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Committee Secretary
Senate Foreign Affairs, Defence and Trade
References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Re: Inquiry into the China-Australia Free Trade Agreement (ChAFTA)

Dear Committee members,

I am writing to recommend that the China-Australia Free Trade Agreement (ChAFTA) be renegotiated by the Government to exclude investor-state dispute settlement (ISDS). As it stands the ISDS provisions in ChAFTA have limited application, covering only disputes that purportedly concern discrimination. However, the parties commit to further negotiations including on the addition of provisions in controversial areas such as expropriation and the minimum standard of treatment. Essentially, the chapter is unfinished at this point in time and, as such, neither the committee nor I can properly assess its regulatory implications. In the attached submission, I discuss this in more detail and I also outline serious problems with some of the provisions that have been completed. The key points are:

- ISDS is a very expensive process that lacks democratic accountability;
- Legitimate public policies, particularly in the area of environmental protection, have been challenged by corporations under ISDS in many countries;
- The ChAFTA does not provide sufficient transparency or third-party participation in ISDS;
- Negotiation of the most contentious provisions (e.g. on expropriation, the minimum standard of treatment) have been deferred until after the ratification of ChAFTA and it is unclear if future amendments to the investment chapter will be subject to parliamentary review.

Please do not hesitate to contact me if you would like me to explain any of these issues further.

Yours sincerely,

Dr. Kyla Tienhaara

1. Introduction

Over the last decade there has been an explosive increase of cases of investor-state dispute settlement (ISDS). Until the mid-nineties, only a handful of cases had emerged. Then, following a few high-profile cases, everything changed. Between 2003 and 2013, one arbitral body registered more than thirty new cases every year and more than fifty cases in each of the last three years of that decade.[1] As of the end of 2014, the total number of known cases was 608. By then, one hundred and one governments had responded to one or more ISDS claims.[2]

Investor complaints have covered the gamut of regulatory measures: from taxes to land-zoning decisions to bans on dangerous chemicals. Measures taken by governments to protect the environment have proven to be particularly susceptible to challenge. Although ISDS panels cannot tell sovereign states how or what to regulate, they can award investors compensation for their losses and even for 'lost future profits'. The stakes are incredibly high.

Many ISDS claims now exceed US$1 billion and although the compensation actually awarded is generally much lower than what is sought, the impact on the public purse can be substantial. Last year the US$1.77 billion award against Ecuador – previously the largest known ISDS award in history – was vastly outstripped with a mind-boggling US$50 billion award against Russia in its high profile dispute with the oil company Yukos.

In 2010, the Productivity Commission issued a report on Bilateral and Regional Trade Agreements.[3] One of the Commission's recommendations was that the government should "seek to avoid" the inclusion of ISDS provisions in its trade agreements.[4]

Three key conclusions led to formulation of this recommendation.[5] First, the Commission found no evidence of the existence of a market failure relating to sovereign risk. Although it was acknowledged that the domestic court systems in some countries might not be as robust as Australia's, the Commission reasoned that in most instances the desire on the part of governments to retain a good reputation with foreign investors was sufficient to quell any impulse to expropriate.[6] The Commission also argued that there is no evidence that regulation (in Australia or abroad) is systematically biased against foreign investors—in fact the reverse may be true.[7]

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[1] UNCTAD, (2014) 'Recent Developments in Investor–State Dispute Settlement', *IIA Issues Note No. 1* (April) at 1, http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf
[2] UNCTAD, (2015) 'Recent Trends in IIAs and ISDS', *IIA Issues Note No. 1* (February), http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf
[3] Productivity Commission. 2010. Bilateral and Regional Trade Agreements: Research Report. http://www.pc.gov.au/__data/assets/pdf_file/0010/104203/trade-agreements-report.pdf.
[4] Ibid, Recommendation 4c, p. xxxviii.
[5] See also the comments of Adam Sheppard, Senior Economist at the Productivity Commission, at a seminar on 'Rethinking Investment Treaty Law - A Policy Perspective', London School of Economics, 23 May 2011. Podcast available at http://www.youtube.com/user/lsewebsite?feature=mhsn#p/c/2/zf1HkqjeJUI
[6] Productivity Commission. 2010. Bilateral and Regional Trade Agreements: Research Report, p. 269.
[7] Ibid.

Despite having found no evidence of a market failure, the Commission went on to assess whether, if such a market failure did exist, there were other options for addressing it. Their second key conclusion was that insurance and investor-state contracts were more appropriate mechanisms for dealing with political risk than international treaties.[8]

Finally, the Commission assessed the issues of regulatory chill[9] and the cost of arbitration to governments. Their third key conclusion was that "[e]xperience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions."[10]

In a report issued last month, the Productivity Commission reiterated its position and further noted that:

> An examination of foreign investment trends with Australia's main foreign investment partners suggests that ISDS provisions are unlikely to have been relevant considerations in the investment decisions of Australian firms investing abroad or foreign firms investing in Australia.[11]

The absence of evidence of any clear benefits of ISDS coupled with substantial concerns about the costs of the system have led many countries to reconsider BITs and the inclusion of ISDS clauses within trade agreements. The European Commission received nearly 150,000 submissions in a public consultation on ISDS in the Transatlantic Trade and Investment Partnership (TTIP) being negotiated with the US.[12] Germany and France have stated that they would not support including an ISDS mechanism in that agreement and Germany may reject a concluded agreement with Canada for the same reason.[13] The recent debate over Trade Promotion Authority ('Fast Track') in the US was also dominated by concerns over ISDS. Around the world, countries from South Africa to India are currently rethinking their approach to ISDS.[14]

Australia does not have a coherent policy on ISDS. The current 'case-by-case approach' involves no transparent criteria for when the Government considers ISDS appropriate. In the past year, the Government has signed three FTAs with Korea, Japan and China. The Korea-Australia Free Trade Agreement (KAFTA) included ISDS and although the Japan-Australia Economic Partnership Agreement (JAEPA) did not, it is subject to a review that may be triggered by ChAFTA (see Box 1). This submission discusses

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[8] Ibid, p. 270.
[9] The regulatory chill hypothesis suggests that states may forgo important policy changes when faced with a threat of arbitration.
[10] Ibid, p. 274.
[11] Productivity Commission. 2015. *Trade & Assistance Review 2013-14*, at p. 80. http://www.pc.gov.au/research/recurring/trade-assistance/2013-14/trade-assistance-review-2013-14.pdf
[12] See http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179
[13] UNCTAD. 2014. "Recent Developments in Investor–State Dispute Settlement," *IIA Issues Note No. 1* (April) at 24, http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf
[14] Peterson, L. "South Africa Pushes Phase-Out of Early Bilateral Investment Treaties After at Least Two Separate Brushes with Investor-State Arbitration," *Investment Arbitration Reporter*, 23 September 2012; Khor, M. "Investor Treaties in Trouble," *The Star Online*, 24 March 2014, http://www.thestar.com.my/Opinion/Columnists/Global-Trends/Profile/Articles/2014/03/24/Investor-treaties-in-trouble/

ChAFTA's investment chapter and compares some of its provisions to other treaties, including KAFTA. A table of the text of the relevant provisions can be found in the Annex.

Box 1: ChAFTA – A trigger for ISDS in JAEPA?

The Japan-Australia Economic Partnership Agreement (JAEPA) entered into force on 15 January 2015. The JAEPA does not include ISDS but it does include a provision that states:

> The Parties shall also conduct such a review if, following the entry into force of this Agreement, **Australia enters into any multilateral or bilateral international agreement providing for a mechanism for the settlement of an investment dispute** between Australia and an investor of another or the other party to that agreement, **with a view to establishing an equivalent mechanism under this Agreement**. The Parties shall commence such review within three months following the date on which that international agreement entered into force and will conduct the review with the aim of concluding it within six months following the same date.

The ChAFTA contains ISDS and thus should trigger this clause. As such, the JAEPA may eventually provide for ISDS as well.

2. Key Substantive Provisions of Investment Protection in ChAFTA

National Treatment

Many investment treaties include a clause on national treatment (i.e. an obligation not to discriminate against investors from the other party in favour of domestic investors). Most treaties only provide for national treatment in the post-establishment phase (i.e. once an investment has been made) although some treaties, particularly those involving the US, also cover pre-establishment. Whichever option is chosen it is customary that both parties have the same obligations; reciprocity is a fundamental principle in trade negotiations. It is puzzling that in the national treatment provision in ChAFTA, Australia has committed to non-discrimination in the case of establishment and acquisition phase but China has not.

Arbitral tribunals have read national treatment clauses broadly as covering not only *de jure* discrimination but also *de facto* discrimination. In other words, there does not have to be evidence of *intent* to discriminate on the part of the state.

Some treaties, including ChAFTA, qualify the definition of national treatment by including the provision that it only applies to investors in 'like circumstances'. While, in theory, this approach offers a narrower scope for comparison than treaties with no qualifying language, in practice a large ambit for interpretation remains. Tribunals are free to determine the criteria on which to assess what investors/investments are in like circumstances; there is no requirement that a tribunal must consider issues such as the environmental impact of an investment activity, which from a state's perspective could provide a justifiable reason for differentiation.[15] If a tribunal is willing to consider the regulatory context (e.g. taking into account environmental and health policy objectives)

[15] Miles, K. 2011 "Sustainable Development, National Treatment and Like Circumstances in Investment Law", in M. Cordonier Segger, M. Gehring and A. Newcombe (eds.) *Sustainable Development in World Investment Law,* Kluwer, pp. 261-294 at 269-270

they will likely place the burden on the state to show that the discrimination was "reasonable".[16] Furthermore, even where policy objectives are deemed reasonable, a tribunal may still find that the regulatory measures themselves are not if the same objectives could have been achieved in another way.[17]

Thus, although the national treatment standard has not received as much scrutiny from academics or policy makers as more contentious provisions on expropriation and fair and equitable treatment, there are implications for Australia's right to regulate that the JSCOT should be aware of. Orellana argues:

> …the application of the non-discrimination standards calls for abstract legal reasoning and involves a measure of subjective assessment. Because of this, there is a degree of uncertainty involved in their operation, which may affect the policy space available to States.[18]

Miles suggests that states that differentiate between investments on the basis of sustainability goals are at risk of facing investor claims of breach of the national treatment standard.[19] In the recent decision in *Clayton/Bilcon* v. *Canada*, the tribunal determined that the decision of an independent environmental review panel constituted a breach of the national treatment standard because a higher standard of environmental review was applied than was the case for other investments in 'like circumstances'.

Most Favoured Nation Treatment (MFN)

The same issues about discriminating on public welfare grounds and problems in defining 'like circumstances' arise with MFN (the commitment not to discriminate against investors from the other party in favour of investors from a non-party). An additional concern is that MFN can and has been used by investors to access provisions in other investment treaties.

In *Maffezini* v. *Spain*, the Tribunal decided that the MFN clause in the Spain-Argentina BIT could be applied to allow the claimant to have access to dispute resolution provisions in a BIT between Spain and Chile. The *Maffezini* decision prompted states to explicitly carve out ISDS provisions from the application of the MFN clause in more recent treaties. ChAFTA follows this trend.

However, investors have also successfully 'imported' the substantive provisions of other treaties (e.g. on fair and equitable treatment) through the application of MFN.[20] The Canada-EU Comprehensive Economic and Trade Agreement (CETA) attempts to deal with both issues, stating:

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[16] Wilensky, M. 2015. Reconciling International Investment Law and Climate Change Policy: Potential Liability for Climate Measures Under the Trans-Pacific Partnership", *Environmental Law Reporter* 45: 10683-10698.
[17] See note 15 above.
[18] Orellana, M. 2011. "Investment Agreements & Sustainable Development: the Non-Discrimination Standards", Sustainable Development Law & Policy 11(3): 3-8 at 3.
[19] Ibid.
[20] For examples see Salomon C. and S. Friedrich. 2013. "How Most Favoured Nation Clauses in Bilateral Investment Treaties Affect Arbitration" *Practical Law Arbitration*, http://www.lw.com/thoughtLeadership/favoured-nation-clauses-arbitration

> For greater certainty, the "treatment" referred to in Paragraph 1 and 2 does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements. *Substantive obligations in other international investment treaties and other trade agreements do not in themselves constitute "treatment", and thus cannot give rise to a breach of this article*, absent measures adopted by a Party pursuant to such obligations. (emphasis added)

ChAFTA does not contain this kind of provision and, as such, it is possible that investors will try to exploit this loophole if the scope of ISDS is expanded beyond national treatment in the future (see below). For example, investors might make claims based on poorly worded clauses providing for 'fair and equitable treatment' in older treaties signed by Australia.

Other Substantive Provisions?

The most surprising aspect of ChAFTA's investment chapter is that it does not contain some of the other substantive provisions that are commonly found in investment treaties such as expropriation and the minimum standard/fair and equitable treatment. These are undoubtedly the most contentious and most utilised clauses in most investment treaties and I have made previous submissions to Senate committees outlining my concerns about them. If the negotiators of ChAFTA had chosen to exclude such provisions because they are highly problematic then I would have nothing further to say on the topic (except to congratulate them on their good sense). Unfortunately, instead the negotiators have only deferred the consideration of these provisions to a later date.

Article 9.9 of the ChAFTA commits the parties to reviewing the existing Australia-China bilateral investment treaty (BIT – see Box 2) and to engaging in negotiations for a 'comprehensive' investment chapter in ChAFTA that would include additional articles on expropriation and the minimum standard of treatment as well as others. This really seems to be putting the cart before the horse – if agreement could not be reached in a timely manner, why not leave investment out of the ChAFTA altogether and simply commence negotiations to amend/terminate the existing BIT?

The incomplete nature of ChAFTA's investment chapter is not something I have come across before and it makes it very difficult to evaluate the regulatory implications of the agreement. It also raises questions about the ability of Parliament to scrutinize the deal, as it is not clear whether any amendments would require review before coming into effect.

Box 2: The Australia-China BIT

The Australia-China BIT has been in force since 1988. Like most BITs from that period, it is a relatively short document and it does not contain any of the 'safeguards' found in modern agreements. It provides for fair and equitable treatment and MFN but not national treatment. It also provides for protection from expropriation. However, investors are only able to access arbitration for disputes concerning the amount of compensation that they have received from the state following an expropriation. This is in line with other Chinese BITs from this period. More recent Chinese BITs are far more liberal which is unsurprising, as China has become a major source of outward FDI.

Since 1998 it has been possible for either China or Australia to unilaterally terminate the BIT with one year's written notice. If this occurred, the treaty would have a further 'sunset' or 'survival' period of ten years with respect to any investments that existed prior to termination.

3. Comments on ChAFTA Chapter 9 Exceptions and 'Safeguards'

General Exception

Article 9.8 of the ChAFTA contains what is commonly referred to as a 'general exception', modelled on Article XX of the GATT 1994. The use of general exceptions like this is quite a recent development in international investment law. As such, it is unclear how investment tribunals will deal with them. However, one expert has hypothesised that "the inclusion of general exceptions in [international investment agreements] is unlikely to have much practical significance" but has also cautioned that the intent of governments might backfire and that arbitral tribunals might actually "interpret general exceptions as providing less regulatory flexibility for legitimate objectives, compared to that under existing [international investment agreements] that do not incorporate general exceptions."[21]

Bernasconi-Osterwalder and Mann also express concerns about the potential for trade law concepts, such as the "necessity test", to be introduced into investment law through clauses such as this one.[22] Discussing the draft of a similar exception clause in CETA, they conclude:

> Far from providing any measure of guarantee for a state's right to regulate, this type of general exceptions clause provides an untested transfer of trade law concepts to investment law, a vastly different domain of regulatory interaction between government-investment as compared to government-product regulatory interaction at a border. In our view it is miscast, but whether or not that is so, its utility in an investment context has never been tested, its scope and means of application is manifestly unclear, and there is no way to review a wrong application of the provision as there is in trade law through the WTO Appellate Body. Thus, this provision cannot be called a guarantor in any form of the right to regulate.[23]

[21] Newcombe, A. 2008. "General Exceptions in International Investment Agreements," Draft Discussion Paper Prepared for BIICL Annual WTO Conference, 13-14 May 2008, London.
[22] Bernasconi-Osterwalder, N. and H. Mann. 2014. "A Response to the European Commission's December 2013 Document 'Investment Provisions in the EU-Canada Free Trade Agreement'", p. 4, http://www.iisd.org/pdf/2014/reponse_eu_ceta.pdf
[23] Ibid.

Public Welfare Objectives and Notices

Article 9.11 of ChAFTA excludes measures taken for 'legitimate' public welfare objectives from the purview of ISDS. This is, of course, a very good idea; however, investors regularly dispute the legitimacy of the stated public welfare objectives of governments as well as the efficacy of particular measures (e.g. plain packaging of tobacco) in achieving such objectives. Judgments on whether or not a given measure is legitimate should not be left to tribunals, given the extensive problems with their independence and accountability (see further below). Article 9.18.3 further provides that if China and Australia agree that a measure is for legitimate welfare objectives then this will be binding on the tribunal; this may prove effective in some cases but could also serve to politicise investment disputes (negating one of the purported benefits of the system of ISDS).

The further inclusion of procedures requiring states to issue 'public welfare notices' does not achieve any further protection for regulatory measures as it does not preclude claims from reaching arbitration; it only triggers a consultation period.

Binding Interpretations

Article 9.18 provides that the parties can issue joint declarations on the proper interpretation of provisions in the investment chapter and that these will be binding on tribunals in both ongoing and subsequent disputes. This is an implicit acknowledgement by the parties that investment tribunals have frequently strayed beyond the bounds of reasonable interpretation and need to be more strictly supervised. While it is a positive development, I have some concerns about its efficacy based on the experience of arbitration in the North American Free Trade Agreement (NAFTA) context.

In 2001, the NAFTA Free Trade Commission (FTC) issued Notes of Interpretation of Certain Chapter 11 Provisions, rejecting the interpretation that some tribunals had proffered of the minimum standard of treatment (Article 1105) by clarifying that 'fair and equitable treatment' does not require treatment in addition to or beyond that which is required by customary international law.[24] This should have set a very high bar for breaches of the standard and yet in a recently decided case a tribunal determined that a breach of Canada's domestic law constituted a breach of NAFTA. The dissenting arbitrator in the case, Prof Donald McRae, noted:

> By treating this potential violation of Canadian law as itself a violation of NAFTA Article 1105 the majority has in effect introduced the potential for getting damages for what it is breach of Canadian law, where Canadian law does not provide a damages claim for such a breach. That is not what NAFTA was intended to do. You cannot get a remedy under NAFTA Chapter 11 for breach of Canadian law; you can only get a NAFTA remedy for a breach of NAFTA.[25]

This example illustrates that even when tribunals are operating under a binding interpretive statement issued by the parties, they still find ways to make expansive interpretive decisions in the investor's favour.

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[24] Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission (FTC), 31 July 2001, www.state.gov/documents/organization/38790.pdf

[25] McRae, D. 2015. Dissenting Opinion in Clayton/Bilcon v Canada, http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/clayton-13.pdf

4. Concerns About ChAFTA's ISDS Procedures

Investment tribunals are typically made up of three members: one chosen by the investor, one chosen by the state and a third that is mutually agreed upon and will act as president. Tribunals operate under rules of arbitration. The rules most commonly applied in ISDS are those developed by the UN Commission on International Trade Law (UNCITRAL)[26] and the International Centre for the Settlement of Investment Disputes (ICSID).[27] These are the rules specifically referred to in ChAFTA, though the parties to the dispute are also given the option to use any other arbitration rules that they can mutually agree upon.

Transparency

ISDS has long been criticized for being secretive. However, transparency in in the field has increased substantially in the last decade. Changes to the culture of confidentiality are reflected in both the external arbitration rules (UNCITRAL and ICSID) and through the inclusion within treaties of additional transparency requirements that supersede these rules.

The catalyst for increased transparency came in the form of several high profile cases brought under the NAFTA in which non-governmental organisations petitioned the tribunals for access to documents. This led to the NAFTA states developing a policy that all ISDS awards under the agreement would be published and hearings would be open to the public. Subsequently in 2004, the US re-drafted its model BIT to reflect this new approach. As US models have considerable influence on the treaty drafting practice of other countries (particularly countries like Canada, Australia and New Zealand) rules on transparency have spread in recent years.

In parallel with these developments in treaty practice, the ICSID and UNCITRAL arbitration rules have been revised. The revisions to the ICSID Rules, released in 2006, were as Wong and Yackee put it "modest, incremental and conservative."[28] Most significantly, ICSID tribunal hearings can still be held behind closed doors if one party to the arbitration objects to them being public.

Unlike the ICSID arbitration rules, which were designed specifically for investor-state disputes, the UNCITRAL arbitration rules also apply to commercial arbitrations. Consequently, addressing transparency in the revision of the UNCITRAL rules proved to be a complicated affair. Eventually it was decided that a separate set of Rules on Transparency in Treaty-based Investor-state Arbitration would be produced to supplement the general UNCITRAL arbitration rules. The Rules on Transparency were

[26] UNCITRAL Arbitration Rules, 28 April 1976, Report of the United Nations Commission on International Trade Law on the Work of its Ninth Session, UN Doc. A/31/17 (1976), reproduced in 15 *ILM* (1976): 701. The Rules as revised in 2010 are available here: http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf

[27] 'Rules of Procedure for Arbitration Proceedings (Arbitration Rules)', *ICSID Convention, Regulations and Rules* (2006) http://icsid.worldbank.org.

[28] Wong, J. and J. Yackee. 2010. "The 2006 Procedural and Transparency-Related Amendments to the ICSID Arbitration Rules," in K. Sauvant (ed.) *Yearbook of International Investment Law and Policy 2009-2010* (Oxford University Press), p. 268.

finally agreed upon in July 2013 and took effect on 1 April 2014. They apply to treaties signed after that date unless the parties to the treaty expressly opt out.

ChAFTA does not apply the standard of transparency that has become widely accepted by countries like Canada and the US nor does it meet the level of transparency in past Australian agreements, including the recently signed agreement with Korea. ChAFTA significantly limits transparency by leaving it to the discretion of the respondent state to release certain key documents (e.g. pleadings, memorials) to the public and by requiring the tribunal to obtain the consent of the respondent state before opening proceedings to the public. There is also a side letter to ChAFTA that explicitly excludes the application of the UNCITRAL Rules on Transparency.

The ability of respondent states to limit transparency in ISDS under ChAFTA is particularly concerning in light of the Australian Government's refusal to disclose information about the ongoing dispute with tobacco giant Philip Morris; the secrecy extends even to the cost of defending the plain packaging legislation in arbitration.[29]

Amicus Curiae

Third parties are able to participate in many domestic court hearings and in international legal proceedings through the submission of *amicus curiae* ('friend of the court') briefs. *Amici* are different from expert witnesses, which can be called on in the course of a proceeding, as they are not remunerated for their services and they are in no contractual relationship to the arbitration parties.

While historically there has been no role for *amici* in ISDS, in recent years a trend of such participation has been established in many contexts. It started in the context of disputes brought under NAFTA.

In 2000, two requests for permission to file amicus curiae briefs, to make oral submissions and have observer status at oral hearings were made by non-governmental organizations in the *Methanex* case (which revolved around a Californian ban on a gasoline additive that posed a threat to groundwater). The US and Methanex Corp. both filed submissions responding to the petitioners' requests, as did the non-disputing parties of NAFTA (Canada and Mexico). Methanex Corp. and Mexico opposed the acceptance of *amicus curiae* briefs, while both Canada and the US showed support.

In a groundbreaking decision, the Tribunal concluded that it had the power to accept *amicus curiae* submissions under the terms of the UNCITRAL rules, but no power to authorize access to materials or to allow the petitioners to attend hearings. It is notable that the tribunal made reference to the *amicus curiae* brief of the International Institute for Sustainable Development (IISD) in its Final Award, describing it as 'carefully reasoned'.[30]

On 7 October 2003, the Free Trade Commission of NAFTA issued a statement expressly permitting third party participation in future ISDS cases. Canada and the US also revised

[29] See note 11 at p. 163.
[30] *Methanex Corporation* v. *United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005: para. IV.B.27. Reproduced in 44 ILM (2005): 1345.

their model BITs to include provisions allowing tribunals to consider *amicus* submissions. Such provisions have since been included in a wide range of treaties, including many of Australia's, the most recent being KAFTA.

In 2006, ICSID updated its Rules of Procedure for Arbitration Proceedings. As part of this a change was made to Rule 37 (Visits and Inquiries), where a second paragraph was added stipulating that:

> After consulting both parties, the Tribunal may allow a person or entity that is not a party to the dispute (in this Rule called the 'non-disputing party') to file a written submission with the Tribunal regarding a matter within the scope of the dispute…

Similar language is found in the UNCITRAL Rules on Transparency:

> 4.1. After consultation with the disputing parties, the arbitral tribunal may allow a person that is not a disputing party, and not a non-disputing Party to the treaty ("third person(s)"), to file a written submission with the arbitral tribunal regarding a matter within the scope of the dispute.

The requirement to 'consult' with the parties is the model adopted in KAFTA. In contrast, in ChAFTA the written approval of the disputing parties is required before the tribunal can consider whether to accept amicus briefs. This is a much more onerous requirement and represents a significant barrier to third party participation in ISDS. It is not difficult to imagine a scenario where a public welfare measure is at stake (e.g. plain packaging of tobacco) and the investor refuses to consent to allow the tribunal to consider a submission from a third party (e.g. a non-governmental organisation focused on health issues). Although states can call upon such organisations to directly participate in the dispute (e.g. as expert witnesses) there will inevitably be times when the arguments of respondents and third parties do not completely coincide, but when those of the latter would nevertheless be of assistance to the tribunal and it would be in the public interest for them to be on the record.

Bias & Conflicts of Interest

Unlike transparency and third-party participation, other procedural issues have been given very little attention by treaty negotiators. In part, this may be because many of these issues are structural and would require a fundamental rethink of ISDS. For example, there is an inherent bias in ISDS created by the fact that only investors can initiate disputes.

The means by which arbitrators are chosen and rewarded for their services also creates the appearance of a biased system. Court judges have no financial stake in the outcome of the cases they preside over. Arbitrators, on the other hand, are not only chosen by the parties to the dispute, they are also paid by the hour with no time limits on proceedings. Such incentives inevitably favour the party advancing the claim (i.e., the investor), even if unintentionally.[31]

[31] Garcia, C. 2004. "All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration," 16 *Florida Journal of International Law* 301, p. 352.

The fact that individuals can act as both arbitrators and counsel in different cases is also problematic as they may "consciously or unconsciously" make decisions as arbitrators that will further their client's interests in another case.[32] Furthermore, even when such a direct conflict of interest does not exist, a large number of arbitrators work for law firms with corporate clients that have a direct stake in the interpretation of IIAs.[33]

ChAFTA includes a Code of Conduct that attempts to address some of these issues; however, it is non-binding and arbitrators are largely expected to police themselves.

Inconsistency

Awards rendered in investment arbitration are only binding on the parties involved in the dispute: the rulings of tribunals are said to have no *stare decisis*. Hence, tribunals do not have to base their decisions on the decisions of previous tribunals. Furthermore, unlike in the realm of trade disputes, there is no appellate body to ensure consistent interpretation of international investment law. As a result, there have been cases where several awards have been issued addressing the same facts where panels have reached diverging conclusions. This has led to what some have termed a 'legitimacy crisis' in international investment arbitration.[34]

This problem is compounded by the ambiguous nature of the provisions found in investment agreements (e.g. the requirement to provide 'fair and equitable treatment'). When the outcome of arbitration is uncertain, states that are faced with a threat of arbitration are more likely to settle investor claims, often at the expense of public policy (a phenomenon typically described as 'regulatory chill').

To address the problem of inconsistency, the 'possibility' of a bilateral appellate mechanism being developed in the future is mooted in ChAFTA. However, similar aspirational statements in other agreements have failed to result in the development of any appeals process.

High Costs

Arbitration was initially touted as a cheap and efficient means to deal with disputes but recent experience belies such claims. An OECD survey shows that legal and arbitration costs for the parties in ISDS cases have averaged over US$8 million with costs exceeding US$30 million in some cases.[35] Argentina has reportedly spent US$12 million in the jurisdictional phase of an ongoing case[36] and Turkey was required to pay approximately

[32] Buergenthal, T. 2006. "The Proliferation of Disputes, Dispute Settlement Procedures and Respect for the Rule of Law," 22 *Arbitration International* 495, p. 498.
[33] Mann, H, 2006. "Is 'Fair and Equitable' Fair, Equitable, Just, or Under Law?" 100 *American Society of International Law Proceedings* 74.
[34] Brower, C., Brower, C. and J. Sharpe. 2003. "The Coming Crisis in the Global Adjudication System," 19 *Arbitration International* 415; Franck, S. 2005. "The Legitimacy Crisis in Investment Treaty Arbitration: Privatising Public International Law through Inconsistent Decisions," 73 *Fordham Law Review* 1521.
[35] Gaukrodger, D. and K. Gordon. 2012. "Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community," *OECD Working Papers on International Investment No. 2012/3*, http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf
[36] Ibid.

US$13.5 million in costs in one dispute, which far outweighed the compensation (~$US 9.1 million) it was ordered to pay the investor.[37]

As a result of the high costs of investment arbitration and the potential for very large awards, third party funding of litigation is becoming more common. This increases the potential for claims to be pursued against states that do not have similar mechanisms at their disposal to finance their participation in arbitration.[38]

The ChAFTA does not address the issue of the high costs associated with ISDS.

5. Conclusions

ChAFTA's investment chapter is highly unusual and very difficult to evaluate. On the one hand there are some novel attempts by the ChAFTA negotiators to remedy some of the problems associated with ISDS (e.g. through binding interpretations and exception clauses), although there are no guarantees that the mechanisms employed will be effective. On the other hand, ChAFTA diverges from the recent trend of increased transparency and third party participation in ISDS; in this respect the agreement appears antiquated.

In terms of the potential regulatory implications of the agreement, it is significant that in the current version of the investment chapter ISDS is restricted to only cover breaches of national treatment. While there are legitimate regulatory concerns associated with broad interpretations of the national treatment standard, what is far more concerning is that ChAFTA will likely be amended in the near future to include additional clauses on expropriation and the minimum standard of treatment. Because the chapter is only half-written, it is impossible to fully assess its implications for Australia's right to regulate.

However, it is possible to conclude that the ChAFTA does not remedy many of the most serious problems associated with arbitration and to reiterate, as the Productivity Commission has done, that there is no convincing economic rationale for the inclusion of ISDS in trade agreements. As such, I would recommend that ChAFTA be renegotiated to remove ISDS and allow only state-state dispute settlement.

[37] *PSEG Global Inc. and Konya Ilgin Elektrik Uretim Ve Tikaret Limited Sirketi* v. *Republic of Turkey* (ICSID Case No. ARB/02/5), Award, 19 January 2007.
[38] Rosert, D. 2014, "The Stakes are High: A Review of the Financial Costs of Investment Treaty Arbitration," (Winnipeg: International Institute for Sustainable Development), p. 8, http://www.iisd.org/sites/default/files/publications/stakes-are-high-review-financial-costs-investment-treaty-arbitration.pdf

Annex: Table of Selected ChAFTA Provisions with Commentary and Comparisons to KAFTA

Article	ChAFTA Text	KAFTA Text	Comments
NATIONAL TREATMENT	9.3 (1) **Australia** shall accord to investors of China treatment no less favourable than that it accords, in **like circumstances**, to its own investors with respect to the **establishment, acquisition**, expansion, management, conduct, operation and sale or other disposition of investments in its territory. (2) China shall accord to investors of Australia treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory.	11.3 (1) **Each Party** shall accord to investors of the other Party treatment no less favourable than that it accords, in **like circumstances**, to its own investors with respect to the **establishment, acquisition**, expansion, management, conduct, operation and sale or other disposition of investments in its territory.	• ChAFTA text is non-reciprocal (Australia provides national treatment for establishment and acquisition but China does not). • Both treaties contain 'like circumstances' language, which has been interpreted very broadly by investors and tribunals.
MOST-FAVOURED-NATION TREATMENT	9.4 (1) Each Party shall accord to investors of the other Party, and covered investments, in relation to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory, treatment no less favourable than that it accords, in **like circumstances**, to investors and investments in its territory of investors of any non-Party. (2) For greater certainty, the treatment referred to in this Article **does not encompass Investor-State Dispute Settlement procedures or mechanisms.**	11. 4 (1) Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in **like circumstances**, to investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory. FN: For greater certainty, the treatment referred to in this Article **does not encompass Investor-State Dispute Settlement procedures or mechanisms** such as those included in Section B.	• Both treaties contain 'like circumstances' language, which has been interpreted very broadly by investors and tribunals. • Both treaties exclude ISDS procedures from MFN which is important because investors have used MFN to access more favourable ISDS provisions in other treaties. • Neither treaty explicitly excludes the substantive provisions of investment treaties from the scope of MFN; this creates a loophole that could be used by investors to try to access more favourable provisions (e.g. on fair and equitable treatment) in other treaties.

Annex: Table of Selected ChAFTA Provisions with Commentary and Comparisons to KAFTA

COMMITTEE ON INVESTMENT	9.7(1) The Parties hereby establish a Committee on Investment that shall meet on the request of either Party or the FTA Joint Commission to consider any matter arising under this Chapter. (2) The Committee's functions shall include: … (c) unless the Parties otherwise agree, **conducting the review referred to in Article 9.9.** (3) The Committee: (a) shall establish and maintain a list of arbitrators pursuant to Article 9.15.5 and Article 9.15.6; (b) may, pursuant to Article 9.18.2 or Article 9.19, adopt a joint decision of the Parties, declaring their **interpretation of a provision of this Chapter** and Annex 9-A; (c) may propose amendments to Section B in the light of experience of its operation.	21.3 The Parties hereby establish a Joint Committee comprising officials of each Party, which shall be co-chaired by the Minister for Trade of Korea and the Minister for Trade of Australia, or their respective designees… (3) The Joint Committee may… (c) as appropriate, issue interpretations of the provisions of this Agreement; 11.22 (3) A decision of the Joint Committee declaring its **interpretation of a provision of this Agreement** under Article 21.3.3(c) shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that decision.	• Both treaties provide the Parties with the ability to issue statements on agreed appropriate interpretations of the provisions in the investment chapter; this is a good idea but has had mixed success in other contexts. • ChAFTA additionally tasks the Committee on Investment with conducting a review of the existing Australia-China BIT, which is discussed further below.
GENERAL EXCEPTIONS	9.8 (1) For the purposes of this Chapter and subject to the requirement that such measures are not applied in a manner which would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures: (a) necessary to protect human, animal or plant life or health; (b) necessary to ensure compliance with laws and regulations **that are not inconsistent with this Agreement**; (c) imposed for the protection of national treasures of artistic, historic or archaeological value; or (d) relating to the conservation of living or non-living exhaustible natural resources.	22.1 (3) For the purposes of Chapter 11 (Investment), subject to the requirement that such measures are not applied in a manner which would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures: (a) necessary to protect human, animal or plant life or health; (b) necessary to ensure compliance with laws and regulations **that are not inconsistent with this Agreement**;…	• Both treaties contain a 'general exception' clause modelled on GATT XX. • The efficacy of such exceptions in the investment context is debatable and has yet to be tested in arbitration. • The 'not inconsistent' language in sub-paragraph (b) renders that part of the exception useless.

Annex: Table of Selected ChAFTA Provisions with Commentary and Comparisons to KAFTA

FUTURE WORK PROGRAM	9.9 (1) Unless the Parties otherwise agree, the Parties shall conduct a review of the investment legal framework between them no later than three years after the date of entry into force of this Agreement. 2. The review shall include **consideration of this Chapter and the *Agreement between the Government of Australia and the Government of the People's Republic of China on the Reciprocal Encouragement and Protection of Investments*.** 3. Unless the Parties otherwise agree, the Parties shall **commence negotiations on a comprehensive Investment Chapter**, reflecting outcomes of the review referred to in paragraphs 1 and 2, immediately after such review is completed. The negotiations shall include, but are not limited to, the following: (a) amendments to Articles included in this Chapter; (b) **the inclusion of additional Articles** in this Chapter, including Articles addressing: (i) **Minimum Standard of Treatment;** (ii) **Expropriation;** …	The KAFTA has nothing comparable (the negotiations on expropriation, minimum standard etc. were completed prior to signature as is normal for trade and investment agreements).	• It would have been sensible for the review of the Australia-China BIT to have occurred before or during the negotiations for ChAFTA and once it was decided that an investment chapter would be included in ChAFTA, steps should have been taken to terminate the BIT. • Leaving the most contentious provisions of the investment chapter (e.g. expropriation, the minimum standard of treatment) for negotiation **after** the treaty has been signed is highly irregular (I have never come across it before). • It is not clear whether amendments to the investment chapter would be subjected to Parliamentary review.

Annex: Table of Selected ChAFTA Provisions with Commentary and Comparisons to KAFTA

PUBLIC WELFARE NOTICE	9.11 (4) Measures of a Party that are non-discriminatory and for the **legitimate public welfare objectives** of public health, safety, the environment, public morals or public order **shall not be the subject of a claim** under this Section. (5) The respondent may …state that it considers that a measure alleged to be in breach of an obligation…is of the kind described in paragraph 4, by delivering to the claimant and to the non-disputing Party a notice specifying the basis for its position (a 'public welfare notice'). 6. **The issuance of a public welfare notice shall trigger a 90 day period during which the respondent and the non-disputing Party shall consult…** 7. The issuance of a public welfare notice is **without prejudice to the respondent's right to invoke the procedures described in Article 9.16.5 or Article 9.16.6**…	Nothing comparable in KAFTA.	• Excluding measures taken for public welfare reasons from ISDS is a good idea; however, investors regularly dispute the 'legitimacy' of the stated public welfare objectives of governments as well as the efficacy of particular measures (e.g. plain packaging of tobacco) in achieving such objectives • The public welfare notice does not preclude claims from reaching arbitration; it only triggers a consultation period. • A further provision (9.18.3) allows that if China and Australia agree that a measure is for legitimate welfare objectives then this will be binding on the tribunal; this may prove effective in some cases but could also serve to politicise investment disputes (negating one of the purported benefits of the system of ISDS).
AMICUS CURIAE	9.16 (3). **With the written agreement of the disputing parties**, the tribunal may allow a party or entity that is not a disputing party to file a written *amicus curiae* submission with the tribunal regarding a matter within the scope of the dispute.	11.20 (5) **After consulting the disputing parties**, the tribunal may allow a party or entity that is not a disputing party to file a written *amicus curiae* submission with the tribunal regarding a matter within the scope of the dispute.	• Amicus participation in ISDS provides a valuable means for increasing public awareness about disputes and assisting tribunals in understanding the public welfare issues at stake. • Requiring the tribunal to have the written agreement of disputing parties before accepting amicus briefs is a step backwards from Australia's approach in previous treaties (e.g. KAFTA) and the standard approach of countries like the US/Canada. • Requiring written agreement significantly limits amicus participation. For example, why would an investor agree to allow a submission by an NGO that would provide evidence that the measure in dispute was important for the protection of the environment?

Annex: Table of Selected ChAFTA Provisions with Commentary and Comparisons to KAFTA

TRANSPARENCY	9.17 (1) Subject to paragraphs 3, 4 and 5, the respondent shall, after receiving the following documents, promptly transmit them to the non-disputing Party: (a) the request for consultations; (b) the notice of arbitration; (c) pleadings, memorials, and briefs submitted to the tribunal by a disputing party and any written submissions submitted pursuant to Article 9.21; (d) minutes or transcripts of hearings of the tribunal, where available; and (e) orders, awards, and decisions of the tribunal. (2) Subject to paragraphs 3, 4 and 5, the respondent: (a) shall make the documents referred to in paragraph 1 (a), (b) and (e) available to the public; (b) **may make** the documents referred to in paragraph 1(c) and (d) **available to the public**; (c) **may make** any written submissions submitted pursuant to Article 9.16.2 **available to the public** provided that prior consent is obtained from the non-disputing Party. (3) **With the agreement of the respondent,** the tribunal shall conduct hearings open to the public…	11.21 (1) Subject to paragraphs 2, 3 and 4, the respondent **shall**, after receiving the following documents, promptly transmit them to the non-disputing Party and **make them available to the public:** (a) the notice of intent; (b) the notice of arbitration; (c) pleadings, memorials and briefs submitted to the tribunal by a disputing party and any written submissions submitted pursuant to Article 11.20.4 and 11.20.5 and Article 11.25; (d) minutes or transcripts of hearings of the tribunal, where available; and (e) orders, awards, and decisions of the tribunal. (2) The tribunal **shall conduct hearings open to the public**…	• Transparency in ISDS is essential and has become accepted best practice. • ChAFTA significantly limits transparency by leaving it to the discretion of the respondent state to release certain key documents (e.g. pleadings, memorials) to the public and by requiring the tribunal to obtain the consent of the respondent state before opening proceedings to the public. • This is a step backwards from Australia's approach in previous treaties (e.g. KAFTA) and the standard approach of countries like the US and Canada. • Both ChAFTA and KAFTA also have side letters explicitly excluding the application of the UNCITRAL Transparency Rules, which is disappointing.
APPELLATE REVIEW	9.23. Within three years after the date of entry into force of this Agreement, the Parties **shall commence negotiations with a view to establishing an appellate mechanism** to review awards rendered under Article 9.22 in arbitrations commenced after any such appellate mechanism is established. Any such appellate mechanism would hear appeals on questions of law.	ANNEX 11-E Within three years after the date of entry into force of this Agreement, the Parties **shall consider whether to establish** a bilateral appellate body or similar mechanism to review awards rendered under Article 11.26 in arbitrations commenced after they establish the appellate body or similar mechanism.	• While the wording in ChAFTA is slightly stronger than KAFTA, neither treaty provides a concrete commitment to establish an appellate mechanism and similar deadlines have passed under other agreements (e.g. Central America FTA) without any evident progress on this issue.