

**Submission to Joint Standing Committee on Treaties (JSCOT) regarding the Investor-State
Dispute Settlement (ISDS) mechanism in the Indonesia-Australia Comprehensive
Economic Partnership Agreement (IA-CEPA)**

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Executive Summary

- Australia and Indonesia have recently concluded negotiations for the Indonesia-Australia Comprehensive Economic Partnership (IA-CEPA) agreement.
- IA-CEPA includes a series of investment provisions, and an Investor-State Dispute Settlement (ISDS) mechanism. However, Australia already has an existing bilateral investment treaty (AI-BIT) with Indonesia (1993), which also includes investment provisions and an ISDS mechanism.
- The Australian and Indonesian governments have not yet agreed to terminate the AI-BIT on entry-into-force of IA-CEPA. If IA-CEPA is ratified and enters-into-force, there will be two sets of bilateral rules covering investment flows between Australia and Indonesia.
- To inform the work of the Joint Standing Committee on Treaties (JSCOT) inquiry into IA-CEPA, this submission analyses and compares the investment provisions and ISDS mechanisms of the BIT and IA-CEPA agreements between Australia and Indonesia.
- The analysis demonstrates that IA-CEPA includes strengthened investment protections, a modernised ISDS mechanism, and better public interest safeguards, than available under the AI-BIT.

Investment rules in Australia's free trade agreements

Despite their name, free trade agreements (FTAs) do not solely address trade policy issues. As trade flows between economies are also influenced by a range of 'trade-related' policies – such as investment regimes, services regulations, intellectual property regimes, and technical standards – it is common for FTAs to include provisions related to these domains. All of Australia's existing FTAs combine trade measures (i.e. tariff and quota reduction) with regulatory provisions designed to standardise these trade-related policy areas.

In IA-CEPA, one of the most important trade-related provisions relates to investment rules. These set mutually-agreed standards for how the Australian and Indonesian governments will regulate investment from the other party, and mechanisms for consultation on resolving disputes over the application of these standards.

IA-CEPA contains four mechanisms for addressing investment:

1. A set of **investment protections**, which guarantee the standards of treatment to be accorded to investors of the other party. (Chapter 14 Section A and related Annexes)
2. Mechanisms for **state-to-state consultations and dispute settlement**, to manage disputes between the governments regarding the application of investment protections if they arise (Chapter 20 and related Annexes)
3. Mechanisms for **Investor-State Dispute Settlement (ISDS)**, which enables investors to bring disputes directly to the host state regarding the application of investment protections (Chapter 14 Section B and related Annexes)
4. A bilateral **Committee on Investment**, which will monitor, review, report and make recommendations regarding the investment provisions to the governments (Article 14.18)

ISDS mechanisms are an important element within FTAs. ISDS provides a mechanism under which an investor can seek arbitration regarding the application of investment rules directly with the host government. This arbitration is usually conducted under one of two internationally-agreed standards for the resolution of investment disputes: the UNCITRAL and ICSID mechanisms¹. Its inclusion in an FTA is intended to provide investors with additional certainty that, if in the event of a dispute regarding the application of investment rules, they can directly access arbitral proceedings without the need for their home government to raise the issue under state-to-state consultation mechanisms.

¹ UNCITRAL (United Nations Commission on International Trade Law) and ICSID (World Bank International Centre for the Settlement of Investment Disputes) are two established international arbitral mechanisms for implementing ISDS. For more details see <https://uncitral.un.org/> and <https://icsid.worldbank.org/en/>

An important feature of ISDS is that it functions primarily as an *enforcement and assurance mechanism* for investment rules which appear elsewhere in a treaty. ISDS does not establish new investment rules and standards itself. It simply provides investors with an arbitration mechanism to enforce the standards agreed in the investment chapter of the FTA.

IA-CEPA is not unique in including an ISDS mechanism. Australia currently has ISDS in:

- Five of its bilateral FTAs (China, Korea, Singapore, Chile, Thailand)
- Both its two plurilateral FTAs (AANZFTA and CPTPP)
- Three bilateral FTAs presently undergoing ratification (Peru, Hong Kong and Indonesia)²
- Eighteen bilateral investment treaties (BITs) which are presently in force³

Despite the ubiquity of ISDS in Australia's economic agreements, it has very rarely been the subject of an ISDS dispute. Since including ISDS in the BIT with China in 1988, only once – the *Tobacco Plain Packaging* case of 2011⁴ – has an ISDS dispute been raised against Australia. In *Plain Packaging*, the arbitral tribunal ruled in Australia's favour, and awarded costs. Australian companies have at times used ISDS to resolve disputes with host states; but as the Australian government is not a party to these arbitral proceedings no official count is maintained.

Moreover, IA-CEPA does not establish ISDS between Australia and Indonesia. Since 1993, the *Agreement between the Government of Australia and the Government of the Republic of Indonesia concerning the Promotion and Protection of Investments* (AI-BIT) has provided both parties' investors access to an ISDS mechanism. As Australia and Indonesia have not agreed to terminate the AI-BIT on IA-CEPA's entry into force⁵, the IA-CEPA ISDS mechanism will co-exist alongside those established in the earlier AI-BIT.

To properly evaluate the regulatory impacts of the IA-CEPA ISDS mechanism, it must be assessed in conjunction with the mechanism presently available under the AI-BIT. Additionally, it is necessary to evaluate the underlying investment protections to which the IA-CEPA mechanism will apply. The remainder of this submission comparative analyses these features of IA-CEPA and the BIT.

² <https://dfat.gov.au/trade/investment/Pages/investor-state-dispute-settlement.aspx>

³ <https://dfat.gov.au/trade/investment/Pages/australias-bilateral-investment-treaties.aspx>

⁴ <https://www.ag.gov.au/Internationalrelations/InternationalLaw/Pages/Tobaccoplainpackaging.aspx>

⁵ In several other FTAs where an ISDS mechanism overlays an existing BIT, Australia and the partner have agreed to terminate the BIT on entry-into-force of the FTA. This has been agreed as part of FTAs with Mexico, Vietnam, Hong Kong and Peru. In the case of Australia's FTAs with Indonesia and China, the existing BIT has not been terminated.

Investment protections in AI-BIT and IA-CEPA

| | <i>Australia-Indonesia Bilateral Investment Treaty (1993)</i> | <i>Indonesia-Australia Comprehensive Economic Partnership Agreement (pending ratification)</i> |
|---------------------------------------|--|--|
| Investment protections | Promotion and protection; most-favoured-nation treatment; transparency; entry and sojourn of personnel; expropriation and compensation; subrogation; transfers | National treatment; most-favoured-nation treatment; performance requirements; minimum standard of treatment; armed conflict and civil strife; transfers; senior management and boards of directors; expropriation and compensation; subrogation; special formalities and information requirements; corporate social responsibility |
| Investment-specific safeguards | None | Non-conforming measures; promotion of regulatory measures; environment and public health |

IA-CEPA includes considerably stronger investment protections than in the AI-BIT:

- It secures three important investment protections that were previously absent: national treatment (NT), minimum standard of treatment (MST) and prohibitions on performance requirements (PR).
- It also includes provisions relating to movement of natural persons (MNPs) for senior managers and boards of directors, protections for armed conflict and civil strife, encourages corporate social responsibility (CSR) initiatives, and mandates informational and transparency requirements.

IA-CEPA also includes modern public interest safeguards in its investment chapter

- Several pre-existing Non-Conforming Measures (NCMs) are excluded from investment protections, which are specified in positive-list form in attached Annexes⁶.
- Parties are entitled to adopt, maintain and enforce any investment measure that they consider appropriate to “*achieve environmental, health, public morals, social welfare, consumer protection or the promotion and protection of cultural diversity or other regulatory objectives*.” (Art 14.16).
- The prohibitions on performance requirements explicitly allow policies designed to protect the environment, public health and/or the conservation of natural resources (Art 14.6.6).
- None of these public interest safeguards are present in AI-BIT.

⁶ These annexes are available at <https://dfat.gov.au/trade/agreements/not-yet-in-force/iacepa/iacepa-text/Pages/iacepa-annex-i-schedule-of-australia.aspx> and <https://dfat.gov.au/trade/agreements/not-yet-in-force/iacepa/iacepa-text/Pages/iacepa-annex-i-schedule-of-indonesia.aspx>

ISDS mechanisms in AI-BIT and IA-CEPA

| | <i>Australia-Indonesia Bilateral Investment Treaty (1993)</i> | <i>Indonesia-Australia Comprehensive Economic Partnership Agreement (pending ratification)</i> |
|------------------------------------|---|--|
| Specified ISDS mechanism/s | <p>The ICSID Convention, if both parties are at time members of the 1965 Convention</p> <p>UNCITRAL if one or both are not members of the 1965 Convention</p> | <p>If Indonesia is the disputing party, to the courts or tribunal of Indonesia, provided the court or tribunal has jurisdiction over the claim; or</p> <p>The ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings; or</p> <p>The ICSID Additional Facility Rules; or</p> <p>The UNCITRAL Arbitration Rules; or</p> <p>If the disputing parties agree, to any other arbitration institution or under any other arbitration rules.</p> |
| Additional procedural rules | None beyond standards outlined in ICSID or UNCITRAL | Extensive procedural rules beyond standards outlined in ICSID and UNCITRAL (Arts 14.22-35) |
| ISDS-specific safeguards | None | <p>Specific definitions of direct and indirect expropriation (Annex 14-B.2-3)</p> <p>Exclusion of: MFN-type claims, claims against measures to promote public health; investments involving illegal conduct; claims which are frivolous or manifestly without merit (Art 14.21)</p> <p>Exclusion of actions designed and applied “to achieve legitimate public welfare objectives, such as the protection of public health, safety and the environment” (annex 14-B.4)</p> |

IA-CEPA includes modernised and expanded ISDS mechanisms and procedures:

- Access to a wider range of arbitral mechanisms, including the ICSID Additional Facility, Indonesian courts/tribunals (where jurisdiction exists), or any other agreed arbitral mechanism
- It also includes considerably more detailed procedural standards (particularly surrounding consultations, arbitrators and awards), which increase certainty and transparency around arbitral processes

IA-CEPA also includes a number of public-interest safeguards that are absent in AI-BIT. These include:

- Explicit and specific definitions of *direct* and *indirect expropriation*, a core legal concept upon which many ISDS cases depend. *Indirect expropriation* is especially important in determining if a regulatory

reform warrants investor compensation; and the more specific definition in IA-CEPA limits the scope of application to a narrower set of circumstances.

- The exclusion of a number of categories of ISDS claims, including those which invoke MFN, claims against measures designed to promote public health, investments where illegality or corruption was involved, and expedited mechanisms for dismissing frivolous claims
- The explicit exclusion of regulatory actions where they are design to achieve “legitimate public welfare objectives”.

Key findings and implications

- IA-CEPA offers a modernised approach to managing investment rules compared to the AI-BIT.
- Its augmented investment protections will offer greater certainty to investors regarding standards of treatment, contributing to an improved environment for bilateral investment.
- Its procedurally-modernised ISDS provisions improve the clarity and transparency of ISDS proceedings, increasing certainty for both governments and investors regarding outcomes.
- Its investment- and ISDS-specific safeguards explicitly protect a range of regulatory measures from ISDS cases, including for environmental, cultural, public health and other issues.
- IA-CEPA ratification and entry-into-force will therefore significantly improve the strength, procedural regularity and public-interest safeguards which govern bilateral investment between Australia and Indonesia.



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