Investor-State Arbitration and Public Policy: Some Opportunities for the Proposed China-Australia Free Trade Agreement

Geoffrey Nicoll
Co-Director, National Centre for Corporate Law and Policy Research
University of Canberra

Conference: Law Reform and Business Efficiency – China and Indonesia
Friday 6 July 2007
INVESTOR-STATE ARBITRATION AND PUBLIC POLICY: SOME OPPORTUNITIES FOR THE PROPOSED CHINA-AUSTRALIA FREE TRADE AGREEMENT

Geoffrey Nicoll
Co-Director, National Centre for Corporate Law and Policy Research
University of Canberra

An interesting phenomenon in recent years has been the growth in Investor-State arbitration, particularly within the context of a range of bilateral regional Free Trade Agreements (FTAs). The growth in this type of arbitration invites a closer consideration of the ways in which the public law and policy of a host state within the FTA might influence, and be influenced by, the private arbitration of commercial trade disputes. Arbitration has become commercially popular and the institutional mechanisms for arbitration are well established. Arbitrated awards are generally more readily enforceable than those obtained through the domestic court system. Because of these significant advantages, arbitration provides an important mechanism for dispute resolution within a growing range of FTAs. The intersection of private arbitration with public law and policy in Investor-State arbitration may also be expected to play some part in the development of universal mechanisms for dispute resolution by the World Trade Organisation (WTO).

In this paper I suggest that the adoption of mechanisms for Investor-State arbitration within FTAs such as the North American Free Trade Agreement (NAFTA) might assist in resolving more complex commercial disputes in newer FTAs in which the interests of individual investors in private arbitration intersect with the public law and policy of host nation states. There exists a common international interest in striving to develop universal principles of public law and policy in those areas directly relevant to the primary interests of trading partners under FTAs. Some such areas in which common principles might now be considered include consumer protection and competition policy, corporate governance and environmental protection. While economic issues are always to the fore in negotiating new FTAs such as that proposed between China and Australia, it is worthwhile considering important aspects of the public law and policy framework within which trade and commercial disputes might arise.

I begin with a consideration of the strengths and limitations of private commercial arbitration and go on to outline the ways in which Free Trade Agreements such as the NAFTA have extended the scope for the resolution of trade-related disputes through arbitration, more particularly through Investor-State Arbitration. In providing this

---

1 I gratefully acknowledge the comments and suggestions made by my University of Canberra friends and colleagues, Dr Xiang Gao (presently on leave at the Centre for Commercial Fraud at the China University of Political Science and Law), Arthur Hoyle and John Gilchrist.
backdrop, I have drawn heavily upon a valuable and stimulating outline of the same terrain given by Professor Doug Jones at the Australian-European Lawyers’ Conference in March this year. From this base, I suggest that the NAFTA framework, which builds upon the International Centre for the Settlement of Investment Disputes (ICSID), International Trade Courts and Tribunals, suggests interesting possibilities for dispute resolution within the proposed China-Australia FTA. In the case of the proposed China-Australia FTA, a closer consideration of these issues promises a much deeper understanding between the judiciary and bureaucracy of each country and a unique bridge between the common law and civil code traditions that each country adopts.

I Private Arbitration Between Individual Investors

The system of international arbitration is based upon private contract and the agreement of trading parties to submit to awards in the event of disputes arising between them. The mechanisms of private arbitration reflect a simple, cheap and pragmatic approach to dispute resolution. They represent an expeditious means for resolving commercial disputes. The reach of international arbitration has been further extended in a growing number of FTAs and Bilateral Investment Treaties (BITs). Within these bilateral agreements, the growing potential for Investor-State arbitration suggests the extent to which private arbitral awards might potentially intersect with the public law and policy of member states. At the same time, Investor-State arbitration invites a closer consideration of the scope of private arbitration and the framework in public policy within which business must operate.

The foundations of private commercial arbitration rest upon agreement between the parties. Private arbitration provides a simple and convenient mechanism for the enforcement of awards. Both the strengths and limitations of private commercial arbitration are well understood and well-supported by participating institutions. By contrast, the hearing and enforcement of traditional court-based awards in commercial disputes across jurisdictional boundaries has encountered significant procedural, constitutional and political obstacles. The practical enforceability of arbitral awards continues to make arbitration a particularly attractive mechanism to commercial disputants.

Again, I am indebted to Professor Jones for his full analysis of the essential features of Arbitration which define its strengths and limitations. For the purpose of enabling me to consider further the potential value and limits of Investor-State arbitration in the context of the proposed China-Australia FTA, I would like to highlight some particular aspects of the five essential features of arbitration considered by Professor Jones in his analysis. These five essential features were:

- The confidentiality of the awards;
- The specialist expertise of the arbitrators;
- The high enforceability of the awards;

- The convenience and efficiency of the institutions available to assist in the arbitration; and
- The generally simple, cheap and pragmatic process of arbitration in practice.

The Confidentiality of Awards

The confidentiality of awards has long been a fundamental attraction of arbitration. Nevertheless, this foundation of arbitration may have been eroded to some extent by developments in procedural and information technology.

Professor Jones notes that in *Esso v Plowman*, the High Court held that arbitration proceedings were private but not confidential, unless the parties expressly agree otherwise. In response to this decision, Article 18 of the Australian Centre for International Commercial Arbitration (ACICA) Rules now makes any arbitration both private and confidential. Despite this confirmation of the confidentiality of awards in the ACICA rules, some tension is likely to persist as awards are more readily available through the internet and interest grows in assessing and analyzing these awards more systematically. Another persistent source of pressure upon the confidentiality of awards might be the constantly improving technology now available to assist and record the arbitral process, in receiving submissions, ascertaining relevant facts and having the arbitrator’s findings of fact verified by the parties before the decision is made (see further below).

The Specialist Expertise of Arbitrators

A second attractive feature of arbitration is the high level of expertise in the area under dispute that may be available to disputants. This tends to engender a high degree of confidence in the result of the arbitration. It also allows expertise in technical areas to develop and grow. At the same time, the absence of public reports tends to limit the development of any formal system of precedent. Within the context of regional FTAs, there exists the potential to develop significant expertise in trade related business matters reflecting the expectations in law of the participating member states.

High Enforceability of Awards

Professor Jones concludes that Australian courts have an excellent record for enforcing foreign arbitral awards although there remains a question as to the interpretation of the term “award” in Australian courts, for the purposes of enforcement.

Briefly, Professor Jones notes that Australia is a signatory to the New York Convention and that s. 8 of the *International Arbitration Act 1974* (Cth), which is based on the Convention, provides that the awards of Convention countries outside Australia are enforceable in Australian states and territories as if the award were made in that state or territory. Section 8 of the *LAA* applies only to awards made in a Convention country

---

4 Jones, Note 2 at 9.
outside Australia so that when the enforcement of awards is not covered by the New York Convention enforcement may be possible under Article 35 of the UNCITRAL Model Law annexed to the IAA. Where enforcement is covered neither by the IAA nor the Model Law, then s. 33 of the Commercial Arbitration Acts will apply.  

Efficiency and Convenience of Arbitration: Experience of Participating Institutions

Professor Jones notes that international arbitral institutions have strong local representation in Australia. Within Australia, the Australian Centre for International Commercial Arbitration (ACICA) supports and facilitates international arbitration. More particularly, "...ACICA assists with the appointment of arbitrators, the arrangement of hearing rooms, transcription services, arbitration rules and law, technology services. It also offers educational activities, seminars and conferences. ACICA is supported by leading Australian law firms and the Commonwealth government and by the Australian Commercial Disputes Centre (ACDC) which provide administrative support to ACICA. These bodies work in close co-operation in the Asia Pacific region."

The ACICA Arbitration Rules are based on the UNCITRAL Arbitration Rules, but have been updated to provide a simple and user-friendly guide. The ACICA Rules deal with the appointment of arbitrators, arrangements in multi-party disputes, interim measures, confidentiality, evidence, preservation of the Model Law and fees. ACICA also provides a Model Arbitration Clause assisting the resolution of more complex disputes in contracts. The Model Clause provides for the forum, the language in which the arbitration is to be conducted and the number of appointed arbitrators.

II The Limits of Private Arbitration: Matters 'Capable of Arbitration'

Professor Jones notes that Australian courts have adopted an expansive approach to the scope of matters capable of arbitration. A 'matter' capable of settlement by arbitration for the purposes of s. 7(2)(b) of the IAA has been interpreted to mean: "any claim for relief of a kind proper for determination in a court".

The expansive approach of the Australian courts in this area is reflected also in their approach to hearing procedural issues, such as in applications for a stay in proceedings. In hearing such applications, Australian courts have agreed to stay court proceedings where there exists a valid arbitration agreement governing the dispute.

---

5 Jones, Note 2 at 9.
6 Jones, Note 2 at 10.
7 Jones, Note 2 at 10.
8 Jones, Note 2 at 11-12.
9 Jones, Note 2 at 14-15.
10 Jones Note 2 at 7-8.
12 Jones, Note 2 at 8.
Section 7 of the IAA generally governs applications to stay court proceedings (see further details at para.2.2) but otherwise, Article 8 of the Model Law applies.

Perhaps more interestingly for the purposes of this paper, Professor Jones also notes that:

Courts have also refused stay applications where the dispute involves antitrust, bankruptcy or insolvency. However, the courts have not stated that these matters are inherently incapable of settlement by arbitration. Rather, they have focused on whether the scope of the arbitration agreement is broad enough to cover such disputes. These situations often arise in relation to the Trade Practices Act 1974 (Cth) (TPA), Australia's antitrust and consumer protection legislation. In *IBM Australia v National Distribution Services Ltd*, the NSW Court of Appeal held that some issues relating to consumer protection under the TPA are capable of settlement by arbitration. More recently, the NSW Court of Appeal in *Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd* and the Federal Court in *Hi-Fert Pty Ltd v Kiujiang Maritime Carriers* confirmed that disputes based on section 52 of the TPA (relating to misleading and deceptive conduct) are arbitrable.\(^{13}\)

### III The Limits of Private Arbitration: Arbitration Contrary to Public Policy

Professor Jones refers to the "...theoretical possibility that public policy could be invoked to limit the autonomy of parties wishing to submit their disputes to arbitration. This possibility is clearly recognized at the international level. Article V (2) of the New York Convention provides that the recognition and enforcement of an arbitral award may be refused by the courts of a country if to do otherwise "would be contrary to the public policy of that country". He concludes that "...an arbitral tribunal should proceed with caution where it appears likely that the award will have more than an incidental impact on the rights and/or interests of third parties [and that there is a "dearth of case law" on the many situations in which an arbitral award might have consequences for third parties]."\(^{14}\)

On this same point, Jones cites the judgment of Kirby J in *Commonwealth v Cockatoo Dockyards Pty Ltd*, who said:

Allowing that a large circle will be drawn within which the arbitrator may make procedural orders, the circle is not without limit. ... The rule of law requires that the court, protective of other competing public and private interests, will define and, where necessary and appropriate, declare the limits beyond which the purported powers in pursuit of private arbitration intrude into competition with other legitimate public and private rights and duties.

---

\(^{13}\) Jones, Note 2 at 7-8.

\(^{14}\) Jones, Note 2.
IV Free Trade Agreements: The NAFTA and New Scope for Private Arbitration

The framework for the NAFTA is essentially different to that established for the European Union (EU) in which nation states have assimilated WTO Principles more comprehensively with their own public law and policy. Rather than rely upon the WTO mechanisms alone, the NAFTA utilizes a framework supported by the International Centre for the Settlement of Investment Disputes (ICSID) and International Trade Courts or Tribunals, in order to resolve disputes between individual investors and nation states. As has been suggested earlier, mixed arbitrations between individual investors and nation states tend to raise more pointedly the need to draw around arbitration the circle described by Kirby J in Commonwealth v Cockatoo Dockyards Pty Ltd. Investor-State arbitration therefore requires a closer consideration of the scope and substance of arbitration as a mechanism for dispute resolution, and of its intersection with the public law and policy of host states.

Investor-state arbitration is not “arbitration” strictly, because it lacks the critical element of agreement between the parties. The public interest in this type of arbitration brings it closer to WTO mechanisms for dispute resolution, although the fundamental underlay for both WTO mechanisms and arbitration remains the utility of the dispute resolution process (see further below). Investor-State arbitration arises from the pursuit of claims by individuals against states in the context of Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs). Investor-State arbitration is thus founded upon an agreement in a sense, but an agreement born of the broader objectives of the FTA and an agreement that these objectives should not be thwarted by the public policy of one participating state. Investor-State arbitration largely adopts the procedures of international arbitration and within the NAFTA it is facilitated by institutions such as the International Centre for the Settlement of Investment Disputes (ICSID), of which ACICA is the local Australian representative.

FTAs such as the NAFTA have greatly extended the scope for arbitration through the adoption of mechanisms for individual investors to pursue remedies when the overall objectives of the FTA might be defeated through the actions of a participating nation state. Potentially, a wide range of matters included in FTAs may be subject to arbitral awards as a result of Investor-State arbitration. This has opened the field of Investor-State arbitrations and raised the possibility of private commercial objectives intersecting with the public law and policy of a host state. Difficult legal issues may be expected to arise, for example, on the question of whether a company registered in the host state might be considered a “foreign” investor for the purposes of enabling a foreign investor to pursue a host state when the objectives of the investment have been thwarted by the policies of that host state.

V The Stimulus to Arbitration Provided by Technology

There have been a number of developments in practice that appear to extend the potential significance of private commercial arbitration and Investor-State arbitration. I have noted above that one persistent pressure upon the confidentiality of awards might be expected to be the technology available to assist the arbitral process, through receiving submissions, ascertaining relevant facts and verifying the arbitrator’s findings by the parties before the decision is made. There would seem to be increasing potential
for key decisions to be publicized via the internet. The High Court’s decision in *Esso v Plowman* (above) would appear to lend support to this development, were the technology available.

In these circumstances, it may be worthwhile considering the ways in which technology might be expected to affect the traditional reach of both arbitral and judicial processes:

- Technology is likely to facilitate the hearing and decision of simple factual disputes. Interestingly in China, the factual decisions of lower courts are also reviewable (not merely questions of law) in an “all grounds” appeal. Many matters may stay within the system for some time during the appeal process. The improvement of the technology needed to maintain records of proceedings and assist in simple factual disputes might be a particularly valuable aid to both arbitral and judicial decision-making;
- Recording parties’ submissions (even if private and confidential);
- Recording reasons for decisions and maintaining precedents; and
- Giving limited publicity to major cases.

VI Private Arbitration and the GATT/WTO Framework

It is commonly believed that the more universal WTO framework is destined to ultimately cover the broader field of disputes in trade-related matters. Collier and Lowe, for example, suggest that “it is almost inevitable that the WTO procedures will exert a gravitational pull, drawing into the WTO system disputes that could not easily find a forum elsewhere, and recasting them as ‘trade disputes’.”

However, it should not be thought that the growth of Investor-State arbitration in regional FTAs is necessarily at odds with this steady consolidation of the WTO framework. One reason for this is that the WTO approach, like that of arbitration, is a utilitarian one which emphasizes the greater good to individuals or nation states in the resolution of trade-related disputes. In the arbitral process, it is the final effect or outcome of the award, rather than the rights and obligations of the parties, that provides both the guiding principles upon which awards are made and the distinctive features of the process.

Likewise, within the WTO framework, Collier and Lowe conclude that:

The procedures for the settlement of disputes arising under the General Agreement on Tariffs and Trade (GATT), and now under the World Trade Organization (WTO) that has replaced it, are remarkable for their departure from the principle that disputes resolved by formal mechanisms should be settled on the basis of what is an essentially retrospective analysis of the rights and duties of the parties at the time that the dispute arose. Rather, the GATT/WTO system proceeds by an

---

analysis of whether benefits (rather than rights) that the parties expected to derive from the substantive rules of the GATT/WTO have been nullified or impaired, or the achievement of any objective of the agreement is being impaired, and then to an essentially prospective analysis of what measures might produce a workable outcome to the dispute for the future.  

There are two interesting points to be made on this conclusion. The first is that the approach to trade-related arbitration may accord more readily with civil code, rather than common law traditions in dispute resolution. This may be one reason why EU member states have been able to adopt and integrate WTO Principles, and to accept that WTO Principles might prevail in the event of conflict with domestic laws.  In other FTAs such as the NAFTA, the integration of the NAFTA agreement and the domestic law and policy of member states has not been possible and the NAFTA sets out safeguards for investors in the agreement itself. These safeguards address a range of matters that might otherwise "nullify or impede the benefits of the agreement" to individual investors. This approach has enabled more individual investors to arbitrate against member states when the benefits of the FTA are not achievable, because of the public policy or domestic laws of that member state. Within the NAFTA, WTO principles are implemented through supervisory institutions such as the International Trade Commission and the Court of International Trade.

A second point on the conclusion reached by Collier and Lowe is that there appears to be a fundamental difference between the approach utilized in the resolution of trade-related disputes and the approach that might be utilized in other types of legal proceedings, such as those requiring the consideration of human rights, criminal intent or negligence, for example.

The WTO framework is ultimately an agreement, albeit one on a large scale between member states with respect to their trading welfare. Both the GATT agreement, and the WTO system that has evolved from it, therefore lend themselves to dispute resolution by way of arbitration and arbitral process. The WTO, for example, relies substantially upon appointed panels and the supervening power of the Dispute Settlement Body (DSB). The guiding principles for arbitration within the GATT/WTO framework are both reflected and refined in regional or free trade agreements which attempt to reconcile the domestic law and public policy of member states with the GATT/WTO principles.

---

16 Collier and Lowe, Note 14 at 96-7.
17 Collier and Lowe, Note 14 at 103. For a good account of the integration of WTO Principles into EU Law, and the subjugation of domestic law to those Principles in the event of conflict, see: Collier and Lowe, Note 14 at 105-107. Compare with this approach, the NAFTA in which domestic law is not subjugated to WTO Principles, but rather integrated into the Free Trade Agreement itself (Collier and Lowe, at 111-117). The NAFTA approach has resulted in the need for mechanisms permitting investors to initiate proceedings in Investor-State arbitration when conflicts arise between the expectations of private investors under the FTA and domestic law or public policy (Collier and Lowe, Note 14 at 113-114).
18 Collier and Lowe, Note 14 at 113.
VII Some Possibilities for the China-Australia FTA

One consideration in this paper is that while the safeguards for member states included in the NAFTA have generally related to aspects of most favoured nation status within the agreement, such safeguards might also include elements of public policy directly relevant to member states in areas such as consumer protection, competition policy, environmental protection, and corporate governance.

The inclusion of an extended range of such public responsibilities in the proposed China-Australia FTA might be a useful consideration, with significant long term benefits for both countries. Taking this step might greatly clarify the position of individual investors within the FTA, and it might even serve to build common foundations in both countries for the discharge of judicial and administrative functions within two different legal systems adhering to common law and civil code traditions. Adopting the approach of the NAFTA, disputant parties might in time prefer to proceed by way of Investor-State arbitration, rather than pursue local remedies. As in the NAFTA, the parties might then forego recourse to domestic law in order to settle the dispute. Such an approach would, of course, require a supervening body, such as ACICA.

A number of factors suggest the potential of this approach. First, arbitration is very popular domestically within the PRC, so that substantial foundations for the extension and development of international arbitration already exist. Second, unlike most of Australia’s traditional trading partners, the PRC adheres to a civil code system of law so that a widely accepted, private dispute resolution mechanism may be a relatively easy way to strengthen the common understanding of trade-related dispute resolution within two otherwise very different legal systems. And finally, technology now seems to facilitate the processes of factual dispute resolution, the recording of reasons for decisions and the maintaining of precedents. Again, these developments promote common foundations in the resolution of factual disputes that may help bridge the divide between the two legal systems.

In the context of the China Australia FTA, several opportunities now appear to have been raised. In summary, these include:

- Considering a possible framework for Investor-State claims to be included in the proposed Australia-China FTA to enable a continuing dialogue between the two countries to develop;
- Exploring the potential to include in the proposed FTA a limited range of relevant public law and policy areas that will be most directly relevant to trade and commerce, such as consumer protection, competition policy and corporate governance; and
- Investigating the full potential of technology in the development of precedents and factual dispute resolution within the existing arbitral framework of courts and tribunals equipped to hear trade-related disputes.
VIII Conclusion

Extending the reach of traditional international arbitration in the three abovementioned areas paves the way for closer judicial and regulatory co-operation in the wider field of international trade and commerce. This is because a larger range of matters now potentially subject to resolution by arbitration lies at the intersection of private commercial arbitration and the public law and policy of host nation states. In the case of the proposed Australia-China FTA, taking the time to consider these matters carefully at a time when economic benefits are sure to dominate negotiations will provide significant long term benefits for both Australia and the PRC.

Geoffrey Nicoll
Co-Director
National Centre for Corporate Law and Policy Research
School of Law
University of Canberra

5 July 2007