Dispute Settlement in the Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA)

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Summary

The proposed U.S.-South Korea Free Trade Agreement (KORUS FTA) follows current U.S. free trade agreement (FTA) practice in containing two types of formal dispute settlement: (1) State-State, applicable to disputes between the KORUS FTA Parties, and (2) investor-State, applicable to claims by an investor of one KORUS FTA Party against the other Party for breach of an agreement investment obligation. An unsuccessful defendant in a State-State dispute would generally be expected to remove the complained-of measure; remedies for non-compliance include compensation and the suspension of KORUS FTA obligations (e.g., the imposition of a tariff surcharge on the defending Party's products) and, as an alternative, payment of a fine to the prevailing Party or, in some cases, into a fund that may be used to assist the defending Party in complying with its obligations in the case. The KORUS FTA also contains special procedures for State-State disputes relating to motor vehicles that would grant the prevailing complainant an automatic right to increase tariffs on motor vehicles of the other Party to most-favored-nation (MFN) rates. If a Party were found to have violated an investment obligation in an investor-State dispute, the tribunal would be authorized only to make a monetary award to the claimant and thus could not direct the State defendant to withdraw the violative measure. If the defending Party did not comply with the award, the investor might seek to enforce it under one of the international arbitral conventions to which the United States and South Korea are party.

The KORUS FTA State-State dispute settlement mechanism differs from most earlier U.S. FTAs in that it applies to all obligations contained in the labor and environmental chapters of the KORUS FTA instead of only domestic labor or environmental law enforcement obligations. In addition, in the event a Party is found to be in breach of one of these obligations and has not complied, the prevailing Party may impose trade sanctions instead of, as under earlier agreements, being limited to requesting that a fine be imposed on the non-complying Party with the funds to be expended for labor or environmental initiatives in that Party's territory. The changes stem from a bipartisan understanding on trade policy between congressional leaders and the George W. Bush Administration finalized on May 10, 2007, setting out provisions that were to be added to completed or substantially completed FTAs pending at the time. Among the aims of the understanding was to expand and further integrate labor and environmental obligations into the U.S. FTA structure. The same approach to labor and environmental disputes is found in FTAs entered into with Colombia and Panama, each of which continue to await congressional approval, and in the U.S.-Peru Trade Promotion Agreement, which entered into force in 2009.

Resort to panels under FTA State-State dispute settlement has been uncommon, and thus there has been relatively little experience with the operation of this mechanism over a range of agreements and issues. FTA investor-State claims have been filed under the North American Free Trade Agreement (NAFTA) and the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA). As is the case with its NAFTA partners, particularly Canada, the United States imports capital from South Korea to a greater degree than it does from parties to other U.S. investment agreements, and South Korean investment in the United States may indeed grow over time. While this situation may create a greater potential for investor-State disputes than exists under most other U.S. investment agreements, the extent to which disputes involving South Korean investors will in fact arise would seemingly depend upon a variety of factors and interests unique to an investor's individual situation and thus for now remains only a matter for conjecture. To date, the United States has prevailed in all investor-State cases brought against it. Implementing legislation to approve the KORUS FTA and to provide legislative authorities needed to carry it out has not yet been introduced.

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Introduction

The proposed U.S.-South Korea Free Trade Agreement (KORUS FTA)[1] follows current U.S. free trade agreement (FTA) practice in containing two types of dispute settlement: (1) State-State, applicable to disputes between the Parties to the KORUS FTA, and (2) investor-State, applicable to claims by an investor of one Party against the other Party for breach of a KORUS FTA investment obligation.[2]

Investor-State dispute settlement procedures have been a key element of U.S. bilateral investment treaties (BITs) and, with the inclusion of investment obligations in most U.S. FTAs, they have become a feature of these agreements as well. The United States originally decided to include reciprocal investor-State dispute settlement in its BITs, as described by one commentator, "to provide investors with a stable and secure dispute settlement device and to de-politicize investment disputes."[3] As further noted, "[c]ompulsory arbitration provisions can deter some disputes, and can resolve others without the necessity of State Department involvement."[4]

The KORUS FTA also contains language relevant to dispute settlement stemming from a bipartisan understanding on trade policy between congressional leaders and the George W. Bush Administration finalized on May 10, 2007, setting out various provisions to be added to completed or substantially completed FTAs pending at the time.[5] Aimed at, among other things, expanding and further integrating labor and environmental obligations into the FTA structure, the May 10 understanding provides that labor and environmental obligations in an FTA are to be subject to the same State-State dispute settlement provisions, enforcement mechanisms, and remedies for non-compliance as the agreement's commercial obligations. The same approach to

[1] The final text of the U.S.-South Korea Free Trade Agreement (KORUS FTA), including supplementary texts agreed to by the Parties on December 3, 2010, is posted on the website of the Office of the United States Trade Representative (USTR) at http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text. For further information on the agreement, see CRS Report RL34330, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications*, coordinated by William H. Cooper; hereinafter CRS Report RL34330.

[2] The North American Free Trade Agreement (NAFTA) is unique in containing a third type of dispute settlement, applicable where one NAFTA Party, that is, the United States, Canada, or Mexico, undertakes an antidumping or countervailing duty investigation involving the goods of another NAFTA Party. Chapter Nineteen of the NAFTA permits a Party, either on its own accord or at the request of private party entitled to domestic judicial review of a final agency determination in a domestic antidumping or countervailing duty proceeding, to request that a final agency determination be reviewed by a binational arbitral panel instead of by a court in the country in which the determination is rendered. The binational panel mechanism was originally included in the now suspended U.S.-Canada Free Trade Agreement. For further information on NAFTA Chapter 19 and pending and completed binational panel proceedings, see the website of the NAFTA Secretariat at http://www.nafta-sec-alena.org/en/view.aspx?x=225.

[3] K. Scott Gudgeon, *Arbitration Provisions of U.S. Bilateral Investment Agreements*, in Seymour J. Rubin & Richard E. Nelson, INTERNATIONAL INVESTMENT DISPUTES: AVOIDANCE AND SETTLEMENT 41, 42 (1985).

[4] *Id.* at 42. See also Kenneth J. Vandevelde, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L. & POL'Y 174-75 (2005).

[5] House Ways & Means Committee summary of the May 10 understanding, at http://waysandmeans.house.gov/Media/pdf/110/05%2014%2007/05%2014%2007.pdf , and Office of the United States Trade Representative, *Trade Facts: Bipartisan Trade Deal*, May 2007, at http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf. See H.Rept. 110-421, at 1-7, for a discussion of the May 10 agreement and the incorporation of its principles into various chapters of the U.S.-Peru Trade Promotion Agreement. See also Office of the USTR, Statement from Ambassador Susan C. Schwab on U.S. trade agenda, [May 10, 2007], at http://www.ustr.gov/about-us/press-office/press-releases/archives/2007/may/statement-ambassador-susan-c-schwab-us-trade-, and *Administration Drafting Legal Text to for Labor/Environment Deal with Congress*, 24 Int'l Trade Rep. (BNA) 675 (May 17, 2007).

labor and environmental disputes is also found in the U.S.-Peru Trade Promotion Agreement, which entered into force on February 1, 2009,[6] and in proposed U.S. FTAs with Colombia and Panama.[7]

The potential scope of KORUS FTA dispute settlement is limited by the scope of KORUS FTA obligations that would be taken on by the Parties, and it is thus important to consider the nature and scope of these obligations in considering the potential ramifications of the dispute settlement articles. Exceptions to KORUS FTA obligations are also an element in assessing the scope of the commitments undertaken by each Party. For example, general exceptions contained in World Trade Organization (WTO) agreements—namely, Article XX of the General Agreement on Tariffs and Trade 1994 (GATT 1994) and Article XIV of the General Agreement on Trade in Services (GATS)—are incorporated into the KORUS FTA for purposes of obligations involving trade in goods and services.[8] The KORUS FTA also contains an "essential security" exception, which a dispute or arbitral panel must find to apply if it is invoked by the defending Party to justify the challenged measure.[9]

In general, resort to panels under FTA State-State dispute settlement has been uncommon and thus there has been relatively little experience with the operation of this mechanism over a range of agreements and issues.[10] This may be the case because of FTA consultative arrangements that

[6] For additional information on dispute settlement mechanisms in the U.S.-Peru Trade Promotion Agreement (PTPA), see CRS Report RS22752, *Dispute Settlement Under the U.S.-Peru Trade Promotion Agreement: An Overview*, by Jeanne J. Grimmett. For further discussion of other aspects of the PTPA, see CRS Report RL34108, *U.S.-Peru Economic Relations and the U.S.-Peru Trade Promotion Agreement*, by M. Angeles Villarreal, and CRS Report RS22521, *Peru Trade Promotion Agreement: Labor Issues*, by Mary Jane Bolle and M. Angeles Villarreal. See also *New Investment and Dispute Settlement Provisions in U.S.-Peru Trade Agreement*, 103 AM. J. INT'L L. 768 (2009).

[7] For further information on these agreements, see CRS Report RL34470, *Proposed U.S.-Colombia Free Trade Agreement: Background and Issues*, by M. Angeles Villarreal; CRS Report RL32540, *The Proposed U.S.-Panama Free Trade Agreement*, by J. F. Hornbeck.

[8] KORUS FTA, art. 23.1.

[9] KORUS FTA, art. 23.2, n.2. The exception provides as follows: "Nothing in the agreement shall be construed: (a) to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or (b) to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." KORUS FTA, art. 23.2. The United States has historically considered clauses of this type to be self-judging, that is, that their invocation is not subject to third-party adjudication. See, e.g., North American Free Trade Agreement Statement of Administrative Action, H.Doc.103-159, at 666 (stating that NAFTA Article 2102, the agreement's national security exception, "is self-judging in nature, although each government would expect the provision to be applied by the other in good faith."). For additional discussion, see generally John H. Jackson & Andreas F. Lowenfeld, *Helms-Burton, the U.S., and the WTO*, ASIL Insight (March 1997), at http://www.asil.org/insight7.cfm.

[10] Five panel reports were issued under the general dispute settlement provisions of the currently suspended U.S.-Canada Free Trade Agreement (Chapter Eighteen) during the five years that the agreement was in effect prior to the entry into force of the NAFTA. In the 18 years that the NAFTA has been in force, only three panel reports have been issued under the agreement's general dispute settlement chapter (Chapter Twenty).

For a discussion of difficulties that the United States has faced in implementing the adverse NAFTA panel report in the U.S.-Mexico trucking dispute, a report finding that the U.S. blanket refusal to process applications of Mexican trucks to operate in the United States violated U.S. NAFTA obligations, see CRS Report RL31738, *North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border*, by John Frittelli. As a result of the U.S. failure to comply, Mexico imposed retaliatory tariffs on imports of selected U.S. products, an action permitted under the NAFTA, beginning in March 2009. In March 2011, the United States and Mexico preliminarily agreed to take steps to attempt to resolve the dispute. The United States has pledged to allow Mexican trucks to operate in the United States to a greater degree than at present and Mexico has agreed to ultimately remove retaliatory tariffs on U.S. goods once the United States takes the agreed-upon actions. *U.S., Mexico Announce* (continued...)

facilitate the informal resolution of disputes or questions over the scope of an agreement or its application in a particular instance before resort to more structured dispute settlement procedures is considered necessary. In addition, the fact that a party may ultimately seek a panel may provide leverage for settlement at an early stage of the dispute.

In addition, WTO dispute settlement is generally available where a dispute arises under both a WTO agreement and an FTA.[11] South Korea and the United States have each initiated disputes against each other in the WTO since the WTO agreements entered into force on January 1, 1995, the cases illustrating the types of trade issues that have been particularly significant to each country. Of the 15 WTO complaints brought by South Korea against WTO Members, nine disputes have been instituted against the United States, each involving a trade remedy, for example, the imposition of an antidumping or countervailing duty on South Korean products.[12] It should be noted, however, that in general WTO complaints brought against the United States have increasingly involved trade remedy issues. The United States has instituted 97 WTO disputes, with six of these brought against South Korea. Five U.S. complaints have challenged restrictive Korean requirements on trade in agricultural products or alcoholic beverages, including restrictions on imports of beef, with one case addressing a government procurement issue.[13]

FTA investor-State claims have been the most prevalent under the North American Free Trade Agreement (NAFTA), with cases filed against all three NAFTA Parties, that is, the United States, Canada, and Mexico. The U.S. State Department currently lists 15 cases against the United States, all but one instituted by a Canadian investor or investors.[14] In addition, four investor-State cases have been filed under the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA), the regional agreement to which Costa Rica, El Salvador, Guatemala,

(...continued)

Preliminary Agreement on New Trucking Program, INSIDE U.S. TRADE, March 4, 2011, at 1. In furtherance of the preliminary agreement, the Department of Transportation has proposed the initiation of a three-year pilot United States-Mexico cross-border long-haul trucking program. For further details, see Pilot Program on NAFTA Long-Haul Trucking Provisions, 76 Fed. Reg. 20807 (April 13, 2011).

Panel reports issued under the U.S.-Canada FTA and the NAFTA are available at the website of the NAFTA Secretariat at http://www.nafta-sec-alena.org/en/DecisionsAndReports.aspx?x=312. No panels have been convened to date under the State-State dispute settlement provisions of U.S. FTAs other than under these two agreements.

[11] As is the case with other U.S. FTAs, the KORUS FTA has a "choice of forum" provision for such cases, permitting the complainant to select the international agreement under which it wishes to resolve its dispute. KORUS FTA, art. 22.6.1. Once the United States or Korea refers a matter to, or requests the establishment of, a panel under the KORUS FTA, the World Trade Organization (WTO) Dispute Settlement Understanding, or other relevant agreement to which the United States and Korea are party, the chosen forum is to be used to the exclusion of the other fora. KORUS FTA, art. 22.6.2. The NAFTA also permits the defending Party to seek resolution of certain disputes under NAFTA provisions if the complainant initially chooses to pursue a case in the WTO. NAFTA, art. 2005. For further information on WTO dispute settlement procedures, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization (WTO): An Overview*, by Jeanne J. Grimmett.

[12] Except for certain provisions in the NAFTA, obligations involving the imposition of antidumping and countervailing duties are contained in the WTO Agreement on Antidumping and the WTO Agreement on Subsidies and Countervailing Measures, respectively, rather than in FTAs and thus disputes over the imposition of such duties, if they are to be brought, must be instituted in the WTO.

[13] For further information on these cases, see the WTO website at http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm. The cases brought by Korea are numbered: DS89, DS99, DS179, DS202, DS217, DS251, DS296, DS402, and DS420. The cases brought by the United States are numbered: DS3, DS5, DS41, DS84, DS161, and DS163.

[14] Dept. of State, NAFTA Investor-State Arbitrations, Cases Filed Against the United States of America, at http://www.state.gov/s/l/c3741.htm.

Honduras, and Nicaragua are also party.[15] Two DR-CAFTA cases have been brought against El Salvador and one each against the Dominican Republic and Guatemala, each filed by a U.S. investor.[16] One claim under the U.S.-Peru Trade Promotion Agreement, filed by the U.S. investor Renco Group, is currently pending.[17] To date, investor-State claims have not been filed under other U.S. FTAs.[18]

The United States has entered into BITs and most of its FTAs with developing countries and, thus, with countries that import capital from the United States rather than exporting it to this country. As is the case with its NAFTA partners, however, the United States imports capital from Korea to a greater degree than it does from parties to these other U.S. investment agreements and Korean investment in the United States may indeed grow over the course of the FTA.[19] While this situation may thus create a greater potential for investor-State disputes than exists under most other U.S. investment agreements, the extent to which disputes involving Korean investors will in fact arise would seemingly depend upon a variety of factors and interests unique to an investor's individual situation and thus for now remains only a matter for conjecture. To date, the United States has prevailed in all investor-State cases brought against it.

[15] A bilateral investment treaty (BIT) is also in force between Honduras and the United States. The United States signed a BIT with El Salvador in March 1999, and a BIT with Nicaragua in July 1995; neither of these has been ratified. See Dep't of State, United States Bilateral Investment Treaties (Updated March 3, 2008), at http://www.state.gov/e/eeb/ifd/bit/117402.htm; see also Dep't of State, *Treaties in Force; A List of Treaties and Other International Agreements of the United States in Force on January 1, 2010*, at 118 (2010).

[16] One of the arbitrations involving El Salvador, *Commerce Group Corp. v. Republic of El Salvador*, was dismissed by the arbitral panel in March 2011 on jurisdictional grounds due to the fact that the complaining U.S. investors had not terminated related domestic court proceedings in El Salvador as required in the DR-CAFTA. *Arbitration Panel Dismisses CAFTA-DR Case Against El Salvador Over Investment Provision*, 28 Int'l Trade Rep. (BNA) 506 (March 24, 2011). The case was heard under the rules of the International Center for the Settlement of Disputes (ICSID); the award, *Commerce Group Corp and San Sebastian Gold Mines, Inc. v. Republic of El Salvador*, ICSID Case No. ARB/09/17 (March 14, 2011), is available at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1971_En&caseId=C741.

For information on NAFTA investor-State disputes, see the U.S. State Department website, NAFTA Investor-State Arbitrations, at http://www.state.gov/s/l/c3439.htm. For information on CAFTA-DR disputes, see the U.S. State Department website, CAFTA-DR Investor-State Arbitrations, at http://www.state.gov/s/l/c33165.htm. Where a dispute is heard under ICSID rules, information regarding the dispute may also be available on the ICSID website at http://icsid.worldbank.org/ICSID/Index.jsp.

[17] See Claimant's Notice of Intent to Commence Arbitration Under United States-Peru Trade Promotion Agreement, *Renco Group, Inc. v. Republic of Peru* (December 29, 2010), at http://ita.law.uvic.ca/documents/RencoGroupVPeru_NOI.pdf; *Renco Commences Arbitration Against Peru in First Case Under U.S. FTA*, INSIDE U.S. TRADE, April 8, 2011, at 15; *Renco asks for arbitration with Peru over Doe Run*, REUTERS, April 13, 2011, at http://www.reuters.com/article/2011/04/14/metals-peru-doerun-idUSN138992720110414.

[18] Investor-State dispute settlement is also contained in U.S. FTAs with Chile, Singapore, Morocco, and Oman. While a bilateral investment treaty (BIT) is in force between the United States and Morocco, its investor-State and State-State dispute settlement provisions were suspended as of January 1, 2006, the date the U.S.-Morocco FTA entered into force; these provisions continue to apply for ten years from this date, however, for investments covered by the BIT as of January 1, 2006, and for BIT disputes that arose prior to this date. Neither the U.S.-Jordan FTA nor the U.S.-Bahrain FTA contains an investment chapter; instead, bilateral investment treaties (BITs) are in force between the parties. While both the U.S.-Australia FTA and the U.S.-Canada Free Trade Agreement (CFTA) contain investment obligations, neither provides for investor-State dispute settlement; the CFTA was suspended, however, upon the entry into force of the NAFTA. The U.S.-Israel FTA, the earliest U.S. free trade agreement, does not contain an investment article, nor have the parties entered into a BIT.

[19] For further discussion of Korean investment in the United States, see CRS Report RL34330, *supra* note 1, at 38.

Implementing legislation approving the KORUS FTA and providing legislative authorities needed to carry it out has not yet been introduced.[20]

State-State Dispute Settlement (Chapter Twenty-Two, Section B)

State-State dispute settlement procedures in most U.S. free trade agreements generally follow the pattern of dispute settlement set out in the World Trade Organization (WTO) Dispute Settlement Understanding and thus provide for (1) initial consultations; (2) a dispute panel if consultations fail to resolve the dispute; (3) an implementation period if the challenged Party is found to be in violation of an agreement obligation; and (4) remedies for non-compliance.

State-State or general dispute settlement is set out in Chapter Twenty-Two, Section B, of the KORUS FTA, which applies to disputes involving the interpretation or application of the agreement or wherever a Party considers (1) that a measure of the other Party is inconsistent with KORUS FTA obligations; (2) that the other Party has otherwise failed to carry out its KORUS FTA obligations; or (3), with some exceptions, that an enumerated KORUS FTA benefit that the complaining Party could reasonably have expected to accrue to it—for example, a tariff reduction—is being nullified or impaired by a measure of the other Party that is not inconsistent with the agreement.[21]

Steps in a State-State Dispute Settlement Proceeding

Initial Consultations

Dispute settlement begins with a consultation request by the complaining Party, to which the other Party must promptly respond.[22] The consultation request must set out the reason for the request, identify the measure or other matter at issue, and indicate the legal basis for the complaint.

Cabinet-Level Consultations

If the dispute is not resolved within 60 days of the initial request (20 days for matters involving perishable products), either Party may request a meeting of the U.S.-South Korea Joint Committee, an administrative body established under agreement consisting of cabinet-level trade

[20] For a discussion of congressional approval requirements for the KORUS FTA, see CRS Report R41544, *Trade Promotion Authority and the U.S.-South Korea Free Trade Agreement*, by Emily C. Barbour. For discussion of congressional approval requirements for U.S. free trade agreements generally, see CRS Report 97-896, *Why Certain Trade Agreements Are Approved as Congressional-Executive Agreements Rather Than as Treaties*, by Jeanne J. Grimmett.

[21] KORUS FTA, art. 22.4. It may be noted that the application of the dispute settlement provisions of the KORUS FTA is not expressly provided for in the February 10, 2011, Agreed Minutes on Korea's new automobile fuel economy and greenhouse gas emissions regulations as applicable to imported motor vehicles. The Agreed Minutes are set out at http://www.ustr.gov/webfm_send/2555.

[22] KORUS FTA, art. 22.7.

officials of the Parties or their designees.[23] A Party may also refer a matter to the Joint Committee if the Parties fail to resolve a matter within 60 days under the consultations provisions of the labor chapter (Art. 19.7) or the environmental chapter (Art. 20.9) of the agreement.[24] In either case, the Joint Committee is to "promptly meet and endeavor to resolve the matter."[25]

Panels

Panel Establishment and Selection of Panelists

If the Joint Committee has not resolved a matter within 60 days after a referral, within 30 days where perishable goods are involved, or within another agreed-upon period, the complaining Party may refer the matter to a dispute settlement panel.[26] The panel is automatically established upon delivery of a panel request to the other Party.[27]

The agreement sets out requirements and procedures for constituting a panel unless the Parties agree on other terms.[28] Panels will consist of three members. The complaining and defending Parties appoint one panelist each. If either fails to do so within 28 days after the panel is established, the panelist is to be selected by lot from a roster of panelists, referred to in the agreement as the "contingent list."[29] Peremptory challenges are also available if an originally designated panelist is not on the contingent list. The Parties are expected to agree on a third panelist to chair the panel, but if they cannot agree to do so within 28 days after the second panelist is chosen, the Parties are to meet within seven days and choose a chair by lot from among individuals on the contingent list who are not nationals of either the United States or Korea.

Rules of Procedure

The United States and South Korea agree to establish model rules of procedure for panels by the date the agreement enters into force. These rules must ensure (1) a right to at least one hearing before the panel; (2) that hearings are open to the public, subject to the protection of confidential information; (3) that each Party may provide initial and rebuttal submissions; (4) that each Party's written submissions and responses and written versions of oral submissions and responses are

[23] KORUS FTA, art. 22.8.1. Joint Committee decisions are to be taken by consensus of the Parties, that is, without objection. KORUS FTA, art. 22.2.7. Regarding the establishment, authorities, and functions of the Joint Committee, see KORUS FTA, art. 22.2.

[24] KORUS FTA, art. 22.8.2

[25] KORUS FTA, art. 22.8.3.

[26] KORUS FTA, art. 22.9.1. The KORUS FTA contains additional provisions for establishing a panel where the dispute involves financial services obligations. See KORUS FTA, art. 13.18.

[27] KORUS FTA, art. 22.9.1.

[28] KORUS FTA, art. 22.9.2

[29] Article 22.9.3 requires the Parties, within 180 days after the KORUS FTA enter into force, to establish "a contingent list of individuals who are willing and able to serve as panelists." Unless the Parties agree otherwise, the list is to include at least six nationals of the United States, at least six nationals of South Korea, and at least eight individuals who are not nationals of either Party. Qualifications for panelists are set out at Article 29.9.4 of the KORUS FTA. For an example of past administrative practice in establishing panel rosters, see, e.g., Free Trade Agreements; Invitation for Applications for Inclusion on Dispute Settlement Rosters for the U.S.-Chile Free Trade Agreement ("FTA"), the Dominican Republic-Central America-United States FTA, the North American FTA, and the U.S.-Peru Trade Promotion Agreement, 75 Fed. Reg. 4607 (January 28, 2010).

promptly made public, subject to the protection of confidential information; and (5) that panelists consider requests from U.S. and South Korean non-governmental organizations to provide amicus briefs that may assist the panel in evaluating the submissions and arguments presented by the Parties.[30]

Panel Reports

Unless the disputing Parties agree otherwise, the panel is to present its initial report to the disputing parties within 180 days after the panel chair is appointed.[31] The report is to contain (1) findings of facts and (2) the panel's determination as to whether a disputing Party is in compliance with its KORUS FTA obligations, or whether a measure is causing nullification or impairment of KORUS FTA benefits, as the case may be, and any other panel determination that the Parties have requested the panel to make.[32] The panel must also include the reasons for its findings and determinations. At the request of the parties, the panel may also make recommendations for resolving the dispute.[33]

After considering any written comments or requests for clarifications by the Parties, the panel will issue its final report.[34] The final report is due 45 days after the initial report is presented unless the Parties agree otherwise. The report is to be made public at most 15 days later.

The panel is to base its report on the relevant provisions of the KORUS FTA and the submissions and arguments of the Parties.[35] Further, the panel is to consider the KORUS FTA "in accordance with the customary rules of interpretation of public international law, which are reflected in Articles 31 through 33 of the *Vienna Convention on the Law of Treaties* (1969)."[36] The Convention's fundamental rule of interpretation is that a treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[37]

Implementation/Remedies for Non-Compliance

Once the Parties receive the final report, they are to agree on a resolution, which should normally conform with the panel's findings and any recommendations, if so requested.[38] If the panel has found that the defending Party is in violation of its KORUS FTA obligations or is causing nullification or impairment of benefits, as the case may be, the defending Party would be

[30] KORUS FTA, art. 22.10.1.

[31] KORUS FTA, art. 22.11.1.

[32] *Id.*

[33] KORUS FTA, art. 22.11.2.

[34] KORUS FTA, arts. 22.11.3, 22.11.4

[35] KORUS FTA, art. 22.11.2.

[36] *Id.* (italics in original). The United States is not a party to the Vienna Convention on the Law of Treaties (VCLT) but considers it to be authoritative as to treaty law and practice. See generally Congressional Research Service, *Treaties and Other International Agreements: The Role of the United States Senate; A Study Prepared for the Senate Committee on Foreign Relations* 43-49 (2001)(S.Prt. 106-71). The text of the Vienna Convention is available at *id.* at 384-403.

[37] VCLT, art. 31.1.

[38] KORUS FTA, art. 22.12.

expected to eliminate the violation or the nullification or impairment.[39] This would presumably occur by the defending Party's withdrawing or modifying the challenged law, regulation, or practice, but the Parties could possibly agree to another solution.[40] Compensation, suspension of benefits, and annual monetary assessments are allowed as temporary measures pending full compliance.[41]

For purposes of U.S. law, dispute settlement results under trade agreements are considered to be non-self-executing and thus, where a federal law or regulation is faulted and the executive branch does not have sufficient delegated authority to act, legislation would be needed to comply.[42]

Compensation and Suspension of Benefits

If the defending Party needs to take action and the disputing Parties cannot agree on resolving the dispute within 45 days after receiving the final report (or within another agreed-upon period), the defending Party must enter into compensation negotiations with the complainant.[43] If the Parties cannot agree on compensation within 30 days, or if they have agreed on compensation or a means of resolving the dispute and the defending Party has not complied with the agreement, the complaining Party may suspend benefits "of equivalent effect," for example, impose tariff surcharges on selected imports from the defending Party in the appropriate amount.[44] The complaining Party must notify the defending Party of its intent, including the amount of proposed retaliation. The prevailing Party may begin suspending benefits 30 days after providing notice unless the defending party requests further panel proceedings or chooses to pay an annual monetary assessment, as described below.

If the defending Party believes that the proposed amount of retaliation is "manifestly excessive," or believes that it has complied in the dispute, it may ask the panel to reconvene to consider the issue.[45] If the panel determines that the proposed suspension of benefits is excessive, it must determine the proper level of retaliation. The complaining Party may suspend benefits up to this level, or if the amount has not been arbitrated, up to the level that it originally proposed, unless the defending Party has been found to be in compliance.

Annual Monetary Assessments (Fines)

The complaining Party may not suspend benefits if the defending Party notifies the complainant by a given date that it will pay an "annual monetary assessment" or fine.[46] The notification must

[39] KORUS FTA, art. 22.13.

[40] Cf. David A. Gantz, *Settlement of Disputes under the Central America-Dominican Republic-United States Free Trade Agreement*, 30 B.C. INT'L & COMP. L. REV. 331, 400 (2007)(discusses identical language in the CAFTA).

[41] KORUS FTA, art. 22.13.

[42] In this regard, implementing legislation for free trade agreements ordinarily contains a provision stating as follows: "No provision of the Agreement, nor the application of any such provision to any person or circumstance, which is inconsistent with any law of the United States shall have effect." See, e.g., United States-Peru Trade Promotion Agreement Implementation Act (PTPA Act), P.L. 110-138, § 102(a), 19 U.S.C. § 3805 note.

[43] KORUS FTA, art. 22.13.1.

[44] KORUS FTA, art. 22.13.2.

[45] KORUS FTA, art. 22.13.3

[46] KORUS FTA, art. 22.13.5.

be made either 30 days after the prevailing Party gives notice that it intends to suspend benefits or, if the panel is reconvened to arbitrate the amount of proposed retaliation, within 20 days after the panel renders its determination.

The disputing Parties are to consult on the amount of the fine, but if they are unable to agree within 30 days, the fine will be set at the level provided for under the agreement. This is a level, in U.S. dollars, equal to 50% of the level of benefits the panel has determined to be proper or, if there has not been a panel determination, 50% of the amount originally proposed by the complaining Party.

The assessment is to be paid to the complaining Party in equal quarterly installments beginning 60 days after the defending Party gives notice that it intends to pay an assessment, unless the Joint Committee decides instead that the assessment is to be paid into a fund and expended at the Commission's direction "for appropriate initiatives to facilitate trade between the disputing Parties including by further reducing unreasonable trade barriers or by assisting a Party in carrying out its obligations under this Agreement."[47] If the defending Party does not pay the assessment, the complaining Party may suspend agreement benefits as proposed or arbitrated, as the case may be.[48]

Compliance Review after Sanctions or Fine Instituted

As explained above, the defending Party has a right to a compliance determination by a panel before the prevailing Party imposes sanctions or the defending Party begins paying a fine. In addition, the defending Party may also seek a compliance panel after either of these actions occurs if the defending Party later believes that it has complied in the proceeding.[49] The panel is to issue its report within 90 days after the defending Party notifies the complaining Party of its panel request. If the panel decides in favor of the defending Party, the complaining Party must promptly terminate any trade retaliation and the defending Party will no longer be under an obligation to pay any monetary assessment it has agreed to.[50]

Labor and Environmental Disputes

Due to its incorporation of principles set out in the inter-branch May 10, 2007, trade agreement understanding discussed earlier, the KORUS FTA differs from most earlier FTAs with labor and environment chapters in containing additional labor and environmental obligations; not restricting its general dispute settlement procedures to specified provisions of its labor and environmental chapters; and not limiting the remedy for non-compliance with an adverse panel report to the payment of an annual monetary assessment (i.e., a fine) by the defending party.[51]

[47] KORUS FTA, art. 22.13.6.

[48] KORUS FTA, art. 22.13.7.

[49] KORUS FTA, art. 22.14.1.

[50] KORUS FTA, art. 22.14.2.

[51] An example of contrasting earlier provisions may be found in the DR-CAFTA at Articles 16.6.7, 17.10.7, and 20.17.1. For a discussion of procedures for labor and environmental disputes under the DR-CAFTA, see Gantz, *supra* note 40, at 400.

Labor Disputes

As noted, the KORUS FTA adds to the substantive labor obligations contained in most earlier FTAs and makes its State-State dispute settlement procedures generally applicable to disputes arising under Chapter Nineteen, its labor chapter. Chapter Nineteen is similar to earlier FTAs in requiring each Party to "not fail to effectively enforce its labor laws ... in a manner affecting trade or investment between the Parties,"[52] but the KORUS FTA further requires, at Article 19.2.1, that each Party "adopt and maintain in its statutes and regulations, and practices" enumerated fundamental labor rights "as stated in" the 1998 International Labor Organization (ILO) Declaration on Fundamental Principles and Rights at Work and its Follow-Up. The enumerated rights are (1) freedom of association; (2) the effective recognition of the right to collective bargaining; (3) the elimination of all forms of compulsory or forced labor; (4) the effective abolition of child labor and, for purposes of the KORUS FTA, a prohibition on the worst forms of child labor; and (5) the elimination of discrimination in respect of employment and occupation.[53] While the labor rights set out in the ILO Declaration are the subject of the so-called ILO "core" labor conventions, the KORUS FTA also provides that "[t]he obligations set out in Article, as they relate to the ILO, refer only to the ILO Declaration."[54] Moreover, to establish a violation of the obligation to adopt and maintain the enumerated ILO-related rights, the complaining Party must show that the other Party has failed to adopt or maintain a statute, regulations, or practice "in a manner affecting trade or investment between the Parties."[55]

The KORUS FTA also prohibits Parties from waiving or otherwise derogating from statutes or regulations implementing Article 19.2.1 in a manner affecting bilateral trade or investment, where the waiver or derogation would be inconsistent with a fundamental right enumerated in that

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[52] KORUS FTA, art. 19.3.1.

[53] *Id.*

[54] KORUS FTA, art. 19.2.1, n.1. The ILO core conventions themselves are not expressly referenced in Article 19.2.

The ILO recognizes eight core labor conventions, seven of which existed at the time that the 1998 Declaration was adopted. These conventions are as follows: Forced Labour Convention, 1930 (No. 29); Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87); Right to Organise and Collective Bargaining Convention, 1949 (No. 98); Equal Remuneration Convention, 1951 (No. 100); Discrimination (Employment and Occupation) Convention, 1958 (No. 111); Abolition of Forced Labour Convention, 1957 (No. 105); Minimum Age Convention, 1973 (No. 138); Worst Forms of Child Labour Convention, 1999 (No. 182). See generally Int'l Labour Office, THE INTERNATIONAL LABOUR ORGANIZATION'S FUNDAMENTAL CONVENTIONS, at http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/publication/wcms_095895.pdf.

The ILO Declaration does not place new legal obligations on ILO members regarding the ratification of these conventions, but instead, at paragraph 2, "[d]eclares that all Members, even if they have not ratified the Conventions in question, have an obligation arising from the very fact of membership in the Organization to respect, to promote and to realize, in good faith and in accordance with the [ILO] Constitution, the principles concerning the fundamental rights which are the subject of those Conventions, namely: (a) freedom of association and the effective recognition of the right to collective bargaining; (b) the elimination of all forms of forced or compulsory labour; (c) the effective abolition of child labour; and (d) the elimination of discrimination in respect of employment and occupation." To date, the United States has ratified two of the eight ILO core conventions: No. 105, concerning the abolition of forced labor, and No. 182, concerning the elimination of the worst forms of child labor. Korea has ratified No. 182, plus three others: No. 100, regarding equal remuneration; No. 111 regarding discrimination in employment and occupation; and No. 138, regarding minimum age. See lists of ratifications at http://www.ilo.org/ilolex/english/newratframeE.htm.

The text of the ILO Declaration is available at http://www.ilo.org/declaration/thedeclaration/textdeclaration/lang--en/index.htm. For discussion of its adoption, see Brian A. Langille, *The ILO and the New Economy: Recent Developments*, 15 INT'L J. COMP. LAB. L. & INDUS. REL. 229 (1999).

[55] KORUS FTA, art. 19.2.1, n.2.

article.[56] It also includes within its domestic labor law enforcement requirement laws adopted or maintained in accordance with the ILO-related provision.[57]

As under earlier agreements, a Party must first seek to resolve a labor issue under the labor chapter's consultation provisions before it may invoke general KORUS FTA dispute settlement provisions.[58] If initial consultations fail to resolve the dispute, either Party may request the assistance of the Labor Affairs Council created under the agreement, a body comprised of appropriate senior officials from the labor ministries or agencies of each Party.[59] If the Parties fail to resolve a dispute within 60 days after Chapter Nineteen consultations are requested, the complaining Party may seek consultations or a meeting of the U.S.-Korea Joint Committee under the general dispute settlement chapter and, following this, may invoke the rest of the chapter.[60]

Unlike most earlier FTAs with labor chapters, the prevailing Party in a KORUS FTA dispute would not be initially limited to seeking the payment of an annual monetary assessment or fine by the defending Party in the event that the Party had not complied with its obligations in a case. Fines under these earlier agreements are imposed by the panel and are ordinarily capped at $15 million annually, adjusted for inflation. The fine is to be paid into a fund administered by representatives of the disputing parties for distribution to the non-complying Party for labor initiatives, including efforts to improve labor law enforcement in its territory. The prevailing Party has a right to impose trade sanctions under these earlier agreements, however, if the defending Party fails to pay the monetary assessment.

Instead, because the general dispute settlement procedures of the KORUS FTA would generally apply to labor disputes to the same extent as disputes involving commercial obligations, the prevailing Party in a dispute would have the right to impose trade sanctions initially on the non-complying Party based on the value of the dispute. As noted earlier, where a prevailing KORUS FTA Party does propose trade sanctions, the defending Party would then have the *option* of paying an annual monetary assessment to the prevailing Party, or, if the Parties agree, to a fund that would distribute funds to the defending Party to facilitate compliance in the proceeding.

Environmental Disputes

As is the case with labor issues, the KORUS FTA differs from most earlier FTAs with respect to substantive environmental obligations as well as the extent to which its general dispute settlement procedures apply to environmental disputes. Like earlier FTAs, Chapter Twenty of the KORUS FTA, the agreement's environment chapter, requires each Party to "not fail to effectively enforce its environmental laws ... in a manner affecting trade or investment between the Parties."[61] It also

[56] KORUS FTA, art. 19.2.2.

[57] KORUS FTA, art. 19.3.1(a).

[58] KORUS FTA, art. 19.7.5.

[59] KORUS FTA, arts. 19.7.3, 19.5.1.

[60] KORUS FTA, art. 19.7.4.

[61] KORUS FTA, art. 20.3.1. The term "environmental law" is defined to mean laws whose primary purpose is to protect the environment or to prevent a danger to human, animal, or plant life of health through: "(a) the prevention, abatement, or control of the release, discharge, or emission of pollutants or environmental contaminants; (b) the control of environmentally hazardous or toxic chemicals, substances, materials, and wastes, and the dissemination of information related thereto; or (c) the protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas, in areas with respect to which a Party exercises sovereignty, sovereign rights, or jurisdiction, but does not include any statute or regulation, or provision thereof, directly related to (continued...)

places a new requirement on each Party to "adopt, maintain, and implement laws, regulations and all other measures to fulfill its obligations" under listed multilateral environmental agreements (MEAs), and includes laws implementing the MEAs within its domestic enforcement obligation.[62] To establish a violation of the MEA implementation requirement, however, the complaining Party must also demonstrate that the other Party has failed to act in a manner affecting bilateral trade or investment between the Parties.[63] KORUS FTA general dispute settlement procedures apply to disputes arising under Chapter Twenty, but in any such case, the complaining Party may not resort to these procedures unless it first seeks to resolve the matter under the environment chapter's consultation provisions.[64] If the Parties cannot resolve the dispute in initial consultations under the chapter, either Party may request the assistance of the Environmental Affairs Council, a KORUS FTA-created entity to be comprised of "appropriate senior official from each Party, including officials with environmental responsibilities."[65] If the Parties fail to resolve a dispute within 60 days of the initial consultation request, the complaining Party may seek consultations or a meeting of the U.S.-Korea Joint Committee under KORUS FTA general dispute settlement procedures and may then proceed under the general dispute settlement chapter if it so chooses.

If a dispute panel is convened and the dispute involves an obligation under a covered multilateral environmental agreement, the panel must follow specified directions in making its findings and determination as to whether the defending Member is in compliance with its KORUS FTA environmental obligations.[66] For example, where the MEA "admits of more than one permissible interpretation relevant to an issue in the dispute and the Party complained against relies on one such interpretation," the panel is to accept that interpretation for purposes of its findings and determination.[67]

Unlike most earlier FTAs with environment chapters, the prevailing Party in a dispute would not be initially limited to seeking the payment of a fine by the defending Party in the event the Party has not complied in the case. As in labor disputes, such fines are imposed by the panel and ordinarily capped at $15 million annually, adjustable for inflation. The fine is paid into a fund for distribution to the defending party to assist it in complying with its agreement obligations. The prevailing party may impose sanctions under these agreements, however, if the defending Party has not paid the fine that has been assessed.

As would be the case with labor disputes, KORUS FTA dispute settlement procedures would generally apply to environmental disputes to the same extent as disputes involving commercial obligations and, thus, the prevailing Party would have the right to impose trade sanctions initially

(...continued)

worker safety or health." KORUS FTA, art. 20.11.

[62] KORUS FTA, art. 18.2. Listed multilateral environmental agreements (MEAs) are the Convention on International Trade in Endangered Species, the Montreal Protocol on Substances that Deplete the Ozone Layer, and conventions on prevention of pollution from ships, wetlands, and various marine species. KORUS FTA, Annex 20-A. Other MEAs may be added by mutual consent in the future. The KORUS FTA also generally requires Parties not to derogate from environmental laws in a manner that weakens protections afforded in those laws in a manner affecting bilateral trade and investment, KORUS FTA, art. 20.3.2.

[63] KORUS FTA, art. 20.2, n.1.

[64] KORUS FTA, art. 20.9.5.

[65] KORUS FTA, arts. 20.9.3, 20.6.1

[66] KORUS FTA, art. 20.9.6

[67] KORUS FTA, art. 20.9.6(c).

on the non-complying Party based on the value of the dispute. In the event the prevailing KORUS FTA Party does propose trade sanctions, the defending Party, as in labor disputes, would then have the *option* of paying an annual monetary assessment to the prevailing Party, or, if the Parties agree, to a fund that would distribute funds to the defending Party to facilitate compliance with its obligations in the case.

Alternative Procedures for Disputes Concerning Motor Vehicles (Annex 22-A)

If a matter that may be brought to dispute settlement under the KORUS FTA Chapter Twenty-Two, Section B, "relates to motor vehicles," the United States or Korea may choose to initiate dispute settlement procedures under Annex 22-A of the KORUS FTA instead of under the general KORUS FTA dispute settlement procedures just described. Annex 22-A varies from Chapter Twenty-Two in three major ways: (1) panels would have the added task of determining if a measure found to be violative "materially affects" originating goods of the complaining Party; (2) the process would be subject to shorter deadlines than those in Chapter Twenty-Two; and (3) in the event of panel findings adverse to the defending party, a tariff increase or "snap-back" on motor vehicles of the Party that qualify as originating goods would be immediately available to the complaining Party as a remedial measure.

Annex 22-A procedures are to terminate 10 years after the KORUS FTA enters into force so long as no panel established under the Annex during this 10-year period has determined that a Party has violated the agreement or has imposed a measure that has caused nullification or impairment of KORUS FTA benefits.

Consultations

Annex 22-B provides that unless the Parties otherwise agree, the following rules will apply. The complaining Party would first refer the matter to the KORUS FTA Joint Committee, which will be given 30 days (instead of the usual 60 days) to resolve the issue. If the Joint Committee fails to do so, the complaining party may notify the other Party that it is referring the matter to a panel. Within seven (as opposed to the usual 28) days after the complainant gives notice, the Parties are to select panelists by lot from the "contingent list" described earlier. The panel is to be composed of one national of Korea, one national of the United States, and one person who is not a national of either who will serve as chair.

Panels

The Chapter Twenty-Two rules of procedure and the Article 22.11 procedures for panels will apply to such disputes except for the following. The panel must decide not only if there is a violation or nullification or impairment of benefits, as the case may be, but also whether the challenged measure "has materially affected the sale, offering for sale, purchase, transportation, distribution, or use of originating goods of the complaining party," that is, goods that satisfy the rules of origin set out in Chapter Six of the agreement. The agreement does not define the term "materially affected," nor does it specify the types of originating goods that may be affected.

In addition, the panel process would be expedited as follows: (1) the initial panel report must be presented to the Parties within 120 days after the panel is established instead of 180 days; (2)

each Party may submit written comments on the initial report within 7 days of receiving the report instead of 14 days; and (3) the final report is due within 21 days after the initial report is presented instead of the usual 45 days.

Remedy: Automatic Tariff Increase

Further, if both the panel determinations are adverse to the defendant,[68] the complaining Party may increase the rate of customs duty on originating goods under tariff heading 8703, that is, passenger motor cars and other motor vehicles, to its "prevailing most-favored-nation applied rate of duty" on those goods. This current most-favored-nation (MFN) rate for the covered items is 2.5% in the United States and 8% in South Korea. The snap-back does not apply with respect to trucks, which are covered under tariff heading 8704 and are subject to a 25% MFN rate in the United States.

Determining Compliance/Removing Increased Tariff

These increased duties may remain in effect until the defending Party complies. If the defending Party believes it has complied and the duties are not removed, it may request that the original panel reconvene to determine whether or not the Party has complied. The panel must reconvene as soon as possible after it has received such a request and deliver its report to the Parties within 90 days after it does so. If the panel decides in favor of the defending Party, the complaining Party must promptly rescind the duties.

Relationship of Annex 22-A to February 2011 Exchange of Letters on Automotive Issues

On February 10, 2011, the United States and Korea exchanged letters on various issues involving motor vehicle tariffs, safety standards, transparency, and safeguards, referring to the exchange as an "understanding."[69] The Parties made specific provisions of the KORUS FTA applicable to the understanding, including the KORUS FTA general exceptions for obligations related to trade in goods (Article 23.1.1), and additionally agreed to apply the KORUS FTA general dispute settlement provisions as well as Annex 22-B to the understanding, *mutatis mutandis*, that is, with the necessary changes having been made.[70] The letters also contain various clarifications as to possible elements of disputes involving the understanding, including that "Neither Party may claim in a dispute settlement proceeding that a measure is inconsistent with one or more provisions of the KORUS FTA if the measure is consistent with the relevant provisions of this understanding."[71]

[68] If the panel finds a KORUS FTA violation or a nullification of benefits, as the case may be, but does not find the requisite "material" effect on originating goods, the ordinary Chapter Twenty-Two provisions for implementation and non-implementation will apply. KORUS FTA, Annex 22-A, n.5.

[69] See Letter of February 11, 2011, from Ron Kirk, United States Trade Representative to Hon. Jong-Hoon Kim, Minister for Trade, Republic of Korea, at http://www.ustr.gov/webfm_send/2557.

[70] *Id.* Section F, paras. 1-4.

[71] *Id.* Section F, para. 4, n. 9.

No Private Rights of Action

The KORUS FTA prohibits a Party from providing a private right of action under its domestic law against the other Party on the ground that the latter has failed to conform with its KORUS FTA obligations.[72]

If past FTA practice is observed, KORUS FTA implementing legislation would preclude private rights of action under the KORUS FTA or private rights of action based on congressional approval of the agreement.[73] The implementing legislation would also prohibit persons other than the United States from challenging any action or inaction by a U.S. federal, state, or local agency on the ground that the action or inaction is inconsistent with the KORUS FTA.[74]

Investor-State Dispute Settlement (Chapter Eleven, Section B)

Like bilateral investment treaties (BITs) and the investment chapters of other U.S. free trade agreements, Chapter Eleven, the KORUS FTA investment chapter, sets out rights and obligations aimed at facilitating investment by nationals of the United States and Korea in each other's territory. It also contains investor-State dispute settlement provisions providing for compulsory arbitration of investment disputes between investors and the State parties to the FTA.[75]

Overview of Investment Obligations

As in other U.S. investment agreements, key elements of Chapter Eleven are its coverage of all forms of investment and the fundamental obligations placed on the Parties to accord foreign investors and investments national and most-favored-nation (MFN) treatment; to grant foreign investments also a minimum standard of treatment (set out here as "treatment in accordance with customary international law, including full protection and security");[76] to compensate investors

[72] KORUS FTA, art. 22.16.

[73] See, e.g., PTPA Act, P.L. 110-138, § 102(c)(1), 19 U.S.C. § 3805 note. See also H.Rept. 100-421, at 9.

[74] See, e.g., PTPA Act, P.L. 110-138, § 102(c)(2), 19 U.S.C. § 3805 note.

[75] The United States and Korea had engaged in negotiations over a bilateral investment treaty in the late 1990s, but negotiations were later suspended reportedly due in large part to issues related to domestic restrictions involving the Korean film industry. CRS Report RL30566, *South Korea-U.S. Economic Relations*, by Mark E. Manyin, at 20; see also *Model BIT Review Delayed Indefinitely; Korean BIT Still Pending*, INSIDE U.S. TRADE, January 14, 2000.

[76] As is the case with the U.S.-Peru Trade Promotion Agreement and pending FTAs with Colombia and Panama, the KORUS FTA does not adopt the broad interpretation of "fair and equitable treatment" applied by some early NAFTA arbitral panels and instead expressly provides that treatment must be in accordance with "customary international law." The agreement also contains an annex stating what constitutes the Parties' shared understanding of the quoted term, specifically, that such law "results from a general and consistent practice of states that they follow from a sense of legal obligation."

Article 1105(1) of the NAFTA states that each Party "shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." In response to the above-referenced NAFTA cases, none of which involved the United States, the three NAFTA parties adopted a binding interpretation of the agreement, an action provided for under NAFTA Article 1131, stating that the minimum treatment standard set out in NAFTA Article 1105(1) "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard to be afforded to investments of investors of the other Party" (continued...)

promptly, adequately, and effectively for expropriation of their property; to permit the free transfer of investment-related funds into and out of the host Party's territory; and to refrain from imposing certain performance requirements, for example, requirements that an investment achieve a given level of domestic content or export a given level of goods or services.

While the KORUS FTA investment chapter does not contain a list of general exceptions that apply to its obligations overall, Chapter Eleven obligations are nonetheless subject to various specific exceptions, exemptions and qualifications, including the essential security exception mentioned earlier.[77] It also contains annexes to Chapter Eleven pertaining to specific investment issues, such as the situations that will give rise to a "direct" or "indirect" expropriation, and broader annexes in which a Party may (1) exempt existing non-conforming laws and regulations from certain KORUS obligations and (2) identify sectors and activities to which the Party might not accord full investment benefits with respect to both existing or future laws and regulations. These annexes permit Parties to exempt listed measures and sectors from Chapter Eleven MFN and national treatment obligations, as well as from prohibitions on performance requirements for investments and nationality requirements for senior management of firms.

The agreement itself exempts government procurement and subsidies or grants provided by a Party, including government-supported loans, guarantees or insurance, from Chapter Eleven national treatment and MFN obligations and obligations involving nationality requirements for senior management.[78] Government procurement is also exempted from those prohibitions on performance requirements focusing on domestic content, preferences for domestic goods and services, and technology transfer to domestic persons.[79] In addition, the KORUS FTA contains a GATT-like exception for certain performance requirements, stating that KORUS FTA prohibitions on performance requirements involving domestic content, local preferences, and technology

(...continued)

and that "the concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law standard of treatment of aliens." Further, in a 2009 arbitral award involving a NAFTA claim by a Canadian company against the United States, the arbitral panel adopted the U.S. view of what constitutes the minimum standard of treatment under customary international law, namely, that a governmental act will violate the standard if it is "sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below the accepted international standards." The panel further found that the U.S. federal and state measures at issue did not violate this standard and thus the United States did not deny the investor "fair and equitable treatment" under Article 1105 of the NAFTA. Glamis Gold, Ltd. v. United States, paras. 627, 824-829, at http://www.state.gov/documents/organization/125798.pdf. This narrow interpretation of the customary internal law minimum standard was set out in *Neer v. Mexico*, a 1926 case involving a claim before the Mexican-U.S. General Claims Commission. Neer v. United Mexican States, para. 4, at http://untreaty.un.org/cod/riaa/cases/vol_IV/60-66.pdf.

For further discussion, see Stephen W. Schill, *Glamis Gold, Ltd. v. United States*, 104 AM. J. INT'L L. 253 (2010); *New Investment and Dispute Settlement Provisions in U.S.-Peru Trade Agreement*, 103 AM. J. INT'L L. 768, 769 (2009), and Andrew P. Tuck, *The "Fair and Equitable Treatment" Standard Pursuant to the Investment Provisions of the U.S. Free Trade Agreements with Peru, Colombia and Panama*, 16 LAW & BUS. REV. AM. 385 (2010).

[77] See *supra* note 9 and accompanying text.

[78] KORUS FTA, art. 11.11.5. The agreement contains a separate procurement chapter, see KORUS FTA, Chapter Seventeen, and both the United States and Korea are parties to the WTO Agreement on Government Procurement.

[79] KORUS FTA, art. 11.8(3). See also KORUS FTA, art. 11.8.3(a), n.5, exempting from the prohibition on performance requirements involving the establishment, operation or disposition of an investment requirements by a KORUS FTA host country to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory, provided the host country does not require that technology be transferred to a particular person in its territory.

transfer are not to be construed to prevent a Party from adopting or maintaining measures, including environmental measures, that are (1) necessary to secure compliance with KORUS FTA-consistent laws and regulations; (2) necessary to protect human, animal, or plant life or health; or (3) related to the conservation of living or non-living exhaustible natural resources, provided that the measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment.[80]

A KORUS FTA Party may deny Chapter Eleven benefits to investors of the other Party that are enterprises and to their investments in two circumstances, these taking into account sanctions regimes and shell companies established to take advantage of KORUS FTA benefits. These situations are as follows:

1. if the persons of a non-Party own or control the enterprise *and* (a) the denying party does not maintain normal economic relations with the non-Party *or* (b) it adopts or maintains measures with the non-Party that would prohibit transactions with the enterprise or would be violated if Chapter Eleven benefits were accorded to the enterprise or its investments;
2. if the enterprise has no substantial business activities in the territory or the other Party *and* persons of a non-Party, or of the denying Party, own or control the enterprise.

The KORUS FTA also incorporates language reflecting a trade negotiating objective set out in the Trade Act of 2002, namely that negotiators, in seeking to reduce foreign investment barriers, also ensure that "foreign investors in the United States are not accorded greater *substantive* rights with respect to investment protections than United States investors in the United States,"[81] an issue raised by various critics of FTAs that was also addressed in the May 10 understanding discussed earlier. To this end, the KORUS FTA states in its preamble that the Parties are resolved to "Agree that foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement."

Investor-State Dispute Settlement Procedures

Another long-standing and fundamental element of BITs and FTA investment chapters that is contained in the KORUS FTA is its provision for investor-State dispute settlement, permitting U.S. investors in Korea and, likewise, Korean investors in the United States, to file arbitral claims against Korea and the United States, respectively, for violations of Chapter Eleven obligations. Claims may involve not only federal measures, but also measures of states and localities to the extent they are subject to Chapter Eleven obligations.

An arbitral proceeding may be initiated by an "investor of a Party" on the ground that (1) the other Party has breached a KORUS FTA investment obligation, an investment authorization, or an

[80] KORUS FTA, art. 11.8(3)(c). In addition, nothing in the KORUS FTA investment chapter may be construed "to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns." KORUS FTA, art. 11.10.

[81] Trade Act of 2002, P.L. 107-210, § 2103(b)(3), 19 U.S.C. § 3802(b)(3)(emphasis added).

investment agreement; and (2) the investor has incurred loss or damage from the breach.[82] The investor may also submit a claim alleging a breach on behalf of an enterprise of the other KORUS FTA Party that the investor owns or controls, where the enterprise is alleged to have been injured by the breach.[83] Investor-State dispute settlement may also be invoked in certain cases involving investors and investments in financial services institutions in the United States and Korea.[84]

While the KORUS FTA refers to the possible breach of an "investment authorization," neither Party has an authority that provides such authorizations, nor does the definition of this term include actions taken by a Party to enforce laws of general application such as competition laws.[85] The term "investment agreement" is defined to include specific types of agreements and to require the investor to have relied on the agreement in establishing or acquiring an investment:

> **investment agreement** means a written agreement between a national authority of a Party and a covered investment or an investor of the other Party, on which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself, that grants rights to the covered investment or investor:
>
> (a) with respect to natural resources that a national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale;
>
> (b) to supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or telecommunications; or
>
> (c) to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government.[86]

At least 90 days before submitting a claim for arbitration, the investor must deliver to the respondent government a written notice that it intends to do so.[87] Further, six months must have elapsed since the events giving rise to the claim before the investor may submit the claim to an arbitral institution.[88] Filing a notice of intent does not commit the investor to submitting the claim to arbitration in the event issues are not resolved during the required notice period. Chapter Eleven also contains a statute of limitations, prohibiting a claim from being brought if more than three years have elapsed from the date that the claimant "first acquired, or should have first

[82] An "investor of a Party" is "a Party or a state enterprise thereof, or a national or an enterprise of a Party, that attempts through concrete action to make, is making, or has made an investment in the territory of another Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his or her dominant and effective nationality." KORUS FTA, Art. 11.28. The KORUS FTA generally defines the term "national," with respect to Korea, as "a Korean national within the meaning of the *Nationality Act*," but adds that "a natural person who is domiciled in the area north of the Military Demarcation Line on the Korean Peninsula shall not be entitled to benefits under this Agreement." KORUS FTA, art. 1.4.

[83] An "enterprise of a Party" is "an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there." KORUS FTA, art. 11.28.

[84] KORUS FTA, art. 13.1.2.

[85] See the term "investment authorization" as defined in KORUS FTA, art. 11.28 and *id.* notes 16, 17.

[86] KORUS FTA, art. 11.28 (footnotes omitted). See also KORUS FTA, art. 11.16.

[87] KORUS FIA, art. 11.16.2.

[88] KORUS FTA, art. 11.6.3.

acquired, knowledge of the alleged breach" and knowledge that the claimant or enterprise "has incurred loss or damage."[89]

The United States and South Korea give their blanket consent in the KORUS FTA to the submission of Chapter Eleven investor claims against them.[90] The claimant must consent to arbitration in writing.[91] Chapter Eleven does not require that an investor, or an investor and an enterprise, exhaust local judicial or administrative remedies before a claim may be filed.[92]

The investor may submit a claim under various arbitral mechanisms, including the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the ICSID Rules of Procedure for Arbitration Proceedings,[93] UNCITRAL (United Nations Commission on International Trade Law) Arbitration Rules, or, if the disputants agree, any other arbitration institution or rules.[94] Both the United States and Korea are Parties to the ICSID Convention and may thus avail themselves of the Convention and its procedural rules.[95]

Once an investor claim is filed, a three-member arbitral tribunal will be established. One arbitrator is to be appointed by each disputing party, and the third, the presiding arbitrator, is to be appointed by agreement of the disputing parties.[96] The Secretary-General of the International Center for the Settlement of Investment Disputes (ICSID) is to serve as appointing authority for Chapter Eleven investment disputes. If the tribunal has not been constituted within 75 days after the claim is filed, the Secretary-General, if requested by a disputing party, will appoint the outstanding arbitrator or arbitrators.[97] The Secretary-General may not appoint a national of either Party as the presiding arbitrator unless the disputing parties agree.

Chapter Eleven contains rules for the conduct of the arbitration, including various provisions aimed at transparency and efficiency of the arbitral proceedings.[98] Tribunals may accept and consider *amicus* submissions from persons or entities that are not disputing parties. Tribunals are required to rule expeditiously on any preliminary objections by the defending Party that the claim submitted is legally not a claim for which a Chapter Eleven award can be made or that the dispute is not within the competence of the tribunal.[99] As a result, defending Parties need not wait for a ruling on a jurisdictional issue until the tribunal rules on the merits and may thus dispose of

[89] KORUS FTA, art. 11.18.1.

[90] KORUS FTA, art. 11.17.1.

[91] KORUS FTA, art. 11.18.2(a).

[92] Chapter Eleven, however, precludes investors (and investors and enterprises) from maintaining local proceedings and Chapter Eleven arbitrations simultaneously except for, in some cases, local proceedings for interim injunctive relief that does not involve the payment of monetary damages. KORUS FTA, arts.11.18.2, 11.18.3; Annex 11-E (separate rule for U.S. investors).

[93] Arbitrations filed under the ICSID Convention and its rules are ordinarily conducted at the headquarters of the International Centre for Settlement of Investment Disputes (ICSID), a body established under the Convention located in Washington, D.C. For further information, see the ICSID website at http://icsid.worldbank.org/ICSID/Index.jsp.

[94] KORUS FTA, art. 11.16.3

[95] For further information on arbitration under the ICSID Convention, see http://www.worldbank.org/icsid/.

[96] KORUS FTA, art. 11.19.

[97] KORUS FTA, art. 11.19.3.

[98] KORUS FTA, art. 11.20.

[99] KORUS FTA, arts. 11.20.6, 11.20.7.

frivolous claims at an early stage without needing to expend resources on further defense of the claim. Multiple claims with certain common elements may be consolidated. Subject to provisions aimed at preventing disclosure of protected information, documents submitted by the parties and tribunal orders, awards, and decisions are to be made available to the public. The tribunal must also conduct public hearings.

When a claim involves an alleged breach of a KORUS FTA obligation (as opposed to the breach of an investment agreement), the tribunal is to decide the issues in accordance with the KORUS FTA and "applicable rules of international law."[100] In the event that the U.S.-Korea Joint Committee issues an interpretation of a KORUS FTA provision, as it is authorized to do under Article 22.3.3(d) of the agreement, the decision declaring the interpretation would be binding on the tribunal and any tribunal decision or award must be consistent with the Joint Committee decision.[101]

A tribunal may only make monetary awards and thus may not direct a Party to withdraw or modify a disputed measure.[102] An award may consist of monetary damages, restitution of property, or both. If restitution is awarded, the Party is to pay monetary damages and applicable interest in lieu of restitution. The tribunal may also award costs and attorneys' fees. It may not award punitive damages.

An arbitral award has no binding force except between the disputing parties and with respect to the case at hand.[103] A prevailing investor may not seek enforcement of the final award until 90 or 120 days after it is issued (depending on the arbitral rules used), a period allowing for possible proceedings to revise or annul the award.

If the Party does not ultimately abide by a final award, the investor may request that a panel be established under the KORUS FTA State-State dispute settlement chapter and ask that it determine that the defending Party's failure to comply with the award is inconsistent with KORUS FTA obligations and recommend that the Party comply.[104] Regardless of whether a compliance panel is sought, however, the prevailing investor may seek judicial enforcement of the award under either the ICSID Convention or the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, two multilateral conventions providing for the recognition and enforcement of foreign arbitral awards to which the United States and Korea are party.[105]

[100] KORUS FTA, art. 11.22.1. Certain special rules apply in an investor-State proceeding where an investor alleges that Korea as breached an investment obligation involving payments and transfers. KORUS FTA, Annex 10-G.

[101] KORUS FTA, art. 11.22.3. See supra note 76 for an example of a binding interpretation adopted by the NAFTA Parties. See also KORUS FTA, art. 11.23, permitting responding Parties to request interpretations of KORUS FTA Annexes by the Joint Committee.

[102] KORUS FTA, art. 11.26.1.

[103] KORUS FTA, art. 11.26.5.

[104] KORUS FTA, Art. 11.26.9.

[105] KORUS FTA, Art. 11.26.10.

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