E21C81CB-B59A-49DC-91F2-A7BEE2848901/190248/DBSCH_SCR_5090_Internationaltreatyexaminationofthe.pdf. On CER and the TTMRA more generally, see {Nottage 2009}.

altogether? In other words, will the treaty-based ISA system begin to unravel, especially in a regional context?

Will foreign investors instead try to obtain the “consent” to arbitration required by the ICSID Convention, in order to secure an award enforcement regime arguably more favourable than under the New York Convention, by having host states agree either to arbitration through one-off investment contracts, or investment-specific legislation? This way “back to the future” has been urged more generally in a “public statement on the international law regime” issued originally on 31 August 2010 by a group of scholars – predominantly legal academics and especially from Canada, but including six from Australian universities (five from ANU), one from New Zealand, another from Singapore and four from China.⁵ Yet will countries like Australia also reject such ad hoc deals on an economic theory similar to that underpinning Gillard Government’s Trade Policy Statement, as outlined in Part II below? (Namely, that this would still open up an enforcement regime not available to local investors – thereby supposedly creating an artificial advantage attracting more “inefficient” foreign investors into the Australian market.) Even if countries like Australia do make exceptions and allow ICSID arbitration provisions through one-off contracts or legislative enactments for particular foreign investors, how much extra transaction costs will this entail on both sides in negotiating and drafting such contracts?

Will foreign investors from home states that may not be able to obtain ISA protections in those ways, nor in bilateral agreements with Australia (like investors from Japan or China, both still negotiating FTAs with Australia), instead incur transaction costs to route their investments into Australia through jurisdictions (eg Singapore or Hong Kong) that already have treaties containing ISA protections? Or will foreign investors just lobby their home states harder to initiate inter-state “diplomatic protection” claims (either under treaties, or background “customary international law”), against the home states where they have invested, possibly at the expense of taxpayers in their home states? Or will investors instead turn to “political risks” insurers, only to find that the latter typically provide only narrower coverage (against expropriation, for example, but not broader “fair and equitable treatment” – a frequently-invoked cause of action nowadays under ISA proceedings: {Rheinisch 2009})? Even if they can negotiate the level of coverage typically provided by contemporary investment treaties, will the lack of ISA provisions in treaties further add to the premiums quoted by insurers, leading to proposed investments being abandoned?

These are only some of the potentially far-reaching general implications of the Australian government’s policy stance that do not appear to have been fully appreciated or explored even in the study into “Bilateral and Regional Trade Agreements” conducted by its Productivity Commission (“PC”), which resulted in a Final Report (December 2010) containing Recommendation 4(c) on ISA that the government has basically

⁵ See Public Statement on the International Investment Regime, OSOODE HALL LAW SCHOOL, YORK UNIVERSITY, http://www.osgoode.yorku.ca/public_statement/.

adopted in April 2011.⁶ Rather than elaborating all these implications in detail,⁷ **Part II** of this paper briefly revisits some of the economic theory and evidence underlying the PC's recommendation, including some more recent case studies involving investment both in and out of Australia.

In light of problems identified by that analysis as well as the many complex implications of the government's new policy stance, **Part III** (and **Appendix A**) outline some less radical ways for Australia – and other countries in the region – to rebalance private and public interests in the ISA system. However, **Part IV** outlines how Australia's recent experience suggests more generally that nowadays there may be surprisingly few constituencies prepared to come out strongly in favour of refining the present-based ISA system in those ways. Within many states, there are probably more public and private interest groups now wishing to see it more drastically curtailed – along the lines recently announced by the Australian government or, indeed, even more restrictively.⁸ **Part V** concludes that many other states in Asia already or potentially negotiating investment treaties with Australia – including Japan – are also unlikely to achieve a relaxation of the policy stance. The treaty-based ISA system, despite its remarkable expansion world-wide over the last decade and signs that it had started to get established in Asia, will probably therefore end up declining significantly in the region over the medium- to longer term.

Economic theory and evidence behind Australia's policy stance

Possible benefits of ISA

The PC begins by positing that the 'principal economic rationale' for granting ISA protections to foreign investors is to overcome market failure related to foreign investment, which it does concede may improve economic output, income and social services provision. However, it argues first that governments are unlikely to take away favourable conditions initially offered to foreign investors by expropriating their assets, because of 'reputational effects' – the fear of scaring off future investors (p269). Second, the PC dismisses the argument that foreign investors face systematic bias compared to local investors by pointing to analyses suggesting that foreign firms in fact enjoy *advantages* compared to local competitors (Huang 2005; Desbordes and Vauday 2007).

Yet both studies analyse results from the same survey conducted back in 1999-2000. That era is prior to the entry into force of anti-bribery legislation in many

⁶ Compare PRODUCTIVITY COMMISSION (Austl.), *Bilateral and Regional Trade Agreements* (2010), <http://www.pc.gov.au/projects/study/trade-agreements> with my preliminary critiques at *Australia's Productivity Commission Still Opposes Investor-State Arbitration*, JAPANESE LAW IN ASIA-PACIFIC SOCIO-ECONOMIC CONTEXT BLOG, UNIVERSITY OF SYDNEY, (Dec. 14, 2010), <http://blogs.usyd.edu.au/japaneselaw/2010/12/isapc.html> (regarding the PC's final Research Report) and *Australian versus Japanese approaches towards investor-state arbitration*, EAST ASIA FORUM (Sep. 9, 2010), <http://www.eastasiaforum.org/2010/09/08/australian-versus-japanese-approaches-towards-investor-state-arbitration> (PC's Draft Report of July 2010).

⁷ For some more details, see Luke Nottage, *What future for investor-state arbitration provisions in Asia Pacific treaties?*, EAST ASIA FORUM (Apr. 26, 2011), <http://www.eastasiaforum.org/2011/04/26/what-future-for-investor-state-arbitration-provisions-in-asia-pacific-treaties/>.

⁸ For my other preliminary thoughts related to Parts I, III and IV, see also Luke Nottage, *Good for the Goose, Not Good for the Gander? Australian versus Japanese Approaches Towards Investor-State Arbitration*, ANZSIL – SCIL RESEARCH SYMPOSIUM ON INTERNATIONAL ECONOMIC LAW (Feb. 25, 2011), http://law.anu.edu.au/anzsil/ielig/NOTTAGE_paper.pdf.

developed countries (Burnett and Bath 2009), for example, which might be expected to reduce the political influence of foreign firms in particular. The two studies also do not focus on parts of the world where investment flows are of large significance for Australia, such as South and East Asia. This therefore seems a shaky empirical basis for rejecting the idea of market failure based on particular problems encountered by foreign firms abroad due to host state interference. It also goes against many qualitative studies highlighting those very problems, especially for foreign investors in countries like China (Bath 2011) or Indonesia (Butt 2011).

As for the PC's counter-argument that reputational effects discipline host states, an assertion not substantiated by any empirical studies, this may be quite true regarding outright expropriation (although there are still counter-examples where states nationalize assets without adequate grounds and/or compensation). But it is only partially true regarding indirect or "creeping" expropriation caused by government action disproportionately impacting on foreign investors, let alone breaches of the broader "fair and equitable treatment" obligation under international law. The PC itself provides several examples where violations have been alleged by foreign investors, and sometimes expressly upheld by arbitral tribunals (p268: see also generally {Dolzer and Schreuer 2008}). Putative "reputational effects" were obviously insufficient to deter the behaviour in such cases.

Consider also a case study unfolding in New South Wales. In early May 2011 the NSW government announced that it would renege on a promise to ensure electricity retailers provided a feed-in tariff of 60 cents per kilowatt hour generated by approved solar panel generators installed by householders. The proposed new rate of 40 cents / kWh would impact on up to 110,000 households, and attracted enormous domestic political controversy as an egregious example of legislation having retrospective effect – upsetting the plans of householders who had invested in solar panel installation based on payoff projections based on the promised higher tariff rate. There is no constitutional prohibition on retrospective legislation in Australia, but the aversion to it is evidenced by a general presumption that legislatures do not intend retrospective effect unless clearly so expressed.⁹

However, there appears to have been very little appreciation by the government that this policy change also impacts on foreign companies, especially those producing and selling solar panels into Australia. Yet a strongly worded op-ed from the CEO of a major German supplier's operations in NSW did appear in the *Sydney Morning Herald* on 20 May 2011, arguing that:¹⁰

The biggest concern is the proposal to make changes that effectively breach

⁹ See {Garnett and Nottage 2011}, highlighting the retrospective effect on pre-existing arbitration agreements created by the *Commercial Arbitration Act 2010* (NSW). We also point out that the prospective effect of the 2010 reforms to the *International Arbitration Act* (Cth) unfortunately leaves a legislative black hole for certain pre-2010 arbitration agreements with the seat in NSW where parties have excluded the UNCITRAL Model Law. But that's another story.

¹⁰ At p11; see also Oliver Hartley, *Rebate policy change undermines confidence in solar industry*, SYDNEY MORNING HERALD, May 20, 2011, <http://www.smh.com.au/opinion/politics/rebate-policy-change-undermines-confidence-in-solar-industry-20110519-1eusx.html>. For more on this public policy debacle, See, e.g. p1 of that issue; and Sean Nicholls, *Solar industry take it to the MPs*, SYDNEY MORNING HERALD, May 23, 2011, <http://www.smh.com.au/environment/energy-smart/solar-industry-take-it-to-the-mps-20110522-1ez0y.html>.

investment contracts and negatively affect past investments. A retrospective change to the feed-in-tariff rate would undermine investor confidence and create a level of uncertainty that will have consequences well beyond the borders of NSW. The solar industry would need to come to grips with a commercial environment where government-backed contracts can be reneged on at will. No industry can be expected to flourish under such conditions. In the case of our company, we will postpone the planned extension of our workforce in Australia until we have regained confidence in the politics of solar energy in this country.

Our experience tells us that for an industry to grow, the ground rules need to be clear and predictable. In Germany, a feed-in-tariff was guaranteed for 20 years and, once signed up, investors and customers could rely on it. That enabled the German renewable energy industry to become an economic solar powerhouse that now employs more than 60,000 people.

If this proposed change becomes law it will introduce a level of sovereign risk for renewable-energy investments in Australia - and in NSW in particular - that will undermine the confidence of customers, investors and businesses for many years to come.

Fortunately for that particular company, it has not expanded factory facilities in Australia – its panels are mainly imported from China and Malaysia¹¹ – but it has committed funding to expand its marketing and distribution capacity. Although the NSW government’s original promise of a 60c/kWh was directed primarily to end-users (the customers), it *might* be arguable that foreign suppliers had a “legitimate expectation” that this would be maintained. Reneging on that commitment might then attract liability vis-à-vis suppliers that had invested in Australia in reliance on that promise, for lack of “fair and equitable treatment” by the host state due to retrospective legislation – under customary international law, even absent a treaty with the home state of the investor. If ISA provisions had been available in a treaty, the government would have had to take this possibility more seriously than if the affected foreign investor was limited to entreating its home state to initiate an inter-state “diplomatic protection” claim.¹² The likelihood of an investor succeeding on this particular substantive claim is admittedly slim,¹³ and anyway for this particular German investor the amount directly at stake would be small. But two points are important. First, this scenario provides a

¹¹ I thank the CEO, Mr Oliver Hartley, for clarifying this point – and for other helpful discussions on this situation (Telephone Interview with Oliver Hartley, CEO, Q-Cells Australia, May 23, 2011).

¹² Australia has no investment treaty with Germany: (Mangan 2010) Appendices. But it has ones with China (1988, with ISA limited to certain expropriation claims) and with Hong Kong (1993, with full ISA protections). Australia is also negotiating FTAs with China and Japan, two other leaders in the solar panel industry world-wide (see EUROPEAN PHOTOVOLTAIC INDUSTRY ASSOCIATION, *EPIA’s Global Market Outlook Released*, <http://www.epia.org/index.php?id=491> (last visited May 26, 2011) and JAPAN PHOTOVOLTAIC ENERGY ASSOCIATION, *Tokei Shiryo [Statistical Material]*, <http://www.jpea.gr.jp/04doc01.html>) (last visited May 26, 2011), with each of those two countries interested in including full-scale ISA protections in those agreements (as outlined in Part V below).

¹³ It is even more unlikely that the investor could successfully claim (for expropriation etc) even if it faced cancellations of orders for the supply of panels to Australian importers, after they in turn faced cancellations of orders from householders (relying on the contract law doctrine of “frustration of contract”) following even possibility of a new lower feed-in tariff rate. This is because, even under most treaties, “investment” is not usually understood to encompass one-off sales. But tribunals do tend to apply a multi-factor test: see generally (Dolzer and Schreuer 2008) and (Coppens 2011) (discussing the *Malaysian Historical Salvors* case).

contemporary example of how investment treaty backed ISA provisions could make a host state think more carefully about its obligations, under international law as well as domestic law. Second, it indicates some propensity for public authorities in Australia to take decisions interfering with foreign investors either without being aware of likely adverse “reputational effects” on future investments, or being aware of them but deciding to forge ahead regardless.

Returning to the economic analysis of potential benefits from ISA, sketched in the PC’s Report, the Commission also points to some econometric research indicating that adding ISA in investment treaties has ‘no statistically significant impact on foreign investment into that country’ (p269). Yet, to paraphrase Bismarck, “economics is not an exact science” – otherwise we wouldn’t have crises like the GFC! Econometric studies depend on many things, including the estimation techniques adopted. Interestingly, one method used in the study relied in by the PC in fact finds a highly significant relationship (at the 99% confidence level) between including ISA provisions in treaties and higher inbound FDI – namely, for Regional Trade Agreements (or FTAs), albeit not so for BITs alone nor for FTAs and BITs when combined {Berger et al 2010: 17}.¹⁴

The selection of time frame is also often important. This study only looks at data through to 2004, whereas treaties with stronger forms of ISA protections (eg in treaties concluded by China, former communist countries of Eastern Europe, or ASEAN nations) probably represent a higher proportion of all treaties concluded over the last seven years. That can presumably be correlated with very strong growth in FDI flows, at least until the dip during the GFC of 2008, which might well affect the results from a regression analysis re-run with more contemporary data.

The coding, choice and measurement of variables is also crucial. The study by Berger et al code ISA provisions into three levels, in terms of their scope, based on the important study of (Yackee 2009) focused on BITs. But recent arbitral jurisprudence suggests that there are in fact four.¹⁵ We also need to be careful not to include too many dependent variables (risking problems of auto-correlation), but not to include too few (cf eg the extra variables used in (Crotti et al 2010) to find significant effects on inbound FDI into Australia particularly from FTAs with investment chapters, albeit without differentiating between the levels of ISA protections in them). In addition, even with the crucial (dependent) variable in these studies – the amount of inbound FDI – researchers

¹⁴ “A striking difference between the GMM estimations and the previous OLS estimations concerns ISDS provisions in RTAs. The highly significant coefficient of *RTA_with ISDS* in column (3) of Table 3 suggests that their effect on FDI flows is biased *downwards* unless possible endogeneity is accounted for. Such a bias may occur if source country parties to RTAs pressed for stricter ISDS provisions mainly when bargaining with relatively weak host country parties where foreign investors had hardly located so far. Possibly, these host country parties agreed to stricter ISDS provisions precisely because the prospect of contentious FDI-related disputes and the obligation to adhere to the rulings of independent arbitration panels appeared to be rather remote. However, the same reasoning should then apply to ISDS provisions in BITs. All the same, the impact on FDI is insignificant – as before in the OLS and PPML estimations – when combining ISDS provisions in RTAs with those in BITs (columns 5 and 7). It is hard to decide whether ISDS provisions in BITs are less effective than those in RTAs when accounting for possible endogeneity, or whether the difference is mainly due to the reduced sample for which ISDS provisions are available in BITs.”

¹⁵ In addition to (i) “promissory” ISA (where the host state only commits to negotiate about binding arbitration proceedings, as under China’s “first-generation” treaties), (ii) “partial” ISA (where binding arbitration is limited e.g. to the “amount of compensation for expropriation”, as under China’s “second-generation” treaties) and (iii) full-scale ISA, we should now break down category (ii) further as many tribunals and commentators now suggest that treaties limiting arbitration to the “amount” also intended the arbitrators to determine also whether “expropriation” has taken place or not: see (Eliasson 2011).

face great disparities in measurement across countries, especially over lengthy time periods.¹⁶

Lastly, the most important thing about econometric analysis is that it deals in aggregates. Adopting a blanket stance based even on overwhelmingly consistent econometric evidence, say to omit or severely limit ISA provisions in investment treaties, is therefore a risky strategy for real-life policy-makers. Indeed, in discussing ‘implications for future policy’ the PC itself later cites a Submission from the Department of Foreign Affairs and Trade that seems consistent with this general point (p276):

“DFAT submitted that it already ‘advocates a careful, case by case approach to the inclusion of Investors State Dispute Settlement (ISDS) in Australia’s international agreements’, taking into account matters including the nature of the partner country’s legal system, stakeholder views, precedents and the promotion [of] bilateral investment flows (sub. DR98, p. 13).”

The PC also acknowledges that ISA provisions (p270):

“could still benefit particular investors to the extent that they shift political risks associated with investments to host governments and/or provide an avenue for compensation ‘after the event’. In consultations following the Draft Report, it was also suggested that [ISA] could provide additional leverage to businesses when negotiating with foreign governments prior to undertaking (or during the life of) foreign investments, were the businesses willing to threaten to pursue an arbitration case against a foreign government.

However, as noted in chapter 7 [of this Final Report], the Commission received no feedback from Australian businesses or industry associations indicating that ISDS provisions were of much value or importance to them. Indeed, as far as the Commission is aware, no Australian business has made use of [ISA] provisions in Australian [investment treaties], including in its [FTAs].”

Yet, just to my knowledge, one major Australian law firm is presently pursuing a claim under the Australia-India BIT (2000).¹⁷ And an Australian-owned mining company (with interests also in Senegal and Indonesia) is presently bringing ICSID proceedings against Gambia, after its iron sands license was revoked and its British Managing Director was arrested in 2008.¹⁸ That is admittedly under arbitration provisions contained an

¹⁶ Hence for example the OECD’s Benchmark Definition of FDI (4th ed): see DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS, OECD, *OECD Benchmark Definition of Foreign Direct Investment - 4th Edition* (May 30, 2008), http://www.oecd.org/document/33/0,3343,en_2649_33763_33742497_1_1_1_1,00.html.

¹⁷ See the CV of Max Bonnell: MALLESONS STEPHEN JACQUES, *Max Bonnell: Representative Matters and Transactions*, <http://www.mallesons.com/ourPeople/mbonnel/Pages/representative-matters-and-transactions.aspx> (last visited May 26, 2011). India, with which Australia is also now negotiating an FTA, has been subjected to a relatively high proportion of investment treaty claims by Asia standards – but not under ICSID Arbitration Rules because India has still not acceded to the Convention, so less information is publically available about such claims {Nottage and Weeramantry 2011}. On India’s active investment treaty program nowadays, especially as it emerges also a major source of outbound FDI, see generally {Ranjan 2011}.

¹⁸ *Carnegie Minerals (Gambia) Limited v. Republic of The Gambia* (ICSID Case No. ARB/09/19). A challenge to ICSID’s default appointment of the arbitrator due to difficulties in communications with the host state government was recently rejected: 4(7) *Investment Arbitration Reporter* (20 May 2011) at INVESTMENT ARBITRATION REPORTER, <http://www.iareporter.com> (last visited May 26,

investment contract,¹⁹ as there is no investment treaty with Gambia. But this raises the question why Australia has not yet concluded any such treaties with African nations, given that even larger disputes have arisen involving its investors in that region over recent years.²⁰

Overall, the PC speculates that Australian business interests did not express interest in ISA provisions during their Review because investors have found other options to be relatively attractive. For example, it suggests the possibility of negotiating specific (pre-)investment contracts including dispute resolution (DR) clauses. But the PC does admit that this ‘is more feasible for large businesses’ (p270) and indeed gives as one example the Gorgon gas project, where the Western Australian government agreed to arbitration with foreign investors – in fact, by legislation (*Barrow Island Act 2003* (WA) Schedule 1). That is indeed an exceptionally large LNG development project, 47% owned by Chevron with 25% each held by ExxonMobil and Shell, involving also many long-term export sales contracts to Japan and Korea.²¹

The PC also mentions political risks insurance against expropriation. But it does not acknowledge that coverage is often for shorter periods, nor that it is typically unavailable for host state interference that instead falls short of “fair and equitable treatment” requirements. Indeed, in a strong dissent to the PC’s majority view on ISA registered by Associate Commissioner Andrew Stoler (seconded from the University of Adelaide, and a former WTO Deputy Director-General and US government trade negotiator): “this is analogous to arguing against the need for a fire department because homeowners can buy property insurance” (p320 in Appendix A of the PC’s Report).

From this brief analysis, open to many counter-arguments along the lines outlined above, the PC reaches its Finding 14.1 (p271), underpinning its Recommendation 4(c) on ISA: “There does not appear to be an underlying economic problem that necessitates the inclusion of [ISA] provisions within agreements. Available evidence does not suggest that [ISA] provisions have a significant impact on investment flows.”

Risks of ISA

Already unconvinced about significant benefits from ISA, the PC Report then outlines various risks involved in Australia agreeing to them in its investment treaties, highlighted in some Submissions. These include the possibility of “regulatory chill” on public authorities; the undermining of democratic (legislative and other) processes; and disadvantaging domestic investors, thereby distorting efficient flows of investment (pp 271-2). However, as Stoler points out generally (p320):

2011). However that decision is not yet available at INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, <http://icsid.worldbank.org/ICSID/> (last visited May 26, 2011).

¹⁹ See, e.g. FREEDOM NEWSPAPER (Gambia), *Breaking News: Gambian Gov't Reacts To Freedom Newspaper Story on the expulsion of an Australian minning [sic] Firm!!*, Jan. 17, 2008, <http://www.freedomnewspaper.com/Homepage/tabid/36/mid/367/newsid367/2776/Breaking-News-Gambian-Govt-React-To-Freedom-Newspaper-Story-on-the-expulsion-of-an-Australian-minning-Firm/Default.aspx>.

²⁰ See, e.g. Kate Askew and Violeta Ayala, *Slick Operator*, SYDNEY MORNING HERALD, Jun. 3, 2006, <http://www.smh.com.au/articles/2006/06/02/1148956541283.html>.

²¹ See HERALD SUN (Melbourne), *Gorgon gas to Japan*, Jan. 25, 2011, <http://www.heraldsun.com.au/businessold/gorgon-gas-to-japan/story-e6firfh4f-1225994327878>.

Opponents of [ISA] cite cases such as where governments may back off regulating cigarette packaging due to the threat of a suit by a foreign investor.²² In the Associate's view, the appropriate response to these concerns is to ensure that the [ISA]-related provisions of [an investment treaty] are drafted carefully enough that they preclude challenges to those regulatory areas that Australia wants to ensure are protected (for example, health-related policies). In addition, in the Associate's view, there is reason to believe that a little bit of 'regulatory chill' might be a good thing, even in Australia."

The present solar panel tariffs debacle outlined above provides a good example of his last point. A treaty backed by ISA provisions might have made the NSW government think more carefully before announcing its drastic policy reversal. Indeed, in this case international law would have reinforced rather than undermined democratic values within Australian society – namely concerns about enacting legislation with serious retrospective effects – even if there is no outright constitutional prohibition on that and the "legitimate expectations" in domestic law may be somewhat narrower than in international investment law. Admittedly, giving foreign investors (possibly) greater substantive rights underpinned by (probably) stronger procedural rights through ISA provisions might "crowd out" local investors. But Australia is woefully behind the ball in developing its solar power potential,²³ so attracting foreign investors and suppliers in this field should provide countervailing economic benefits. More generally, for decades the Treasury and other parts of the government have emphasized the broader efficiencies created by allowing in foreign investors to compete in the domestic market (Crotti et al 2010), yet the (Treasury-linked) PC does not mention this broader consideration in relation to ISA policy.

The PC instead goes on to identify concerns raised about damages awards in ISA cases, including "the degree of freedom arbitral tribunals have in determining" amounts and the "the potential for large claims" by foreign investors. It also various problems identified with arbitral procedure, ranging from the lack of appeals (for substantive error of law, presumably) and putative "institutional biases and conflicts of interest, inconsistency and matters of jurisdiction, a lack of transparency and the costs incurred by participants" (p272). The PC therefore concludes with Finding 14.2: "Experience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions." (p274).

²² Indeed, on 17 January 2011 after release of the PC's Final Report, the Australian media also highlighted a submission by Philip Morris to the USTR in 2010 that reportedly listed Australia's proposed regulations as among "initiatives of concern", illustrating the need for ISA to be included in the TPPA. Australia's would not commit to insisting that ISA be excluded but was quoted as stating that the firm would be "whistling in the wind" if it tried to undermine national anti-tobacco laws and that "I will not be recommending the empowering of Philip Morris or any other tobacco company to overturn Australian government policy on plain packaging of cigarettes". See Julie Robotham, *Tobacco giant makes move to thwart plain package law*, AGE (Melbourne), Jan. 17, 2011, <http://www.theage.com.au/national/tobacco-giant-makes-move-to-thwart-plain-package-law-20110116-19sjx.html>. I thank Dr Chris Kee for bringing this to my attention. See also now AUSTRALIAN FINANCIAL REVIEW, *The Great Tobacco Wars*, May 21, 2011.

²³ See, e.g. Hartley (op cit) and Paddy Manning, *If the Brits Can Do It, Why Can't We?* SYDNEY MORNING HERALD, May 21-22, 2011, at Weekend Business 14-15.

At least this final Report has abandoned the assertion contained in the Draft Report that US investors had never lost an ISA claim, after contrary data was provided in Submissions from Mark Kantor (reiterated by myself). But empirical studies also suggest more generally that damage claims are much less successful in terms of awards on both liability and damages, and even incur less (direct) costs, than conventional critiques and anecdotes tend to assume.²⁴ This still leaves the various procedural problems highlighted by the PC. Yet these can be addressed in through other more moderate and targeted reforms to the ISA system, as outlined next.

Alternative means to rebalance private and public interests in ISA

Compared to the Draft Report, the PC devotes far more attention to measures for ‘reducing the risks’ of ISA (pp 274-6). These include:

- more precise definitions of more contentious terms, such as “expropriation” or “investment” and “most favoured nation” treatment related to ISA provisions (but cf the – very contestable – opinion expressed at p275 n6!);
- “time-limiting agreements” (eg where a “partner country is rapidly developing, such that its legal system can eventually resolve investment-related disputes” fairly anyway); and
- carve-outs for developed countries, as under AANZFTA – speculating that this might also be a way forward for the expanded TPPA negotiations.

The PC also acknowledged my Submission that concerns about procedural rules in ISA:

can be reduced by the Australian Government through the inclusion of clauses in [investment treaties] that change the default rules of the ICSID or UNCITRAL. These changes could include requiring foreign investors to exhaust domestic legal channels prior to initiating arbitration, requiring that the existence of arbitration cases, documentation and awards be transparent and publically available; and providing for arbitration appeals. One way to do so could be for Australia to develop a ‘Model International Investment Agreement’ that includes more tailored arbitration rules (sub. DR63, p. 1).

Indeed, Australia followed this course in its agreement with Chile [2009], which contains considerably more detailed procedural requirements than for Australia’s other agreements, including the requirement that investors attempt to consult with the host government prior to arbitration, the

²⁴ See {Frank 2007}; {Frank 2009}. Of course, these econometric studies must address similar methodological concerns to those identified in the text above. Particular problems include the small sample size, partly due to confidentiality requirements especially in many non-ICSID arbitrations, a related concern that the sample of publically available awards may not be representative, and the more general point that host states (especially developing countries) may be risk-averse precisely about “outlier” cases. Franck also does not consider indirect costs involved in formal ISA proceedings, which may be significant especially for countries in Asia {Nottage and Weeramantry 2011}.

selection of arbitrators and the conduct of arbitration, as well as requiring transparency of arbitration documentation and any awards that are made.

The latter approach in fact corresponds to reform strategy no 3 in Appendix A of this paper, leaving several problems. The former approach, allowing institutions like ACICA to develop tailored ISA Rules for the government to add in treaties as another option (strategy 2: (Nottage and Miles 2009)), may be more flexible but may not have a large impact on practice – at least in the short term. A more intrusive procedural reform could be to require “exhaustion of local remedies” in host state courts or administrative processes before allowing access to ISA (strategy 3a), but specifying a time limit for local proceedings after which ISA can be invoked (as in many of China’s investment treaties). This would reduce – but not eliminate – the procedural advantages afforded to foreign over domestic investors, albeit at a cost.²⁵

Another reform option comprises carve-outs in treaties for various sectors, such as natural resources; or various types of measures, such as taxation measures – assisting countries like Australia interested for example in taxing mining companies more heavily (strategy 4). There can also be more broadly worded exceptions preserving regulatory capacity, for example in relation to public health (strategy 5). A flexible combination of these approaches, already seen in recent treaty practice world-wide,²⁶ seems the best way forward in terms of balancing the benefits and risks of ISA for countries like Australia. It is preferable than pressing for often one-sided obligations favouring only its investors abroad, or even (especially in the context of regional agreements) agreeing to reciprocal rights but only with partners with allegedly “developed” legal systems (strategy 6). One could at least consider the novel approach of allowing only inter-state DR but with the power of an investor to force its home state to initiate proceedings against the host state (strategy 8), as under the present OECD Model Tax Treaty (and indeed the revised Australia-NZ Tax Treaty).

Instead, the PC’s Report and now the Gillard Government Trade Policy Statement prefer a policy stance that may result in no ISA at all, or at least significantly curtail its scope of application in future treaties. This is therefore much more likely that foreign investors will be left only with the possibility of inter-state DR (not a right to activate it), individually negotiated investor-state contracts or ad hoc legislative consent to arbitration, or otherwise only remedies provided by host state courts (strategy 7); and perhaps political risks insurance if commercially viable (in the short term) and the chance of long-term general improvements in host states legal systems thanks to home state ODA (strategy 9). In discussing ‘implications for future policy’, the PC did note (p276) that:

²⁵ See my Submission to the PC, available above n [[6]], with further references e.g. to the work of Professor William Dodge.

²⁶ See, e.g. UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), *UNCTAD World Investment Report 2010*, available at <http://www.unctad.org/templates/WebFlyer.asp?intItemID=5539&lang=1> (last visited May 26, 2011).

Dr Nottage argued that the international arbitration system ‘probably offers net benefits overall and Australia should promote it more extensively’ (sub. 63, p. 6), while the Law Council of Australia stated that:

Future preferential trade agreements should, where appropriate, include more broad regimes for dispute resolution, encompassing not just state party dispute resolution but investor-state regimes, especially where Australia is dealing with a country that does not have a developed and predictable legal system. (sub. 47, p. 9)

Despite such views, the PC concluded (pp 276-7):

although some of the risks and problems associated with [ISA] can be ameliorated through the design of relevant provisions, significant risks would remain. Meanwhile, it seems doubtful that the inclusion of [ISA] provisions within [investment treaties] (including the relevant chapters of [FTAs]) affords material benefits to Australia or partner countries. The Commission has also not received evidence to suggest that Australia’s systems for recognizing and resolving investor disputes have significant shortcomings that should be rectified through the inclusion of ISDS in agreements with trading partners.

Against this background, the Commission considers that Australia should seek to avoid accepting ISDS provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already provided by the Australian legal system. Nor, in the Commission’s assessment, is it advisable in trade negotiations for Australia to expend bargaining coin to seek such rights over foreign governments, as a means of managing investment risks inherent in investing in foreign countries. Other options are available to investors.

The Commission notes that, if perceptions of problems with a foreign country’s legal system are sufficient to discourage investment in that country, a bilateral arrangement with Australia to provide a ‘preferential legal system’ for Australian investors is unlikely to generate the same benefits for that country than if its legal system was developed on a domestic non-preferential basis.

Nonetheless, the PC seems to have over-estimated the (non-manageable) risks of ISA, while under-estimating some of its general and specific benefits (as argued in Part II). In addition, the implications of its Recommendation 4(c), adopted by the Gillard Government to limit ISA to situations where it does not offer better rights to foreign compared to domestic investors, are complex and potentially far-reaching (Part I). It therefore seems timely already to reassess that policy stance, and to explore more

moderate and flexible approaches to addressing more specific problems within the ISA system.

Private and public interest group incentives for ISA reform

Australia's recent experience, however, suggests that few private or public interest groups are likely to have strong or unambiguous incentives to press in that direction. Indeed, this may also be true more generally, as sketched by the following thought experiment as to likely constituencies for ISA reform within contemporary nation states.

Private sector constituencies

The private sector made few submissions to the PC's review in 2010, for example, and the Keidanren (Japan's key business federation) has not played a large role in Japan's treaty practice regarding ISA.²⁷ But perhaps this is unsurprising. *Large investors* can rely anyway on informal links with host and especially home states to resolve cross-border disputes, and may also have the resources to take a longer-term approach. *Smaller investors* have less knowledge of the pros and cons of ISA – thus creating a Catch-22 situation. *Exporters* will generally be more interested in their governments pressing for trade preferences in FTAs rather than strong investment chapters, although exporters nowadays are also increasingly investors or licensors of intellectual property (potentially protected also under investment chapters). *Domestic market oriented firms* are likely instead to oppose calls by foreign investors or their governments to “level the playing field” by allowing foreign investors to access the more familiar international arbitration process, not just local courts.

Even large *law firms* may be quite ambivalent, despite their greater access to the policy-making process compared to smaller law firms. After all, they disproportionately represent larger investors (with theoretically less need to press for ISA compared to small investors).²⁸ Admittedly, some large increasingly promote ISA because growing ICSID caseloads represent potentially lucrative fees as advocates and arbitrators. It also raises law firms' profiles in the burgeoning and partly overlapping field of commercial (inter-firm) arbitration. But there remain many hundreds of investment treaties, many with ISA, hence plenty of work advising clients on how to structure investments to take advantage of such provisions.

Likewise, the *academic community* appears to be split. Many specialists in international law are now appointed as consultants, experts or arbitrators in investor-state disputes. But many others are now making their mark as strong critics of the entire system, as indicated by the signatories of the “public statement on the international law

²⁷ {Hamamoto and Nottage 2010}. Cf more generally {Pekkanen 2008}.

²⁸ The picture is further complicated in countries like Australia, as large firms have generated an increasing proportion of fee income from litigation and other legal services provided to the government since deregulation in 1999 {Nottage and Green 2011}. If foreign investors sought to retain such firms when claiming against the Australian government, they might be reluctant to take on such cases as they might have a conflict of interest or it might jeopardize other potential work for the government.

regime” mentioned above (Part I). As for *non-governmental organizations*, a growing voice in international rule-making, there are probably many more opposed to ISA than in favour – although those favouring it may be better funded or have significant influence on governments, such as pro-business (or ‘small government’) groups. Consider the invitation-only workshop on ISA policy convened by the PC on 29 September 2010, in response to various Submissions including some (like mine) critical of its Draft Report. It involved a few other academics (economists including Dr Emma Aisbett, one of the “public statement” signatories), some officials, and representatives from AFTINET (the Australian Fair Trade and Investment Network) and the Australian Council of Trade Unions (see **Appendix B**). The business sector was not represented.

Public sector constituencies

Different parts of government can also be expected to adopt different views. A *foreign ministry* (like DFAT) can be keen on treaty-based ISA because it can minimize time-consuming and expensive involvement in disputes reported by their own investors, and ISA may even avoid friction with host states. Home state investors obtain formal control over prosecuting claims themselves, so diplomats have more capacity to tell them to resolve disputes directly with their host states. If host states complain, the home state’s diplomats can say that the matter is now out of their hands. However, diplomats will probably want transparency obligations included into treaties (as in the Australia-Chile FTA) so they at least remain informed about claims lodged by their outbound investors. They can then mediate informally with the host state if necessary to maintain good diplomatic relations overall. On the other hand, foreign ministries can often have political incentives to conclude FTAs promptly for their political masters, and therefore prefer a negotiating position that minimizes controversy associated with pressing for ISA provisions. Such reduced commitment to ISA seems more likely where, as in Japan (Mulgan 2008), true negotiating authority is widely dispersed among government departments and political leaders – with multiple potential veto or blockage points.

A *justice ministry* (like Australia’s federal Attorney-General’s Department) often has the responsibility of defending international law claims brought against the government. Typically it would also provide legal opinions about the legality of governmental action, if asked beforehand. Particularly if the government takes action that generates a claim, that justice ministry might feel under threat. In any event it will need to spend time and seek resources to defend claims, which could be allocated to more productive and less stressful pursuits. A justice ministry therefore may exhibit some reticence towards ISA, especially as it is a new and expanding field that demands careful monitoring of new developments and overall trends.

An exception might be a justice ministry where many staff are very familiar with the legal and practical issues involved in foreign investment (e.g. because they have had experience in or coordinate closely private law firm practice) and/or they are likely to move into such legal practice (with law firms keen to retain the ex-officials’ expertise in ISA proceedings in order to expand the services available to foreign investors). This

pattern is found in the US government (although the main government lawyers for its international law disputes are not from the Department of Justice), and this may be a significant factor behind the US policy of actively promoting ISA.²⁹ Yet it is probably quite unusual among countries world-wide, especially in the Asian region. It is not true in Australia and certainly not in Japan – government specialists in international law matters tend to serve within the public service for long periods.

It is also possible that a justice ministry might favour ISA in a more general sense because it perceives overlaps with international commercial arbitration, which it might also happen to be promoting. Yet there are significant differences between the two fields {Nottage and Miles 2009}, and different parts of the ministry may be charged with policy developments anyway. Certainly, despite its support of ACICA and arbitration law reform particularly over recent years, the AGD (and other parts of the government) did not publically voice this sort of argument to press for Australia to maintain a more pro-active approach towards ISA.

There are few other parts of government that appear likely to strongly support ISA, either. A *commerce ministry* may fall in that category, like METI in Japan. The Ministry of Economy, Trade and Industry is keen to support its importers of natural resources from abroad to fuel Japan's world-class exporters of processed goods. But this sort of commerce ministry would normally also have jurisdiction over less globally competitive industries, which it might want instead to shield from inbound FDI – by preserving “regulatory capacity”, and opposing ISA for foreign investors. Other line ministries, such as a *ministry of agriculture*, are even more likely to take that approach, or (less cynically) to be concerned about treaty-based limits to their capacity for regulatory responses to emerging socio-economic problems.

A *finance ministry* will also usually be very concerned about liability exposure from ISA claims from foreign investors. But what if it or a related entity also has primary jurisdiction to develop policy about inbound investment (like the Treasury in Australia) and to screen it in the national interest (through the Foreign Investment Review Board, which advises the Treasurer), and if it generally welcomes inbound FDI to promote allocative and dynamic efficiency? This should elicit a more positive view towards ISA. Yet that seems likely to diminish as the local economy is progressively opened up to inbound FDI (reducing marginal efficiency gains, perhaps) or if further economic studies begin to suggest strongly that offering ISA does not significantly increase inbound FDI anyway (as suggested by the PC).

Overall, therefore, this preliminary outline of both public and private sector (sub)groups within nation states which might potentially be interested in ISA indicates few obvious strong constituents for maintaining the present ISA system. A few commentators in Australia expressed surprise when the PC's final Report recommended a potentially quite drastic diminution in the likelihood of including ISA provisions in future treaties, and more expressed concern when the Gillard Government adopted the PC's approach in April 2011. But perhaps this should have been expected. Policy-makers

²⁹ I am grateful to Professor Paul Stephan (University of Virginia Law School) for this point.

throughout the Asia-Pacific should therefore consider this sort of broader backdrop and its practical implications.

Conclusions: The stillbirth of ISA in Asia?

The seemingly rather belated emergence of ISA in Asia therefore may well be halted by a domino effect around the region, created by the Gillard Government's recently-announced policy stance for Australia – which continues to target treaty negotiations with partners in the rapidly growing Asian region. The following brief analysis of some major ongoing FTA negotiations suggests that international pressure may not create much pressure, either, for Australia to adjust its policy position.

Australia's policy does not exclude incorporating ISA in treaties if the legal system of the partner country, such as China, offers *lower* protections than Australian domestic law – provided the bilateral FTA obligations are capped at the Australian domestic law level (otherwise, Chinese investors would enjoy higher protections against the Australian government than local Australian investors). But the economic reality is that actual and especially potential investment flows are vastly imbalanced in China's favour, as it expands its interests in Australia's natural resources sector. This creates incentives for China to press for full-scale ISA, to protect its investors in Australia – ideally, at the international law level if this higher than the Australian domestic law level.

If Australia invokes its present policy to limit substantive treaty protections combined with ISA to its domestic law level, China may well respond that “this is meaningless, because by definition Chinese investors can get this through Australian courts even without a treaty”. If China then insists on a higher standard set by international law (eg in its treaties with other countries), this may result in stalemate and no FTA. Another stalemate arises if China decides to mimic Australia's policy stance by accepting all the arguments presented by the PC, and therefore not offer to Australian investors rights (at least to the Australian law standard) offered to its local investors in China. Perhaps the Australian government is betting that neither stalemate will arise because China is so desperate for Australia's natural resources, so FTA negotiations can be successfully completed including some ISA protections favourably really only to Australian investors into China. But it seems a risky strategy even in the short-term, especially as China's recent treaty practice has been to press for full-scale ISA provisions (as in the China-NZ FTA) mainly to protect its outbound investments (Bath 2011).

Other problems arise in case of FTA negotiations with Japan.³⁰ Even more so than China, Japan is a large net capital exporter to Australia. Yet Japan's domestic law protections for foreign investment, both substantive and procedural, are of a high standard anyway {Hamamoto and Nottage 2010}. Under the Gillard Government's policy, if the protections are largely the *same* as those provided to Japanese and foreign investors under Australian domestic law, both countries could probably incorporate (non-ICSID³¹) arbitration provisions in their FTA, provided they agree to cap the

³⁰ The situation and therefore the following analysis is probably quite similar in the case of Korea: see generally {Kim 2011}.

³¹ Cf Part I fn [[2]] above about some complications even in this respect.

substantive protections at that level in the event that international law protections (eg of “fair and equitable treatment”) happen to be generally higher. If the Japanese law level of protection is *higher* than its Australian law counterpart, ISA can only be included if the Japanese government agrees to drop the bilateral treaty standards down to the Australian domestic law level of protection. Such concessions are quite likely with Japan – unlike, perhaps, the US – because Japan’s treaty practice has been quite flexible, especially when drafting substantive protections (Hamamoto 2011). (This is despite Japan’s general preference to negotiate pro-investor FTAs especially in the resources sector, epitomized by the Japan-Indonesia FTA signed in 2007 (Sitaresmi 2011)). But again in both cases, Japanese investors and their government may say anyway that such concessions would be “meaningless, because we can achieve that level of protection through Australian courts even without bilateral treaty protections”.³²

Japan therefore may well give up pressing for ISA altogether, especially as the recent natural disaster and ongoing nuclear power plant emergency have heightened its need for Australia’s gas and other natural resources. Large-scale Japanese investment into Australia since the 1960s has also generated few reported disputes anyway, although the recent mining “super tax” issue has focused the minds of some investors and their advisors on potential sovereign risk in Australia. The Treasury will press to exclude ISA to minimize Australia’s liability exposure from Japanese investors anyway. Thus, it seems quite likely that ISA will end up being completely excluded from this bilateral treaty, even though Japan managed to achieve ISA in its FTA with Switzerland signed in 2009.

However, that example could well exacerbate tensions as negotiations continue for an expanded regional TPPA, especially if Japan formally joins those talks. They will get complicated anyway as other countries that have long pressed for ISA in their treaty practice, like the US and Singapore, come up against Australia’s policy stance. More generally, the ISA system could unravel surprisingly quickly if other countries, even influential developing countries (like India), begin to mimic that stance as well.

³² In the second case, Australian investors won’t press their government to include ISA provisions at the higher Japanese law standard, as they get that anyway through local courts in Japan. Anyway, apart e.g. into the Niseko skifields, there is very little FDI from Australia into Japan (more likely to encounter host government interference than the much larger portfolio investment flows). Macquarie has sold its stake in Haneda Airport, for example.

Appendix A: Possible strategies to improve investor-state ISA

Note: The PC’s final Report primarily promotes strategies Nos 7 and 9 (shaded below), but no longer – directly – strategy No 6(b) (as in its draft Report).

Strategy	Main problem(s)
1. No change ('business as usual')	Efficiency and legitimacy concerns
2. No or limited substantive rule changes but extra (tailored, more balanced) Rules options in treaties, eg: <ul style="list-style-type: none"> - Disclosures, Third-Party Participation and Appellate Review; Arbitrator Appointment and Remuneration; Time Limits and ADR; Interim Measures and Tribunal Voting {Nottage and Miles 2009} - Arbitrator Challenges (not determined by co-arbitrators; clarify time limits) - Fee shifting rules (eg full legal cost recovery by winning side – if more concerned that investors bring more frivolous claims than, than respondent host state mounting poor defences) 	Investors lose benefits of ICSID enforcement mechanism so may not choose arbitration under those Rules (although 1958 New York Convention is nowadays often an effective alternative, and investors may be so urged by home govt etc, or inclined eg to facilitate execution of any award later won against a host state)
3. Add similar procedural provisions (instead or also) into treaties themselves	May not be suitable for all investors or even host state respondents, especially if treaties not updated as regularly as Rules can be; likely also to vary across treaties; some provisions in treaties may be

	trumped by ICSID framework treaty provisions (eg an Appellate Review mechanism for substantive error of law, or arbitrator appointment/challenge rules)
3a. "Exhaustion of local remedies" before access to ISA	Extra financial costs and delays for foreign investors
4. No ISA for certain types of investment (eg natural resources, finance) and/or measures (eg taxation - excluded from "expropriation" claims)	Works against home state's investors (unless one-sided in treaty); difficult to anticipate and justify exceptions (especially if treaty is long-term)
5. Other substantive provision changes (eg more broadly worded exceptions preserving regulatory discretion eg re public health; more clarification of key terms like "expropriation")	Works against home state's investors; some definitions may be copied too readily from other countries' treaties / legal systems (eg Australian treaties following US constitutional law 'takings' jurisprudence)
6. (a) Substantive obligations one-sided (only benefiting Australian investors); and/or (b) ISA only with developing countries	Mainly legitimacy problems; impedes treaty regionalisation
7. Limited or no treaty provisions for ISA or substantive rights; Investors must mainly or primarily rely on (i) inter-state DR, or (ii) conclude investor-state contracts (perhaps with home state support in negotiations), or (iii) rely solely on host state courts	(i) Inter-state DR is more politicised and uncertain (especially if falling back on customary international law due to limited treaty provisions); (ii) host state particularly burdened with transaction costs of negotiating various contracts (although could eg seek duties on investors amenable to counter-claims in ISA); (iii) local courts may be unreliable or allow only inadequate domestic law remedies
8. No ISA but investor can trigger inter-state DR (like taxpayers can under the OECD Model Tax Treaty since	Difficulties in designing process whereby private interests involved even though not a party

2007)	
9. Rely only or mainly on political risk insurance (with or without home state support); and/or 'technical legal assistance' to improve host state's courts and substantive law to protect all investors	Limited insurance coverage, difficulties in pricing risk and with subrogation; improving host state's legal system only feasible in long-term (and other countries' investors can "free ride" on the home state's efforts)

Appendix B: Participants in PC's invitation-only roundtable on ISA policy

Source: PC Final Report (2010) Appendix B at p336

Table B.1 **Workshop – Canberra 29 September 2010**

Harvey Purse (video)	AFTINET
Stephen Bouwhuis	Attorney-General's Department, Office of International Law
Amy Schwabel (video)	Australian Council of Trade Unions
Dr Emma Aisbett	Australian National University
John Larkin	Department of Foreign Affairs and Trade
Kim Debenham	Department of Foreign Affairs and Trade
Angela McGrath	The Treasury
Nirmalan Amirthanesan	The Treasury
Dr Luke Nottage	University of Sydney
[Dr] Perry Shapiro visiting]	[University of California, Santa Barbara;

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