



Associate Professor Dr Luke Nottage
 Program Director (Comparative and Global Law), Sydney
 Centre for International Law
 Co-director, Australian Network for Japanese Law (ANJeL)

Room 640, Building F10,
 Eastern Avenue, University of
 Sydney, NSW 2006
 Telephone: +61 2 9351 0210
 Facsimile: +61 2 9351 0200
luke.nottage@sydney.edu.au

21 August 2010

Productivity Commission
 Canberra ACT
 By email: tradeagreements@pc.gov.au

**Submission to the Productivity Commission (PC) –
 Critical Analysis of the “Investor-State Dispute Settlement” (ISDS) section in the Draft Report
 (16 July 2010) from the PC’s *Review of Bilateral and Regional Trade Agreements****

Summary:

1. On this topic, the PC’s Draft Report’s Recommendation 5 states (emphasis added):

“The Australian Government should be cognisant of the capacity of legal systems in prospective partner countries to resolve disputes on all relevant aspects emerging from cross border commerce.

 - Where the legal systems of partner countries are relatively *underdeveloped*, it may be appropriate to refer cases to third party dispute settlement mechanisms.
 - However, such process should not afford foreign investors in Australia or partner countries with *legal protections not available to residents*.
 - Investor-state dispute settlement procedures should be subject to regular review to take into account changing international best practice and the evolving legal systems in partner countries.”
2. I have no great difficulty regarding the last point. However, I would urge the government to achieve that objective by:
 - a. developing and publicising a Model International Investment Agreement (IIA); and
 - b. encouraging organisations like the Australian Centre for International Commercial Arbitration (ACICA) – which has received government funding for other projects over the years – to develop and regularly update more tailored rules for Investor-State Arbitration (ISA), which the Government can then include in its IIAs as one possible procedure for investors affected by excessive host state interference.
3. However, on the first two points in Recommendation 5 the PC’s analysis is too simplistic. The Final Report needs better research, more persuasive and extensive arguments, and more

* Available, with other Submissions, via <http://www.pc.gov.au/projects/study/trade-agreements>.

careful drafting, underpinned by more wide-ranging consultation regarding the pros and cons of:

- a. including ISA even with developed countries/legal systems; and
- b. the substantive and procedural aspects of the ISA-based international law regime compared to domestic dispute resolution procedures open to local investors.

Analysis:

4. The present Draft in effect makes three brief and highly contestable arguments in favour of limiting ISA procedures in future IIAs. First, the draft expresses repeated concerns about Australia being exposed to claims from foreign investors.
 - a. But one problem here is inadequate research. For example, in the context of Australia and the US negotiating to join the Trans-Pacific Partnership Agreement (TPP, which seems likely to add ISA), the draft states that the PC “understands that no US business has been unsuccessful in pursuing [sic] an ISDS claim against a foreign government”. The Appendix below lists at least 16 unsuccessful claims, readily identifiable from publically available sources.
 - b. Other difficulties lie in the PC’s example given of expansive definitions of “investment” which can be included in IIAs.
 - i. Even if this were true and the Australian government were thereby exposed to greater claims, the flipside is that expansive definitions help Australian investors abroad. And Australia so far has only concluded IIAs with developing countries, where these claims are more likely to predominate.
 - ii. Admittedly, there is a real possibility of those countries (eg in Asia) emerging in time as net capital exporters to Australia, eventually accumulating more investment stock (and thus chance of disputes and claims against Australia) than vice versa. But one response then would be for Australia to negotiate shorter-term IIAs (especially BITs, rather than FTAs).
 - iii. Anyway, it is arguable that expansive provisions on investment in IIAs do not trump possibly more restrictive definitions in the ICSID Convention regime. So if Australia really wanted to limit its exposure, its IIAs could provide only for ICSID arbitration.
 - iv. The alternative solution is to be more careful in defining “investment” in its IIAs, balancing both short- and long-term interests for both foreign and Australian investors.
 - c. The bigger flaw in the PC’s argument is that IIAs involve give-and-take. Australia will very likely be exposed to more claims – otherwise its partner will not agree to the IIA ... or it will insist on a trade-off eg in another part of the FTA. But Australia gets the benefit of more claim potential for its own investors in the host state abroad.
 - i. In this respect, we need to consider first not just the total volume of Australian investors and investments in that country. In particular, ISA can benefit smaller investors less likely to have domestic influence on Australian government sufficient to make it bring an inter-state claims against the host state, on their behalf.

- ii. For this reason, moreover, in negotiating IIAs the Australian government should also be sure to consult widely with local businesses – not just with the large players, who may well feel that their political clout with the government, and/or indeed the host state, give them a competitive advantage over smaller existing or potential investors which it would lose by pushing the government to include ISA. (A similar phenomenon has been observed in trade liberalization initiatives. Quite often the larger players are not the most active supporters, because their economic and political influence allows them preferential access anyway.)
- 5. Secondly, the PC follows closely the Submission (No 45) by Bonnitcha and Aisbett in emphasising that foreign investors can enjoy more rights under ISA procedures than local investors who may be more efficient, thus reducing overall economic efficiency.
 - a. One problem is that, elsewhere, the government has actively promoted FDI into Australia precisely on the argument that foreign investors can bring other efficiency benefits to the local economy. The empirical question would then be whether they bring net efficiency benefits, even after allowing for ISA provisions that supposedly give more rights to foreign over local investors.
 - b. The bigger difficulty lies precisely in the argument that the ISA system affords more rights to foreign investors anyway. The core substantive rights in IIAs enforced through ISA, such as non-discrimination and “national treatment”, are designed to level the playing field, not to tilt it in favour of foreign investors.
 - i. Admittedly, there may be a very few international law rules that do favour them somewhat. An example may be the attribution of liability to the state for actions of its sub-units. However, Australia is always free to attempt to agree otherwise through specific IIA provisions. One difficulty will again be a trade-off for Australian investors, who would lose their rights to claim against the host state itself for the actions of the latter’s constituent part. And NAFTA jurisprudence reveals that it is often precisely the constituent part (eg the court system in Mississippi) that causes grief to the foreign investor (eg from Canada: *Loewen*, 42 ILM 811 (2003)). One way around that difficulty would be for Australia to negotiate a one-way provision whereby it is not liable for the actions of its own states etc, but its IIA partner is liable for actions of its constituent parts. But in dealing with developed countries Australia is unlikely to have negotiating power to impose such a provision – especially there appears to be virtually no precedent even in treaties with developing countries – and pressing for such a solution anyway undermines the perceived legitimacy of the entire ISA system.
 - ii. The preferred approach for Australia therefore should be to (a) undertake a detailed comparative analysis of domestic and international law on substantive protections for local vs foreign investors, (b) reflect the results in a Model BIT (which the country should probably do anyway, like so many counterparts nowadays world-wide – to improve efficiencies in negotiations as well as transparency of government decision-making), but then (c) adopt a short- and long-term cost-benefit approach in diverging from the Model depending on the particular circumstances and overall deal.

- c. As for procedure, although arbitration is certainly *different*, it is also difficult to grasp how ISA can be considered as giving foreign investors too much of an advantage compared to the rights afforded to nationals through local courts.
- i. For one thing, ISA may well be more expensive, even after allowing for more expansive grounds of appeal from judgments, because the court system is often heavily subsidised by the state for users.¹ Foreign investors and states pressed nonetheless to establish the ISA system because local courts displayed bigger disadvantages, such as lack of jurisdiction, expertise or professional ethics. We therefore need a more sophisticated assessment of the comparative advantages of both systems.
 - ii. The premise that ISA provides significant additional benefits only for “foreign investors” already seems implausible. There is limited – if any – evidence of forum shopping in the sense of local investors channeling investments abroad (eg into Singapore) to invest back into Australia, securing the supposed benefits of ISA.
- d. Even if the ISA procedure can be proven, on balance, to offer foreign investors more advantages than local court procedures:
- i. Australia’s IIAs could always require investors to exhaust local remedies.² Again, however, this will need to be weighed against the disbenefit (extra cost etc) to Australian investors in the particular partner country abroad – or Australia will need to press for a one-sided provision.
 - ii. An additional (perhaps Court-annexed) arbitration facility could be provided by national legislation for Australian investors wishing to claim against their own government. Again, however, there appears to be no real demand for this; local investors rarely press the government to conclude investment contracts containing arbitration provisions.
- e. Interestingly, under s2102(b) of the Bipartisan Trade Promotion Authority Act enacted by the US Congress in 2002, negotiating objectives for the government regarding ISA included “ensuring that foreign investors in the US are not accorded greater *substantive* rights with respect to investment protections than US investors in the US”. Despite this, the US Model BIT includes extensive provisions on ISA.³
6. The PC Draft argues thirdly, in suggesting that ISA may be appropriate only for Australia’s IIAs with developing countries, that ISA is less certain than developed countries’ judicial and substantive law systems protecting foreign and local investors alike against illegal government action.

¹ See eg Attorney-General’s Department “A Strategic Framework for Access to Justice in the Federal Civil Justice System” (September 2009) at <<http://www.ag.gov.au/a2j>>.

² Indeed, see already William Dodge “Investment Treaties Between Developed States: The Dilemma of Dispute Resolution” in Catherine Rogers and Roger Alford (eds) *The Future of Investment Arbitration* (OUP 2009) 165 at 179-80 (giving the example of the 1998 Hong Kong – UK BIT).

³ See generally Mark Kantor, “The New Draft Model U.S. BIT: Noteworthy Developments” (2004) 21 *Journal of International Arbitration* 383.

- a. Yet the draft already acknowledges that this uncertainty is already being reduced by more careful drafting of IIA provisions, and that the picture is already complicated by the emergence of regional Agreements (such as the TPP, but also AANZFTA which includes de facto developed countries like Singapore).
- b. In addition, we can expect the jurisprudence to become more predictable over time, rather like we witnessed in the early years of the WTO system. The latter includes a permanent Appellate Body, which has facilitated that clarification process, but this could be partly replicated by Australia negotiating for its own Appellate Review mechanism in its IIAs – possibly with a panel including pre-appointed senior arbitrators from Australia as well as other countries. It could also insert requirements for ISA awards to include more elaborate reasoning than under the current ICSID and other arbitration regimes. Such innovations would take the ISA process outside the ICSID self-contained enforcement regime, but the 1958 New York Convention provides a ready alternative nowadays.
- c. The PC's Draft also does not acknowledge that, as in most things in life, there are offsetting advantages in the ISA system anyway. One is the expertise of arbitrators chosen by the parties, compared to judges from local courts who may rarely encounter international law issues particularly in these partly commercial contexts. Another is that jurisdiction is assured, whereas courts – even in countries with “developed” legal systems such as the US – may not even be able to hear the claim.⁴ And national court systems are not necessarily paragons of certainty, even in developed countries, as investors have found in the *Loewen* case and others under NAFTA.
- d. A broader point is that Australia should be engaged in improving the overall ISA system, rather than being a “free rider” on other countries' efforts. Many developed jurisdictions are now concluding IIAs with others,⁵ as well as attempting to improve treaties concluding with developing countries. Relatedly, Australia needs to promote the legitimacy of the system, and this will not occur if developed countries all adopt the policy of only agreeing to ISA in IIAs with developing countries. That certainly gives the appearance of bias against developing countries, even if the system is not actually biased (a persistent bone of contention, as evident particularly in several states within South and Central America). In this respect, for example, Australia could take the initiative in establishing an equivalent international organization to the Geneva-based Advisory Centre for WTO Law, which it has – rather belatedly – agreed to fund to assist developing countries in using that international dispute resolution system.

⁴ Both the Australia and US governments publically declared that they omitted ISA in their 2004 FTA out of respect for each others' legal systems. Yet the implementing legislation in the US is expressly not “self-executing” so Australian investors cannot bring treaty claims in US courts, and nor can US investors claim in Australian courts: Dodge (1999) at 178. See also his “Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement” 39 (2006) *Vanderbilt J Transnational Law* 1.

⁵ Among those including ISA, Dodge (2009) lists NAFTA, the HK-Japan BIT, the Japan-Korea BIT, the US-Singapore FTA and (albeit allowing direct claims only after exhausting local remedies) the Hong Kong – UK BIT. To this list can be added the Australia-Singapore FTA, and now the Australia-Chile FTA (with a sophisticated legal system, and per capita GDP of US\$14,000 similar eg to the Czech Republic – albeit less impressive on a PPP comparison: <http://www.indexmundi.com/g/r.aspx?c=mr&v=67>) and AANZFTA (albeit including mostly developing countries, and a Side Agreement excluding ISA between Australia and New Zealand), the Japan-Switzerland FTA, and the Japan-ASEAN FTA. The TPP, with expanded membership, also seems likely to add ISA provisions.

- e. There are also more diffuse economic benefits to Australia remaining more fully engaged in the ISA system. The government has recently amended its International Arbitration Act and taken other measures aimed at “cultural reform” in arbitration, aimed at establishing Australia a regional hub for international dispute resolution.⁶ This cannot be taken seriously if the country opts out so much from the ISA system.
- f. Finally, there are broader benefits for Australia. The increased risk of claims in fact can be a good thing if it helps promote transparency, consistency and other good governance, as the ISA system aims to do. These may bring economic benefits, but even if on balance they come at a net financial cost, good governance should be part and parcel of genuine democracy. After all, Australia’s “developed” legal system does not hinder it from adopting international human rights instruments, for example.

Conclusion:

- 7. In short, Australia needs to look more closely at the long-term and more diverse national interests involved in including ISA provisions in its IIAs. The ISA system, like anything, can certainly be improved. The PC’s draft recommendation that ISDS procedures should be “subject to regular review” is welcome. But these reviews should be comprehensive, and indeed the Australian government should seriously consider developing and publicizing a broader Model BIT. Many commentators already urge greater recognition of public values and interests, ranging from more procedural transparency to clearer substantive “public interest” exceptions. Yet such improvements are achievable even when negotiating treaties on a bilateral and regional basis, and Australian IIAs in fact are already increasingly addressing such these concerns even while retaining ISA (see eg the Australia-Chile FTA).
- 8. However, apart from drafting (often diverse) specific provisions into each Agreement, there exists another means of building in more tailored procedures for ISA that better balance contemporary public interest concerns. Australian arbitration institutions (such as ACICA) could craft – and regularly re-craft – specialist ISA Rules. The government could specify these as another option in its IIAs, and then encourage foreign investors to choose those Rules (appealing eg to greater likelihood of smoother proceedings and execution of any resultant award).⁷
- 9. The ISA system therefore probably offers net benefits overall and Australia should promote it more extensively.⁸ And in fact, contrary to the impression given in the draft Report’s quote, the Law Council of Australia also supports fuller utilization of the system (see para 38 of its Submission No 47).

Yours sincerely

⁶ See, with extensive further references and broader historical and international context, Part I of Luke Nottage & Richard Garnett “Introduction” in *ibid* (eds) *International Arbitration in Australia* (Federation Press, October 2010) [manuscript available on request]: <http://www.federationpress.com.au/bookstore/book.asp?isbn=9781862878051>.

⁷ Luke Nottage and Kate Miles, “‘Back to the Future’ for Investor-State Arbitrations: Revising Rules in Australia and Japan to Meet Public Interests”, *Journal of International Arbitration*, Vol. 26, No.1, pp. 25-58, 2009; Sydney Law School Research Paper No. 08/62, <http://ssrn.com/abstract=1151167>; updated in Nottage and Garnett (eds, 2010) chapter 10.

⁸ See also some further arguments presented on my Blog at http://blogs.usyd.edu.au/japaneselaw/2010/08/good_for_the_goose_not_good_for_the.html

Luke Nottage

Appendix: (Selected) Unsuccessful ISA Claims Brought by US Investors under IIAs

US investors have had their claims dismissed in their entirety in a number of investment treaty arbitration cases on either jurisdictional or merits bases, among them the following awards:

1. Merrill & Ring v. Canada
2. UPS v. Canada
3. Azinian v. Mexico
4. Fireman's Fund v. Mexico
5. Gami v. Mexico
6. Texas Water Claims v. Mexico
7. Thunderbird v. Mexico
8. Waste Management v. Mexico

9. Empresa Eléctrica del Ecuador v. Ecuador
10. Champion Trading Company v. Egypt
11. Genin v. Estonia
12. CCL v. Kazakhstan
13. Link Trading Joint Stock Company v. Moldova
14. Noble Ventures v. Romania
15. Mihaly v. Sri Lanka
16. Generation Ukraine v. Ukraine

The above list is based on an initial review of the public databases. Further research may identify other investment treaty arbitration cases, in addition to the foregoing, in which US claimants were unsuccessful. Moreover, that list of course does not include cases where the US claimant investor was only partially successful or was awarded damages in very modest amount.