Resolving Disputes Amidst Japan-Korea Trade and Investment Tensions: Part II

Kluwer Arbitration Blog
August 12, 2019

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Please refer to this post as: James Claxton, Luke Nottage, and Brett G. Williams, 'Resolving Disputes Amidst Japan-Korea Trade and Investment Tensions: Part II', Kluwer Arbitration Blog, August 12 2019, http://arbitrationblog.kluwerarbitration.com/2019/08/12/resolving-disputes-amidst-japan-korea-trade-and-investment-tensions-part-ii/

Our previous posting set out the background to the current trade tension between Korea and Japan. It outlined the possibility of Japan bringing claims under a 1965 Treaty that purported to settle claims resulting from Japan's colonisation of Korea, or under two investment treaties, regarding Korean courts recently ordering Japanese companies to pay compensation to war-time Korean labourers. Yet such claims also face procedural and/or substantive law difficulties. Then it showed how Korea might bring a formal claim before the World Trade Organization (***WTO***), but face difficulties with substantive law and especially procedure, given the general breakdown in the WTO's usual two-tier inter-state dispute resolution process.

We now elaborate the possibility of affected Japanese companies instead or in parallel bringing investor-state dispute settlement (***ISDS***) claims against Korea, similarly alleging denial of justice in Korean court proceedings, under the two treaties. We conclude that these extra complications bolster the attraction of a formal mediation to bring both countries and the affected companies together in order to achieve an overall negotiated settlement.

4. Japanese Companies vs Korea Through ISDS

Apart from the difficulties outlined in our previous posting over proving a denial of justice, a major problem for the Japanese companies if they initiate ISDS arbitration is that they would have to fork out tribunal, lawyer and expert witness fees. Empirical evidence confirms those are often hefty, even if the claim ultimately succeeds, which is one major reason why investors try to mobilise and involve their home states even if relevant treaties allow them to "go it alone" by providing the option of ISDS as well as inter-state arbitration.

A major problem for the Japanese government, in turn, is that any ISDS claims brought by the companies would likely further incense not only the current Korean government, but also some groups within Korean society (including an association of judges). They and the then opposition party first became critical of ISDS especially as it was negotiated into the Korea-US Free Trade Agreement (***KORUS***) and their presidential candidate ran on a platform that was critical of ISDS. However, that candidate lost resoundingly, which practically ended the debate, and KORUS was brought into effect from March 2012. Nonetheless, ISDS also remained on the radar as the first-ever treaty-based claim was brought against Korea from late 2012 by a Belgian subsidiary of US-based Lone Star. The claim is

still pending, despite some expectations it would be resolved by March 2019.

One Australian NGO now even interprets a recent Korean newspaper report of current Prime Minister Lee Nak-Yeon as suggesting that Korea may "abolish" ISDS. More likely he was expressing his personal views because Korea's investment treaty policy and practice largely remain unchanged. This is evident from the recent Korea-Armenia BIT and Korea-Central America FTA, which both contain ISDS, although wider policy and practice have been evolving somewhat (*e.g.*, regarding transparency in ISDS). Nonetheless, an ISDS claim by Japanese companies and/or an award favouring Lone Star would further inflame simmering political tensions. This potential is heightened as this year another US investor (Gale) has filed a notice to initiate ISDS regarding a development in Incheon, while Chinese and now Malaysian investors have filed notices regarding projects on Jeju Island.

Despite such practical difficulties, as early as 2014 (in the wake of the first-instance Korean court judgments against Japanese companies like Nippon Steel) *Investment Arbitration Reporter* commentators had reported that Japanese companies could be preparing ISDS claims against Korea. Apart from questions over the substantive grounds under the relevant treaties, outlined in our previous posting, another threshold issue to consider is: how likely are Japanese investors generally to bring ISDS claims anyway?

Japanese investors were initially very "reluctant claimants", with an analogy potentially with Japan's "reluctant litigants" as measured by comparatively few per capita civil suits filed in Japanese courts. In contrast to home countries with much higher ISDS claiming per capita (such as Canada, more so say than the US), there had been only a few indirect treaty-based claims from companies linked to Japan, notably Nomura via its Saluka Investments subsidiary against the Czech Republic (settled in 2007), and Bridgestone via a US subsidiary against Panama (with public hearings over the internet, 29 July – 2 August 2019, illustrating incidentally the growing transparency of ISDS proceedings). At least one other threatened ISDS claim was seemingly based on consent to arbitration administered by the International Centre for the Settlement of Investment Disputes (***ICSID***) contained not in a treaty but an investment contract, namely between an aluminium smelter consortium and Indonesia. However, this also settled (in 2013) so no arbitration was commenced by the Japanese investors.

Nonetheless, Japanese firms have filed three Energy Charter Treaty claims arbitrations against Spain since 2015. This follows the lead of investors from many other states, also impacted by Spain's abrupt changes in renewable energy policy. Their precedents allow Japanese companies and their legal advisors to reduce costs and other "institutional barriers" to pursuing formal dispute resolution procedures. Nissan's UNCITRAL Arbitration Rules claim in 2017 under the India-Japan FTA is even bolder, as few of the many ISDS claims brought against India (since a 2011 award for Australia's White Industries) have involved investments in manufacturing. This claim may indicate a changing mindset among the leaders of at least larger Japanese companies, towards more active engagement in international arbitration. However, Nissan is quite unusual given its alliance with French shareholder Renault (although that relationship is itself now impacted by securities law prosecutions against CEO Carlos Ghosn).

Tracing the emergence of claims by Japanese investors generally, the possibility of ISDS claims against Korea now by Nippon Steel and other affected companies cannot be excluded simply on the basis say of some general "cultural" aversion to formal dispute resolution processes. As for those who still favour instead the "elite management" theory put forward for such aversion to explain low levels of civil litigation within Japan, whereby government and business elites divert cases away from formal dispute resolution, it is noticeable that peak business associations (especially the Keidanren) have long pressed for ISDS-backed investment treaty protections. And the Abe Administration since 2012 has signed 16 standalone BITs (all with ISDS), albeit still far fewer than Korea, as well several FTAs. This sends the message that investment treaties are important and to be used, paralleling more

active engagement with ISDS in other parts of Asia especially as various "institutional barriers" slowly start to come down. However, in highly politicised cases such as this they are probably best used as part of a multi-level negotiation and an overall dispute resolution as elaborated in the concluding section below.

Article 15 of the 2002 BIT envisages the investor seeking "consultations or negotiation" with the host state for up to 3 months, then a notice of intent triggering a cooling-off period of at least another 3 months, before being able to commence arbitration under the ICSID Convention (as both Japan and Korea are parties), with its more favourable enforcement regime, or any other separately agreed Arbitration Rules. (Articles 17-18 exclude ISDS for disputes over prudential measures concerning financial services and temporary safeguards for cross-border capital transactions, which are inapplicable here.)

Article 15 of the trilateral agreement requires more details in the investor's request for consultations so the dispute can be "solved amicably", but if no settlement is reached after four months the investor can seek arbitration under the ICSID Convention, UNCITRAL Rules or any other separately agreed Arbitration Rules. The host state can require the investor to first seek administrative review under any local requirements, but only for up to four months before arbitration is commenced. (ISDS exclusions regarding certain intellectual property rights or temporary safeguards are again inapplicable here.)

Nonetheless, filings would mean investors incurring significant arbitration expenses up-front, with empirical studies on ISDS costs showing claimants are often unable to recover all lawyer and expert witness expenses even if successful. More importantly, filings by Nippon Steel and others would likely inflame the underlying tension, resulting in boycotts, protests or even strikes around their affiliated companies in Korea. Perhaps for such practical reasons, this point has not been raised by general media, relevant companies or the Keidanren, although the *Investment Arbitration Reporter* has reiterated the possibility of ISDS claims since the Korean Supreme Court judgment late last year.

5. Mediation to Assist a Negotiated Settlement

In light of this complex and delicate situation, how could a global settlement be reached? One possibility is for one or more affected Japanese companies to seek direct consultations with Korea, but include a request for mediation to help reach a negotiated outcome. Neither the BIT or the trilateral agreement mention mediation or conciliation, unlikely some investment treaties that refer to it as an option, but mediation can be agreed separately as neither treaty's "fork in the road" provision preclude this possibility.

Recent empirical research highlights the pervasiveness of settlements even after arbitration is filed, contrary to some commentators' scepticism. This therefore demonstrates the potential for even more settlements through greater use of investor-state mediation.

An advantage of such ad hoc mediation is that skilled mediators could also bring in the host states, and come up with a resolution of the disputes under the 1965 treaty and the WTO as well. Mediation has not been so popular in inter-state dispute resolution, but a recent successful settlement of a maritime boundary dispute between Australia and Timor-Leste has highlighted its wider potential for large-scale international disputes nowadays.

There are otherwise few signs that Japan and Korea will be able to work out the dispute on their own at the moment. President Moon has warned of a "prolonged" conflict and has committed that Korea

"won't be defeated again", while Japan initially resisted engaging in negotiations after Korea refused to arbitrate under the 1965 treaty and is now ratcheting up pressure on Korea in the trade dispute. This suggests that the states' positions have hardened as public sentiment on both sides has soured amidst protests, product bans, disruptions to business and tourism, and even self-immolation by Korean nationals in protest against Japan.

High-level officials from the US have tried to extricate the parties from their entrenched positions. An early offer by Donald Trump to mediate did not get traction, but the US has continued to try to play a role in resolving the dispute including calls for a "standstill agreement" to prevent further escalation of tensions. Yet the US suffers from a credibility problem, as the Trump Administration has itself been using trade policy in a more confrontational way, evidenced by the WTO Appellate Body problem and bilateral trade war with China. Some see that approach as having spread now to Japan's dealings with Korea. Others urge the US to keep exploring ways to "quietly nudge" both nations to resolve their disputes, but acknowledge the limited scope for informal interventions even for a superpower.

Australian (former) officials or politicians from Australia may have a role to play, or from another influential state (such as Singapore) in current negotiations around the WTO DSU as well as a Regional Comprehensive Economic Partnership (RCEP, or ASEAN+6 FTA). Furthermore, Singapore is actively positioning itself as a proponent of international mediation, not least by hosting last week the diplomatic conference for a new UN Convention on cross-border enforcement of mediated settlement agreements – signing up along with 45 others (including Korea, China and the USA, but not Australia or Japan), attracting widespread commentary. Although the new treaty is designed to promote commercial and potentially investor-state mediation, it could heighten interest also in inter-state mediation.

It would further delay RCEP negotiations if there were a collapse in trust and values shared between Korea and Japan, including generally regarding ISDS and investment commitments. Already, some have suggested that this bilateral tension is behind Korea getting cold feet about seeking to join the regional CPTPP now partly in force, which Japan (with Australia and Singapore) pushed to bring into force after the Trump Administration withdrew US signature of the earlier Trans-Pacific Partnership FTA.

However, even Australia or Singapore could be seen as having their own interests in the bilateral spat. Better candidates as neutral mediators – especially for a more structured and sustained mediation process – could be senior figures (formerly) within the United Nations, such as UNCTAD, or another international organisation such as:

- the OECD, although it is more policy – than practice – oriented;
- the International Bar Association, which produced investor-state mediation rules in 2012, although those are hardly used so far and the Association's leaders tend now to be full-time practitioners especially from larger law firms; and
- the International Law Association, instead comprising mostly professors specialising in international law.

Both ICSID and the Centre for Effective Dispute Resolution (CEDR) have started to promote investor-state mediation recently, including running courses with the International Energy Charter and International Mediation Institute to train up mediators for investment disputes. They too could be consulted for possible mediators, with experience also preferably in WTO law and broader international relations, especially in Asia.

Overall, successful mediation and negotiated settlements tend to arise in two ways. One is where the litigation behind the mediation, including likely costs and delays, has a predictable outcome. (This is

one reason sometimes given for low levels of civil litigation in Japan, epitomised by traffic accident data.) But another is where the dispute becomes very complicated, allowing skilled mediators to help parties find novel ways to perceive and develop shared interests. This would not be possible before an adjudicatory forum, like the ICJ or an arbitral tribunal, with a limited mandate to decide claims. An imposed solution, with a perceived winner and loser, might also fail to calm the tide of nationalism, public unrest, and deteriorating relations between the countries. These circumstances offer both a unique opportunity for mediation as well as a challenge for international dispute resolution.

This analysis derives from a project on Asia-Pacific international business dispute resolution funded jointly over 2019 by the University of Hong Kong and the University of Sydney. It will be tabled at a second symposium on 15 November.