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The Australian Trade Policy Statement on Investor-State Dispute Settlement

By Jürgen Kurtz



Introduction

On April 12, 2011, the Australian Government released a Trade Policy Statement outlining a series of five principles and six disciplines that will guide Australian trade policy in the future. Having laid out a comprehensive map, the Statement pointedly expresses opposition to investor-state dispute settlement

provisions in future Australian trade agreements:

The Gillard Government supports the principle of national treatment—that foreign and domestic businesses are treated equally under the law. However, the Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will the Government support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses. The Government has not and will not accept provisions that limit its capacity to put health warnings or plain packaging requirements on tobacco products or its ability to continue the Pharmaceutical Benefits Scheme.

In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice. If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries.[1]

This *Insight* analyzes the background to this deep shift in policy and evaluates its likely implications.

The Trade Policy Statement: Context and Focus

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Australia is currently a signatory to twenty-two bilateral investment treaties (BITs), most of which have been signed with developing states.^[2]

Australia's BITs provide substantive protections for foreign investors and their investments in the territory of a party (including guarantees against discrimination and the payment of market-based compensation in the event of expropriation). On a procedural level, all of these BITs give foreign investors (of a state party) the right to bring a claim for breach of treaty protections directly against another state party in a range of international *fora*, including the World Bank-based International Centre for the Settlement of Investment Disputes. Unlike other mechanisms to resolve disputes in international law, investor-state dispute settlement does not require a foreign investor to convince its government to espouse a legal claim or to exhaust local remedies in the host state before bringing the claim. Historically, capital-exporting states have insisted on this strong form of dispute settlement to insulate their economic actors from the under-developed regulatory and judicial institutions of developing and transition economies.

Australia is also a member of the World Trade Organization (WTO). Since 2000, it has entered into six free trade agreements (FTAs)^[3], four of which contain investment chapters (based on the BIT model) with rights to investor-state dispute settlement.^[4] The Australian Government's Statement begins by setting the contours of Australia's future *trade* policy, with a clear focus on the complex question of whether that policy is best implemented via multilateral processes (such as the WTO) and/or through bilateral and regional treaties. The Australian Government is increasingly sceptical of the latter as mechanisms to achieve meaningful trade liberalization. In the Government's view, "[m]ultilateral agreements offer the largest benefits" while "[r]egional and bilateral agreements must not weaken the multilateral system – they must be genuinely liberalising, eliminating or substantially reducing barriers to trade."^[5] We may then be witnessing a shift back to the principled commitment to multilateralism that characterized both Australian trade policy and Australia's broader engagement with international legal institutions from the 1950s to late 1990s.^[6] Yet the practical feasibility of a strong move away from bilateral and regional FTAs is not without question. The Doha Round of WTO negotiations remains in stalemate (despite having commenced in 2001), and even the WTO has recently conceded that preferential trade agreements are critical mechanisms to achieve deep levels of economic integration.^[7]

Background and Process: The Role of the Australian Productivity Commission

The Policy Statement's substantive conclusions were based on a November 2010 Research Report on Bilateral and Regional Trade Agreements by the Australian Productivity Commission, an independent research and advisory body with expertise in economic analysis.^[8] The Commission's past reports on the benefits and costs of increased trade liberalization have offered Australian governments a powerful mechanism to resist the siren call of protectionism in the policy-making process. The 2010 Research Report builds on this long experience in rigorous quantitative analysis, especially in its probing assessment of the limited net economic benefits of bilateral and regional trade agreements.^[9]

By contrast, the Commission's framing and analysis of investment disciplines is shallower and less sophisticated, perhaps reflecting its inexperience with international investment law. It begins by selectively focusing on quantitative liberalization of border restrictions to entry of foreign capital (such as screening processes) in coming to a conclusion that the direct economic impacts from Australia's FTA provisions on investment and services "to date have been modest."^[10] On this point, the Commission is employing a classic methodology typically used when assessing the benefits from increased foreign trade. But unlike trade in goods, the critical barriers to foreign investment do not usually take the form of simple border measures whose effects are easily quantifiable. Of far greater import is the panoply of behind-the-border regulatory interventions, which, if discriminatory or arbitrary, can lessen or even extinguish the profitability of foreign investment in the receiving state.

The Commission's report also singles out Australia's defensive interests in protecting Australian policy space against restriction by trade and investment disciplines (including investor-state arbitration). But it neglects to properly balance those defensive costs against benefits to Australia's offensive interests (understood as the protection of outbound Australian capital). Even though the Commission's report earlier identifies the sectoral distribution of Australian capital inflows and outflows, it fails to apply those facts in its analysis of the substantive value of investment law.

For example, the Commission records the steep growth in outward investment by Australian companies in the mining sector in 2001-2008.^[11] This raises the logical question of what specific operating risks these Australian companies face and how investment treaty disciplines might reduce those risks. The political economy literature addresses this exact question, pointing out that resource-seeking FDI is far more susceptible than other forms of FDI to an "obsolescing bargain."^[12] Natural resource projects have a long duration and high up-front capital costs. Those enormous costs are also truly sunk, having little or no alternative use value, thereby significantly constraining the ability of the foreign investor to exit the host state. It is this deep *ex post* immobility of FDI in the resources sector that creates a strong potential for host governments to raise demands on foreign investment which can extend from readjustment of production shares, royalty rates, or corporate taxes to full-blown expropriation. In contrast, in other types of FDI (including efficiency and market-seeking FDI), foreign investors retain substantial *ex post* bargaining power and so are less vulnerable to host country tactics.^[13] Instead of engaging with this nuanced literature, the Commission merely offers a summary claim that because of "reputational effects" on an expropriating government's economy, the risks of expropriation for *any* form of foreign investment "are likely to be limited."^[14]

When it comes to investor-state dispute settlement, the Commission begins by pointing to a range of problems implicating both process (including lack of transparency) and outcome (inconsistency and expansive substantive rulings) concerns.^[15] The resulting assessment that "there are considerable policy and financial risks arising from ISDS [Investor-State Dispute Settlement] provisions"^[16] substantially colors its general recommendation "that Australia should seek to avoid accepting ISDS provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already provided by the Australian legal system."^[17]

It is surprising that the Commission, with its deep familiarity of the international trading system, did not consider nuanced alternatives in meeting Australia's key defensive concerns. States can protect domestic policy space in an investment treaty by clearly delineating the outer limits of substantive obligations and/or crafting exceptions for state conduct. For instance, the investment chapter of an Australian FTA could include exceptions modeled on the carve-outs in WTO law for, *inter alia*, public health and environmental regulation. Very recent Australian treaty practice adopts this approach,^[18] which Canada has used in all of its investment treaties since the NAFTA.^[19] With such an exception in an FTA, and provided that the FTA partner is a transition state (with an underdeveloped judicial system), it may not be desirable for Australia to forego investor-state arbitration because of purely defensive reasons. In particular, Australian investors abroad (especially in the resources sector) would be significantly exposed to regulatory risk as they would be limited to poorly equipped domestic court mechanisms and, even more importantly, could not "bargain in the shadow of an investment treaty" when dealing with host governments.

There are two reasons why the Australian Government may have been especially receptive to the poorly structured conclusions of the Productivity Commission on investor-state arbitration. For one, those commercial actors who would stand to benefit the most from inclusion of investor-state dispute settlement in FTAs did not engage meaningfully with the Commission as "it received no feedback from Australian businesses or industry associations indicating that ISDS were of much value or importance to them."^[20]

In addition, key domestic imperatives are driving the current hostility to investor-state dispute settlement. The Government has just released an Exposure Draft of a Tobacco Plain Packaging Bill.^[21] The proposed Australian law is far more stringent than Uruguayan tobacco legislation mandating “single presentation” of cigarette brands, which triggered an investor-state claim against Uruguay for breach of the Switzerland-Uruguay BIT.^[22] Under the Australian scheme, tobacco producers would be prevented entirely from using their trade marks on cigarette packets. The Australian Government is clearly concerned about the domestic constitutional implications of this move, especially potential claims for breach of a constitutional guarantee against property takings unless on “just terms” (in Section 51(xxxi) of the Australian Constitution). To counter a constitutional challenge, the draft Bill explicitly preserves trademarks but bans their actual use on cigarette packets,^[23] and also includes a savings clause preserving some parts of the scheme if “its operation would result in an acquisition of property from a person otherwise than on just terms.”^[24] Clearly, if there is a risk of domestic constitutional claims of expropriation, the Government anticipates an equal (if not heightened) potential for investor-state challenges.^[25] That fear has proven to be entirely justified. A bare two months after the release of the Policy Statement, Philip Morris Asia announced the start of an investor-state claim against the plain tobacco legislation under the Hong Kong-Australia BIT.^[26]

Conclusion

The practical implications of the shift in policy may be less than expected, at least in the short-term. Investor-state arbitration is firmly on the negotiating table in a range of current treaty negotiations involving Australia, including the Trans-Pacific Partnership (TPP) trade agreement with Brunei Darussalam, Chile, New Zealand, Peru, Singapore, the United States, and Vietnam. Consistent with the Trade Policy Statement, Australian negotiators may seek to exclude investor-state dispute settlement in the TPP insofar as it applies to Australia but without rejecting its application among other treaty partners. There is precedent for this type of plurilateral structure in the exchange of letters among Australia and New Zealand accompanying the 2010 ASEAN-Australia-New Zealand Free Trade Agreement.^[27]

Harder questions will surround bilateral FTAs where a significant treaty partner insists on investor-state dispute settlement as a core deal breaker. The obvious candidate here is China (with whom Australia has been negotiating an FTA since 2005), given the massive size of inflows of Chinese FDI into Australia, justifiable complaints surrounding the past treatment of proposed Chinese investment in the Australian resources sector, and the deep shift in Chinese treaty policy over the last ten years to reflect China’s strategic interest as a capital exporter.

On a longer-term basis, the new Australian policy may have its greatest impact on the contestation between defenders and opponents of the investment treaty system. Australia’s policy shift (even if based on shaky analysis) will make it far more difficult for the defenders of the system to marginalize growing state opposition to investment treaties as confined to a handful of developing (and largely Latin American) states. Time will tell, however, of the resilience of the new Australian policy. This is an initiative of a minority (centre-left) government which is facing steep and mounting domestic political challenges. In the event of a change in government, the policy could well be scrapped, especially as the other major Australian political party was responsible (when in power) for the commencement of FTA negotiations in 2000.

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Law School, Australia, and directs the International Investment Law Research Programme at the Law School's Institute for International Law and the Humanities. The author would like to thank the Editorial Board for their valuable comments on an earlier draft. He can be contacted at j.kurtz@unimelb.edu.au.

Endnotes:

[1] AUST. GOV'T, DEP'T OF FOREIGN AFF. & TRADE, GILLARD GOVERNMENT TRADE POLICY STATEMENT: TRADING OUR WAY TO MORE JOBS AND PROSPERITY 14 (Apr. 2011), *available at* <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html> [hereinafter TRADE POLICY STATEMENT].

[2] This number was compiled using UNCTAD's Investment Instruments Online database, which lists a total of twenty-three BITs concluded by Australia (as of June 1, 2010). In the author's view, however, the investment instrument listed with New Zealand (signed on Feb. 16, 2010) is mistakenly included as a BIT in UNCTAD's database. That 2010 instrument is a Protocol on Investment, which supplements the 1983 Australia–New Zealand Closer Economic Relations Trade Agreement. The Protocol is thus more accurately to be understood as an investment component of a generalized trade agreement. See UNCTAD, BILATERAL INVESTMENT TREATIES, http://www.unctadxi.org/templates/docsearch_779.aspx. For a complete list of Australian FTAs (including the 2010 Protocol on Investment with New Zealand), see <http://www.dfat.gov.au/fta/index.html>.

[3] Australia has free trade agreements with ASEAN–New Zealand, Chile, New Zealand, Singapore, Thailand, and the United States. *Id.*

[4] Rights to investor-state dispute settlement can be found in Australia's free trade agreements with ASEAN–New Zealand, Chile, Singapore, and Thailand. *Id.*

[5] TRADE POLICY STATEMENT, *supra* note 1, at 9.

[6] See *generally* ANN CAPLING, AUSTRALIA AND THE GLOBAL TRADE SYSTEM: FROM HAVANA TO SEATTLE (2001).

[7] See *generally* WTO, World Trade Report 2011–The WTO and Preferential Trade Agreements: From Co-Existence to Coherence (2011), *available at* http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report11_e.pdf.

[8] Productivity Comm'n, Research Report: Bilateral and Regional Trade Agreements (Nov. 2010), *available at* <http://www.pc.gov.au/projects/study/trade-agreements/report> [hereinafter Productivity Commission Report]. The Trade Policy Statement explicitly acknowledges the foundational role of this Research Report. See TRADE POLICY STATEMENT, *supra* note 1, at 16, and Attachment (Government responses to recommendations of the Productivity Commission report on bilateral and regional trade agreements).

[9] Productivity Commission Report, *supra* note 8, at 117-145.

[10] *Id.* at 161.

[11] *Id.* at 33.

[12] RAYMOND VERNON, SOVEREIGNTY AT BAY: THE MULTINATIONAL SPREAD OF U.S. ENTERPRISES 46-59 (1971). See also Robert Grosse, *The Bargaining View of Business-Government Relations*, in INTERNATIONAL BUSINESS AND GOVERNMENT RELATIONS IN THE 21ST CENTURY 273-90 (Robert Grosse ed., 2005).

[13] Stephen Kobrin, *Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries*, 41 INT'L ORG. 609-38 (1987).

[14] Productivity Commission Report, *supra* note 8, at 269.

[15] *Id.* at 273.

[16] *Id.* at 274.

[17] *Id.* at 276-77.

[18] *E.g.*, Agreement Establishing the ASEAN–Australia–New Zealand Free Trade Area chp. 15, art. 1(2), Feb. 27, 2009, *available at* <http://www.dfat.gov.au/fta/aanzfta/aanzfta.pdf>.

[19] Céline Lévesque, *Influences on the Canadian FIPA Model and the US Model BIT: NAFTA Chapter 11 and Beyond*, 44 CAN. Y.B. INT'L L. 249, 271 (2006).

[20] Productivity Commission Report, *supra* note 8, at 270.

[21] Tobacco Plain Packaging Bill 2011 (Cth), available at <http://www.yourhealth.gov.au/internet/yourhealth/publishing.nsf/Content/tpp-bill2011> [hereinafter Tobacco Plain Packaging Bill].

[22] FTR Holding SA, Philip Morris Products S.A. & Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, Notice of Arbitration (Feb. 19, 2010).

[23] Tobacco Plain Packaging Bill, *supra* note 21, § 14 (requirements for packaging and appearance of tobacco products); and § 15 (effect on the *Trade Marks Act 1995* of non-use of trade mark as a result of this Act).

[24] *Id.* § 11 (acquisition of property).

[25] Indeed, that concern is explicitly articulated in the part of the Policy Statement dealing with investor-state arbitration. See text accompanying *supra* note 1.

[26] Chris Kenny, *Big Tobacco Ignites Legal War*, AUSTRALIAN, June 27, 2011, <http://www.theaustralian.com.au/national-affairs/big-tobacco-ignites-legal-war/story-fn59niix-1226082403380>.

[27] Exchange of letters between the Hon Tim Groser, Minister of Trade, New Zealand and the Hon Simon Crean, Minister of Trade, Australia (Feb. 27, 2009) (confirming an agreement that Chapter 11 (Investment) of the ASEAN-Australia-New Zealand Free Trade Area “shall not create any rights or obligations between New Zealand and Australia”), available at <http://www.dfat.gov.au/fta/aanzfta/index.html#FullText>.