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CRICOS Provider No. 00120C

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

Re: Inquiry into the Trans Pacific Partnership (TPP)

Dear Committee members,

Please find attached a report in response to the invitation to make a submission to the committee's inquiry into the Trans Pacific Partnership. Please do not hesitate to contact me if you would like me to explain any of the issues covered in the report further.

Yours sincerely,

Dr Kyla Tienhaara

THE CANARY IN THE COALMINE:

WHAT CANADA'S EXPERIENCE WITH INVESTOR-STATE DISPUTE SETTLEMENT TELLS US ABOUT AUSTRALIA'S FUTURE UNDER THE TRANS PACIFIC PARTNERSHIP

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SUMMARY

Australia signed the Trans-Pacific Partnership (TPP) Agreement on 4 February 2016. Economists are divided over the anticipated benefits of this 'mega-regional' trade and investment agreement spanning 12 Pacific Rim countries. There has been no comprehensive analysis of the agreement's potential costs. The Productivity Commission has offered to model the impacts of the deal specifically for Australia, but the Turnbull Government believes that this is unnecessary.

One area where governments are likely to experience direct costs as a result of participating in the TPP is through the controversial Investor-State Dispute Settlement (ISDS) mechanism, found in Chapter 9. This report illustrates some of the possible costs of ISDS for Australia based on available global data and a direct comparison with the experience of Canada under Chapter 11 of the North America Free Trade Agreement (NAFTA). This report details that:

- American investors initiate **20%** of ISDS cases globally (Canada has had **39 claims** brought against it by US-based companies);
- The TPP's carve-out of tobacco is of very limited value given that ISDS claims are initiated by investors from a **wide variety of industrial sectors** over a wide range of issues (Canada has had ISDS claims brought against it by investors in the agricultural, chemicals, construction, electricity generation, entertainment, finance, forestry, health, mining, pharmaceuticals, postal, pulp and paper, oil and gas, tourism, and waste disposal industries);
- ISDS cases can arise over measures brought by **any level of government** (more than half of the cases brought against Canada have involved claims against provincial or territorial government measures);
- States **lose or settle ISDS cases more often than they win** them (Canada has lost or settled 11 cases and won 6);
- Even when states 'win', they 'lose' because they have **unrecoverable legal costs** (Canada has spent an average of **CAD 4.5 million** in non-recoverable legal costs per case that has proceeded through arbitration, which is lower than estimated global averages);
- Damages awarded by tribunals and compensation settlements vary wildly—most are in the range of **USD 1-500 million** but some have reached over USD 1 billion (Canada has disclosed compensation payments totaling **CAD 216.7 million**);
- It is difficult to quantify the cost of '**regulatory chill**' but there is mounting evidence that it is an identifiable phenomenon (Canada reversed a ban on a fuel additive when faced with an ISDS case);
- ISDS provides **no discernable public benefits**—the only beneficiaries of the system are corporations, and particularly large multinationals.

When the Government of Canada signed onto NAFTA it had no idea what it was getting itself into. Australia is not entering the TPP in the same position—it has ample opportunity to learn from the past. Canada is Australia's canary in the coalmine.

SECTION 1: INTRODUCTION

1.1. THE TPP & ISDS

On 5 October 2015, in a hotel in Atlanta, the negotiations for the Trans Pacific Partnership (TPP) finally came to an end after nineteen official rounds (supplemented by numerous chief negotiator meetings and ministerial meetings) spanning more than five years. The idea for the TPP first emerged in 2008, when the United States (US) agreed to enter into talks with the Trans-Pacific Strategic Economic Partnership Agreement (P4) members (Brunei, Chile, New Zealand, and Singapore). Shortly thereafter, the group expanded to include Australia, Vietnam, and Peru. Malaysia joined in 2010 followed by Canada and Mexico in 2012 and Japan in 2013. Other countries are expected to join the TPP in the future if it comes into force.

Economists are sharply divided over the expected economic benefits of the TPP.[1] The Productivity Commission's offer to independently model the impacts of the TPP in Australia has not been taken up by the Turnbull Government, which prefers to rely on existing analysis by the World Bank and others.[2] Using different models (with widely differing assumptions) a number of researchers in the US have come to very different conclusions about how the TPP will impact the GDP of member countries and whether there will be job creation or job losses overall. In addition to coming to contradictory conclusions, these analyses provide and incomplete picture of the potential impact of the TPP because do not address its 'non-economic effects', even though, as noted in one report, these "are arguably the most important effects" of the deal.[3]

In this regard, one area of particular concern is the Investment Chapter (9) of the TPP, which includes provisions that enable multinational corporations to sue governments for changes in policy that harm their investments. The process, known as investor-state dispute settlement (ISDS), allows foreign investors to bypass local courts and bring claims for monetary compensation to an international tribunal. These tribunals are composed of three private parties (arbitrators): one chosen by the state involved in the dispute; one chosen by the investor; and a third that is mutually agreed upon, or failing that, appointed by an arbitral body such as the

[1] "Economists Sharply Split Over Trade Deal Effects", *The New York Times*, 1 February 2016, available at: http://www.nytimes.com/2016/02/02/business/international/economists-sharply-split-over-trade-deal-effects.html?_r=0; On the economic impacts of Australia's trade agreements more generally see "The Free Trade Mythology of Added Prosperity", *The Australian*, 24 August 2016.

[2] "Trans-Pacific Partnership: Trade agreement will not be modelled by the Productivity Commission", *Sydney Morning Herald*, 22 February 2016, available at: http://www.smh.com.au/business/the-economy/transpacific-partnership-trade-agreement-will-not-be-modelled-by-the-productivity-commission-20160222-gn0kr1.html

[3] Capaldo, J. and A. Izurieta with J. Kwame Sundaram. 2016. Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement, Global Environment and Development Institute (Tufts University) Working Paper No 16-01, p. 2, available at: http://www.ase.tufts.edu/gdae/Pubs/wp/16-01Capaldo-IzurietaTPP.pdf

International Centre for the Settlement of Investment Disputes (ICSID).

ISDS has been critiqued for failing to live up to the standards of the domestic court system in Australia. For example, the means by which arbitrators are chosen and rewarded for their services creates at least 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.[4]

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.[5] 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 stake in the interpretation of investment treaties.[6]

A further issue concerns the lack of an appeals process. Awards rendered in investment arbitration are only binding on the parties involved in the dispute: the rulings of tribunals do not create precedent. Hence, tribunals do not have to base their decisions on the decisions of previous tribunals. 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.[7]

Unlike other recent US and Australian treaties, the TPP does not even require the parties to discuss the development of an appellate mechanism. It simply stipulates that if such a mechanism is created outside the TPP, the parties can consider whether or not to use it. The TPP Parties have promised to create a Code of Conduct for arbitrators, to deal with issues such as impartiality, but no details are provided in the final text of the treaty. Furthermore, the Code will be non-binding and arbitrators will largely be expected to police themselves.

In contrast, the EU is moving forward both with extensive changes to ISDS, including creating standing rosters of arbitrators, and is also setting up and appeals process. While there are still problems with what is referred to as the Investment Court

[4] 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.

[5] Buergenthal, T. 2006. "The Proliferation of Disputes, Dispute Settlement Procedures and Respect for the Rule of Law," 22 *Arbitration International* 495 at 498.

[6] Mann, H, 2006. "Is 'Fair and Equitable' Fair, Equitable, Just, or Under Law?" 100 *American Society of International Law Proceedings* 74.

[7] 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.

System (ICS)[8], it demonstrates that the European Commission has taken the critiques of ISDS far more seriously than the Parties to the TPP.

1.2. THE AUSTRALIAN CONTEXT

ISDS has been a controversial topic in Australia for over a decade. In 2003, the Howard Government commenced trade negotiations with the United States. The Australia-US-Free Trade Agreement (AUSFTA) "prompted the biggest critical public debate ever held in Australia about a trade agreement" and ISDS was "a major target of community campaigning".[9] In the end the agreement, which came into force in 2005, did not include a standard provision on ISDS. This position was purportedly taken "[i]n recognition of the Parties' open economic environments and shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems".[10]

Five years later, with the Australia Labor Party (ALP) in power (at that time led by Prime Minister Kevin Rudd), the government again sat down at the negotiating table with the US for the TPP. At the start of the negotiations in March 2010, Trade Minister Simon Crean suggested that Australia was taking a comprehensive approach to the trade deal and that "everything was on the table".[11] However, shortly thereafter he clarified that the government had "serious reservations about the inclusion of investor-state dispute settlement provisions" in the TPP.[12]

In late 2010, the Productivity Commission reported on a study into the impact of bilateral and regional trade agreements on Australia's economic performance.[13] One of the Commission's recommendations was that the government should "seek to avoid" the inclusion of ISDS provisions in its trade agreements.[14] The Gillard Government adopted the Commission's recommendation in a Trade Policy Statement in April 2011.[15] The Government continued to participate in the TPP talks, but negotiated an exclusion from the ISDS section of Chapter 9.

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[8] Van Harten, G. 2015. "Key Flaws in the European Commission's Proposals for Foreign Investor Protection in TTIP", Osgoode Legal Studies Research Paper No. 16/2016, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692122

[9] Ranald, P. 2010. "The Politics of the TPPA in Australia", pp. 40-51 in J. Kelsey (ed), *No Ordinary Deal: Unmasking the Trans-Pacific Partnership Free Trade Agreement*, Allen & Unwin, Crows Nest, NSW.

[10] DFAT. 2004. "Guide to AUSFTA: Investment", available at: http://dfat.gov.au/about-us/publications/trade-investment/australia-united-states-free-trade-agreement-guide-to-the-agreement/Pages/11-investment.aspx (last visited 16 September 2016)

[11] "Nations ponder terms for Pacific free trade", *The Sydney Morning Herald*, 16 March 2010, available at: http://www.smh.com.au/national/nations-ponder-terms-for-pacific-free-trade-20100315-q9qd.html

[12] Simon Crean, "Letter to the editor", *Canberra Times*, 17 March 2010.

[13] Productivity Commission. 2010. Bilateral and Regional Trade Agreements: Research Report, available at: http://www.pc.gov.au/__data/assets/pdf_file/0010/104203/trade-agreements-report.pdf

[14] Ibid, Recommendation 4c, p. xxxviii.

[15] DFAT. 2011. "Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity", available at: http://blogs.usyd.edu.au/japaneselaw/2011_Gillard%20Govt%20Trade%20Policy%20Statement.pdf

Shortly after the issuance of the Trade Policy Statement, the tobacco giant Philip Morris launched the first ever ISDS case against the Australian government. The firm challenged the Gillard Government's plain packaging legislation, which required all cigarettes be sold in plain brown packs with very limited branding and large health warnings.

After a change in government in 2013, Australia's position on ISDS shifted. The Abbott Government indicated that it would consider ISDS on a 'case-by-case' basis. ISDS was included in the Korea-Australia-Free Trade Agreement (KAFTA) signed in 2014. The government also signed a treaty with Japan in that year that did not include ISDS but contained a clause indicating that ISDS provisions would be negotiated at a later date if Australia signed any other treaties containing such provisions. Subsequently, Australia signed an agreement with China that included ISDS, though it was more limited in application than that provided in KAFTA.

These agreements were all signed while the negotiations of the TPP were ongoing. When Wikileaks released a draft of the Investment Chapter in January 2015, it still contained a footnote stating that the section on ISDS did not apply to Australia.[16] However, an added note stated "deletion of footnote is subject to certain conditions". When the text of the TPP was finally released to the public in November 2015, the footnote had been deleted.

The TPP is not the first agreement with ISDS that Australia has signed. As former Trade and Investment Minister Andrew Robb has noted, Australia already has ISDS in 29 existing treaties and "the sun still has still come up".[17] But comparing investment treaties with countries like Papua New Guinea (PNG) and one involving the US is comparing apples and oranges. Aside from the obvious differences in levels of investment (PNG-based foreign investors that don't exist can't sue the government), there is the fact that American investors are more litigious than investors from any other country: **American firms have initiated 20% of known ISDS cases** (and that is without counting instances where American multinationals like Philipp Morris bring suits through their foreign subsidiaries because there is no US treaty that they can access).[18]

While is true that creative lawyers can already find ways to bring suits against Australia on behalf of their American clients, the TPP will make it much easier for American investors to launch cases and to win them. For example, Philip Morris eventually lost its ISDS case against Australia on jurisdiction (for reasons related to the timing of its investment restructuring, which was done to access an Australia-Hong Kong investment treaty). While Australia won't see any tobacco related

[16] Footnote 29 of draft Chapter 9, available at: https://wikileaks.org/tpp-investment/WikiLeaks-TPP-Investment-Chapter/page-20.html

[17] "Australia faces $50m legal bill in cigarette plain packaging fight with Philip Morris", *The Sydney Morning Herald*, 28 July 2015, available at: http://www.smh.com.au/federal-politics/political-news/australia-faces-50m-legal-bill-in-cigarette-plain-packaging-fight-with-philip-morris-20150728-gim4xo.html

[18] Based on data available in UNCTAD's Investment Dispute Settlement Navigator, available at: http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry (last visited 16 September 2016)

disputes under the TPP as a result of a specific carve-out, American firms in all other sectors will have access to ISDS.

1.3 METHODOLOGY

This report examines the potential costs associated with ISDS under the TPP for Australia. It does not assess the potential benefits because, as has been extensively documented elsewhere, there is currently no compelling evidence of any public economic benefit from ISDS.[19] In particular, the presence of an investment treaty (or investment chapter in a trade agreement) does not appear to increase flows of foreign direct investment. The only beneficiaries of ISDS are corporations, and particularly large corporations "with more than USD1 billion in annual revenue – especially extra-large companies with more than USD10 billion – and individuals with more than USD100 million in net wealth."[20]

Assessing the costs for Australia of participating in ISDS under the TPP is inherently challenging for three main reasons:

1. ISDS is relatively 'new'. Although it has existed since the 1960s, investors have only routinely employed it since the mid-1990s and the caseload has expanded rapidly in the last decade. Of the 739 known ISDS cases, 257 are pending conclusion.[21] A majority of the cases that have concluded were decided behind closed doors, with little or no transparency, further limiting the data available to draw on.
2. Countries have had varied experience with ISDS – some have never been sued and some, like Spain, have had a very sudden influx of cases (33 cases since 2011). This makes it difficult to predict what Australia's experience will be.
3. There are substantial gaps in the available information on legal costs associated with ISDS and although many awards are now published, settlement agreements are often kept confidential.[22] This makes it difficult to put a price tag on the average ISDS case.

In light of these challenges, this report adopts two approaches. The first approach is to outline the available global data based on all known ISDS cases. This provides a broad picture of the extent of the ISDS system and the range of costs associated with it. However, the value of the global data set is limited when it comes to assessing

[19] See Productivity Commission, note 13 above. Additionally, see: Bonnitcha, J. 2014. *Substantive Protection under Investment Treaties: A Legal and Economic Analysis* (Cambridge: Cambridge University Press); Aisbett, E. 2009. "Bilateral Investment Treaties and Foreign Direct Investment: Correlation Versus Causation," in Karl Sauvant and Lisa Sachs, eds., *The Effect of Treaties on Foreign Direct Investments* (New York: Oxford University Press), 395-437.

[20] Van Harten, G. and P. Malysheuski. 2016. "Who Has Benefited Financially from Investment Treaty Arbitration? An Evaluation of the Size and Wealth of Claimants", *Osgoode Legal Studies Research Paper No. 14/2016*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2713876

[21] UNCTAD Investment Dispute Settlement Navigator, available at: http://investmentpolicyhub.unctad.org/ISDS (last visited 16 September 2016)

[22] UNCTAD only has data on compensation payments for 35% of the settlements in its ISDS Navigator.

Australia's position in the TPP. This is because the experience of countries like Venezuela, Ecuador and Russia (the three countries that have been held liable for the largest ISDS awards) is unlikely to be comparable to Australia.

The types of ISDS cases of greatest concern to Australians are 'regulatory cases' such as the tobacco plain packaging case. In this respect, the best comparator to Australia is Canada. This is why the second approach adopted in this study is to assess Canada's experience under the North American Free Trade Agreement (NAFTA). Although most Australians would probably agree that they have a natural affinity with Canadians, it is important to specify why these two countries are good comparators in this context. Furthermore, it is important to outline why the NAFTA and TPP can be considered broadly equivalent for the purposes of this comparison.

Key similarities:

- Both countries are parliamentary democracies;
- Both countries are federations with subnational governments given significant power to set policy (provinces in Canada, states in Australia);
- Both countries are considered 'middle powers' internationally (membership in OECD, G20, but not Permanent Security Council);
- Both countries have a resource-based economy and are highly dependent on commodity exports;
- The net inward FDI in 2014 for the countries is roughly equivalent (USD 52 billion for Australia and USD 54 billion for Canada)[23];
- Both countries are in the middle of the OECD's FDI Restrictiveness Index[24];
- Both countries have a relatively high level of regulation of business activities (e.g. environmental protection, labour laws);
- Both countries have a social healthcare system;
- Both countries have a well respected domestic court system;
- Both countries have an important economic/political/military relationship with the US.

Key differences:

- Canada is more dependent on trade with the US than Australia is;
- The average amount of FDI inflows from the US into Canada for the last three years where data is available (2010-12) is higher (USD 16 billion) than into Australia (USD 13.6 billion).

The similarities between Canada and Australia in terms of the regulatory environment suggest that Australia is likely to face the same kind of disputes as Canada has – i.e. *disputes over regulatory issues* rather than direct expropriations or other interferences in the operation of an investment project. The fact that both countries have federal systems is also relevant, as a large number of Canada's ISDS

[23] UNCTAD STAT. Foreign Direct Investment: Inward and Outward Flows and Stock, Annual, 1980-2014, available at: http://unctadstat.unctad.org/wds

[24] OECD FDI Regulatory Restrictiveness Index, available at: http://www.oecd.org/investment/fdiindex.htm (last visited 1 July 2016)

cases have *related to provincial measures* (see Annex 1).

However, although the US is the single greatest source of FDI for both countries, American investment has greater dominance in Canada than Australia. This means that extrapolating from Canada's experience with NAFTA may result in an over-estimate in terms of the number of cases that Australia is likely to face (if one assumes that less investors = less likelihood of an ISDS case emerging). On the other hand, Australia will additionally be exposed to ISDS cases from Canadian investors under the TPP. Inward flows of Canadian investment into Australia averaged USD 3.4 billion in the period 2010-2012. Canadian investors have launched 41 ISDS claims, including 15 against the US.[25] Thus, while Australia may not experience as many ISDS cases from US investors as Canada has under NAFTA, the overall number of cases may be as high or higher.

TPP vs NAFTA

It has been argued by the some observers that ISDS under the TPP cannot be compared to ISDS under NAFTA because of the introduction of 'safeguards' into the former agreement. Experts have documented elsewhere why these safeguards are insufficient.[26] To summarise:

- The key difference between NAFTA and TPP on 'National Treatment' and 'Most Favoured Nation Treatment' is a footnote that will have little impact as it allows tribunals to determine whether a government's measures are 'legitimate';
- The same 'safeguard' on the 'Minimum Standard of Treatment' that exists in the TPP was introduced into NAFTA in 2001 (and this has not prevented problematic interpretations);
- The 'safeguard' on the 'Expropriation' provision in the TPP has a significant loophole (allowing regulatory action to be considered expropriatory 'in rare circumstances');
- All of the 'safeguards' in the TPP can be negated if a tribunal allows the investor to use the 'Most Favoured Nation Treatment' clause to access the substantive provisions of other treaties.

While most of the substantive provisions of investment protection are not markedly different in the two treaties, it should be noted that the TPP actually provides more extensive coverage than NAFTA because it allows foreign investors to claim

[25] UNCTAD Investment Dispute Settlement Navigator – Canada as Home State, available at: http://investmentpolicyhub.unctad.org/ISDS/CountryCases/35?partyRole=1 (last visited 16 September 2016)

[26] L. Johnson and L. Sachs. 2015. "The TPP's Investment Chapter: Entrenching, Rather than Reforming, a Flawed System", Columbia Center on Sustainable Investment (CCSI) Policy Paper, available at: http://ccsi.columbia.edu/files/2015/11/TPP-entrenching-flaws-21-Nov-FINAL.pdf; "TPP's clauses that let Australia be sued are weapons of legal destruction, says lawyer", *The Guardian*, 10 November 2015, available at: https://www.theguardian.com/business/2015/nov/10/tpps-clauses-that-let-australia-be-sued-are-weapons-of-legal-destruction-says-lawyer

compensation for violations of "investment agreements" (i.e., contracts) with governments.[27]

Another major difference between the TPP and NAFTA is that the TPP is much larger. However, the main concern for Australia is disputes arising from the US. As shown in the map below (Figure 1), Australia already has treaties providing ISDS with 5 out of its 11 TPP partners (Chile, Mexico, Peru, Singapore, and Vietnam; as an aside, this also belies the claim that Australian corporations will benefit from increased access to ISDS in the TPP in countries where political risk is high). With respect to the others, there is no bilateral investment treaty or free trade agreement in place with Brunei or Canada. While Australia and New Zealand are both party to the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA), which includes ISDS, there are side letters that preclude the New Zealand investors from using ISDS against Australia (this is also the case in the TPP). Malaysia and the US both have free trade agreements with Australia that exclude ISDS. Japan also has a free trade agreement with Australia that does not include ISDS, but a clause in that agreement requires the development of ISDS provisions if Australia enters into another agreement with ISDS (this has been triggered by the China-Australia Free Trade Agreement – ChAFTA).

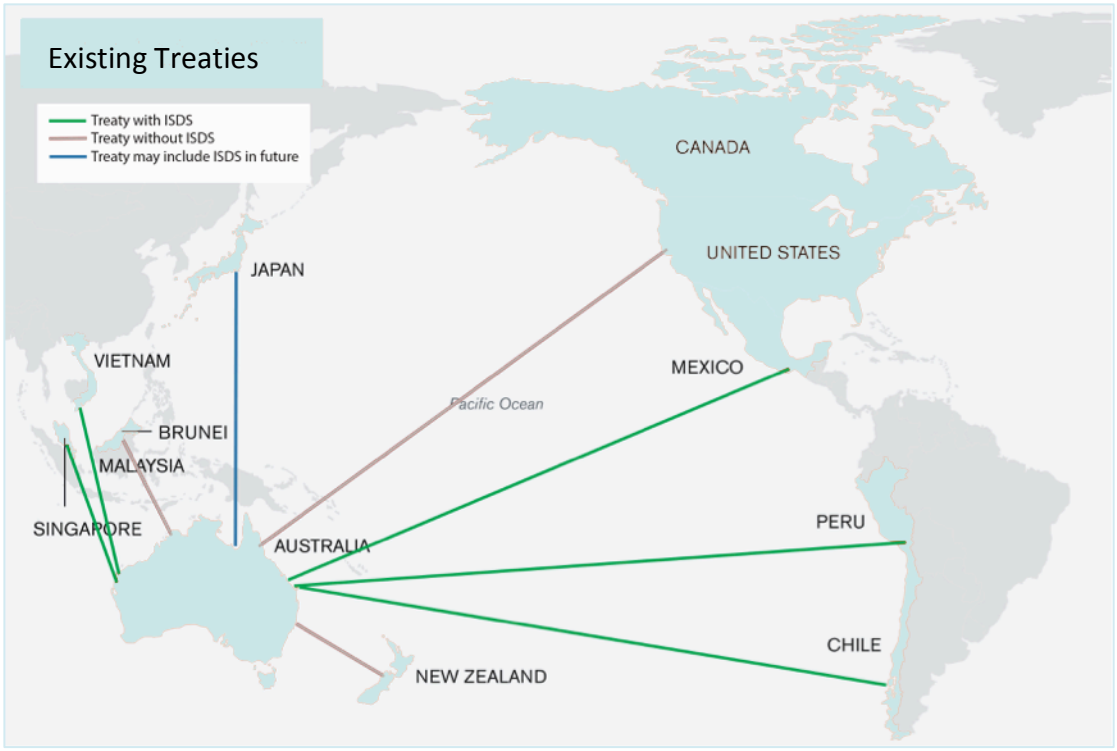

Figure 1: Existing ISDS Arrangements between Australia and TPP Partners

Furthermore, as indicated in Figure 2, of all of the TPP countries, only the US and to a lesser extent Canada are home to a large number of claimants in ISDS cases. This

[27] Van Harten, G. 2016. "Foreign Investor Protections in the Trans Pacific Partnership", Canadian Centre for Policy Alternatives, available at: https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2016/06/Foreign_Investor_Protections_TPP.pdf

may certainly change in the future with the growth of outward FDI from Asian countries; however, for the moment the main threat is US-based companies.

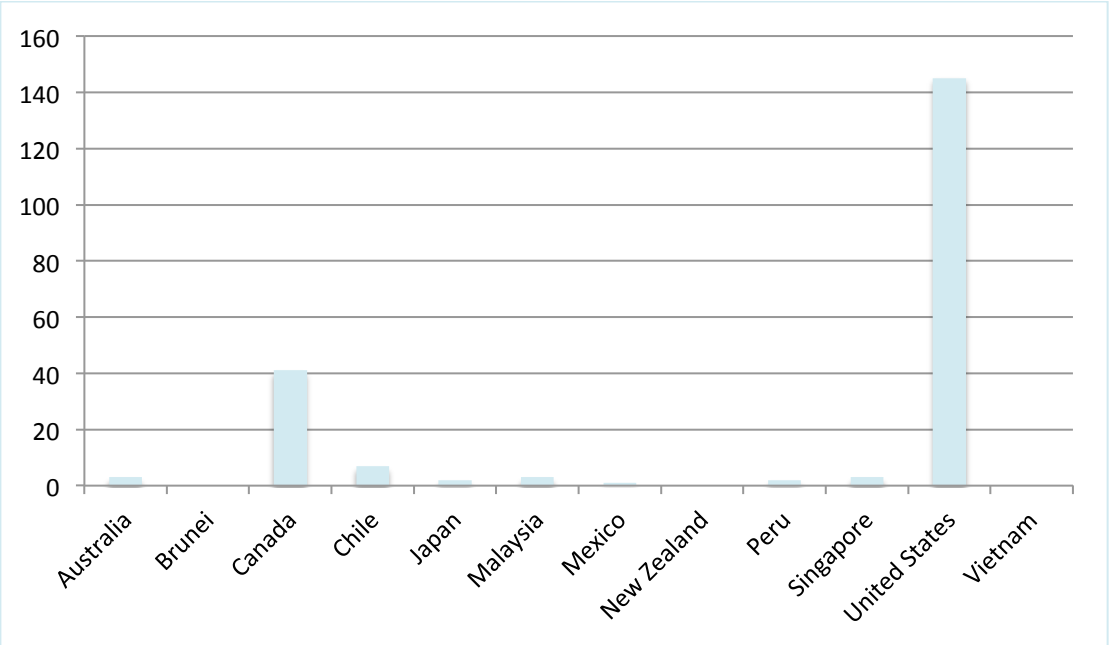

Figure 2: TPP Parties as Home States of ISDS Claimants (Source: UNCTAD)

SECTION 2: ANALYSIS

2.1 HOW MANY ISDS CASES IS AUSTRALIA LIKELY TO FACE UNDER THE TPP?

As of August 2016, the United Nations Conference on Trade and Development (UNCTAD) had counted 739 *known* ISDS cases.[28] As shown in the graph below, there has been a steady increase in cases per year since 1996. Last year had the largest number of cases launched in a single year on record (72).[29] At least 109 countries have been sued in ISDS to date. Argentina has been the most frequently sued (59 cases), followed by Venezuela (40) and Spain (34). These numbers do not include all cases that have been initiated but, for one reason or another, have yet to reach the stage of formal proceedings. For example, UNCTAD only reports 26 cases against Canada, including one very recent dispute brought by an Egyptian investor (Canada's first non-NAFTA dispute). Annex 1 of this report includes 14 additional NAFTA claims that have been initiated but are not counted by UNCTAD.

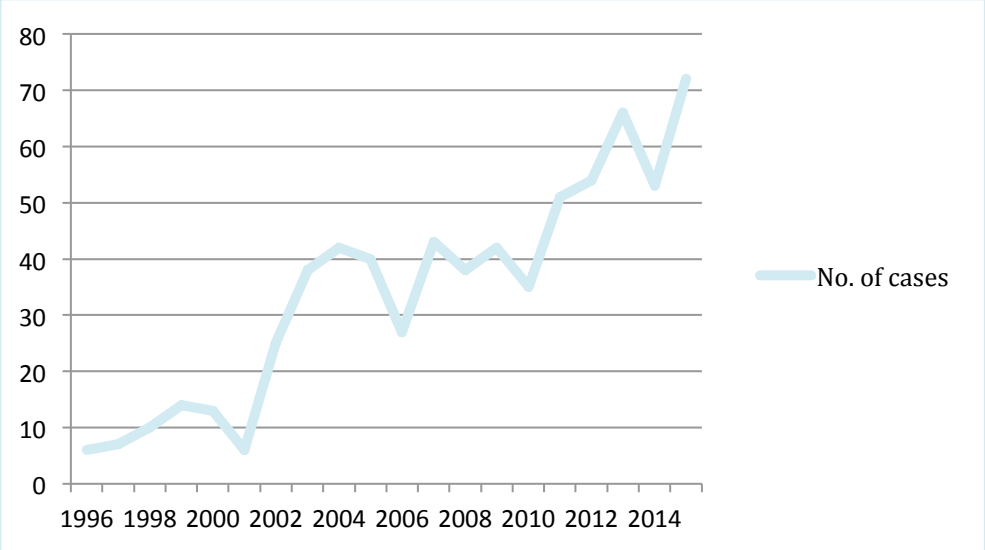

Figure 3: Known ISDS Cases Per Year (Globally) (Source: UNCTAD)

Canada's Experience

Canada has faced 39 NAFTA-based ISDS claims in the twenty-two years that the agreement has been in force, all from American investors (see Annex 1 for details). However, 69% of those cases (27) have been initiated in the last decade (since 2006). On average Canada received 1.2 claims per year in the first decade of NAFTA, and this has risen to 2.7 claims per year in the second decade. The rise in disputes is assumed by many to have corresponded with increased awareness amongst investors that they could use NAFTA to sue Canada over regulatory measures.

14 of the 39 claims against Canada have been withdrawn or have become inactive

[28] UNCTAD, see note 21.
[29] UNCTAD. 2016. "Review of Investor-State Developments in 2015", IIA Issues Note No.2, available at: http://investmentpolicyhub.unctad.org/Upload/ISDS%20Issues%20Note%202016.pdf

without any known settlement agreement from the Government. These tend to be small claims brought by individuals or small companies. A further 7 cases were still pending conclusion at the time of writing, but these cases were brought by large corporations for significant sums and are very likely to conclude in arbitration or through a settlement.

On the one hand, Australia could experience fewer cases than this under the TPP in light of the greater dominance of US FDI in Canada compared with Australia (as mentioned in Section 1.3). On the other hand, it is entirely possible that Australia will experience many more cases, as the government will also be exposed to Canadian investor claims. Furthermore, changing policy in just one area can result in a sudden flood of ISDS cases (sometimes referred to as the 'piling on' effect). This is what happened in Spain when the country made a number of changes to its incentives schemes for renewable energy generation, resulting in 33 investor claims in just 5 years.

2.2 HOW MUCH DOES AN ISDS CASE COST IN LEGAL AND ARBITRATION FEES?

Arbitration was initially touted as a cheap and efficient means to deal with disputes but recent experience belies such claims. Australia reportedly spent AUD 50 million in the Philip Morris case, which never even reached the merits phase.[30] In some instances, the legal costs and arbitration fees associated with a case exceed the compensation awarded to the investor.[31]

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.[32]

In one study of 221 cases, law firm Allen & Overy found that on average, states spent USD 4.559 million defending themselves in arbitration (approximately AUD 6 million).[33] This is lower than that found in an earlier OECD study, which suggested that the average case costs USD 8 million (AUD 10.6 million).[34] Both reports rely on incomplete datasets. The OECD survey covered 143 available ISDS arbitration awards, of which only 28 provided information about both the arbitral fees and the

[30] "Australia faces $50m legal bill", see note 17.

[31] *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.

[32] 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, available at: http://www.iisd.org/sites/default/files/publications/stakes-are-high-review-financial-costs-investment-treaty-arbitration.pdf

[33] Hodgson, M. 2014. "Investment Treaty Arbitration: How much does it cost? How long does it take?", available at: http://www.allenovery.com/publications/en-gb/Pages/Investment-Treaty-Arbitration-How-much-does-it-cost-How-long-does-it-take-.aspx

[34] 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, available at: http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf

parties' legal expenses, 81 provided partial information about costs and 62 provided no information. Half of the Allen & Overy case set had no information on the respondent state's legal costs.

In terms of cost recovery, there is no 'loser pays' rule in arbitration, which means that a state can 'lose' (in terms of expenditure on costs) even if it 'wins'. The Allen & Overy study found that the successful party recovers **some portion** of its costs in 44% of cases but that successful investors are more likely to recover costs (53%), than successful States **(38%).** If one accepts the most optimistic success rates for states (from UNCTAD – see further discussion below) of 58% in cases which are concluded in arbitration (i.e. excluding settlements, withdrawn claims etc.) then this means that **Australia can expect to recover a portion of its costs in only 22% of cases.** It can also expect to have to cover some portion of the investor's costs in 22% of cases.

Canada's Experience

As shown in Annex 2, there are some notable gaps in the data on Canada's costs in NAFTA Chapter 11 cases. Based on the cases with information on costs available, an average per year legal cost (excluding arbitration fees) for a case of CAD 948,344 was estimated. This was used to come up with an estimate for the total expenditure for 9 cases.[35] It should be noted that the total cost of Canada's experience with NAFTA is much higher than the value provided in Annex 2 because 7 further cases are pending (but have already required expenditures) and in 1 decided case (Windstream) it is known that Canada has to pay CAD 2.9 million of the investor's legal fees but no information was available at the time of writing about the government's own costs or the arbitration fees for the case. Furthermore, even cases that are initiated but withdrawn or discontinued have a cost for the government. For example, the *Centurion* case never proceeded past the very preliminary stage of arbitration because the claimant failed to pay the necessary deposit for the arbitration fees. However, Canada reported that it spent CAD 227,651.69 in legal expenses as well as CAD 4667.99 on consultant fees and other costs. The tribunal also charged USD 37,905.45 in fees. The tribunal ordered the claimant to pay the arbitration fees and Canada's consultancy fees but not the government's legal expenses.[36]

If an average case takes 4.5 years, then the average legal costs for Canada is CAD 4.3 million (~3.3 million USD). It makes sense that Canada would have a lower average cost than the global average found in the Allen & Overy or OECD studies discussed above. This is because the country has very experienced in-house counsel (having dealt with so many cases) and does not need to rely on expensive external expertise.

[35] *Ethyl* v. *Canada* was excluded even though it proceeded through the jurisdictional phase of arbitration because no information on costs was available. The award on damages/costs in *Clayton/Bilcon* had not been released at the time of writing.

[36] Order for the Termination of the Proceedings and Award on Costs, *Melvin J. Howard, Centurion Health Corp. and Howard Family Trust* v. *The Government of Canada*, 2 August 2010, available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/centurion-06.pdf

In the cases in which it was successful, Canada recovered an average of 26.4% of its costs. In total, it spent an estimated **CAD 17.3 million on the cases it won**. Overall, Canada has spent an estimated average of **CAD 4.5 million in non-recoverable legal costs and arbitration fees per case** (an average of CAD 6 million in cases it lost and CAD 3.4 million in cases it won).

One would assume that Australia's costs in its next ISDS case would be lower than the reported AUD 50 million spent on the tobacco dispute. However, it might take some time for the government to develop the substantial in-house expertise required to bring the cost of ISDS cases down to the Canadian average. Furthermore, costs in arbitration appear to be on the rise.[37] However, even if we adopt a conservative estimate of AUD 4.5 million per case, this stands in stark contrast to the cost of a domestic court case against the government. For example, defending the plain packaging legislation in the High Court was estimated to cost the government only a few hundred thousand dollars (and the companies were required to pay these costs when they lost the case).[38]

2.3 HOW MUCH DO STATES PAY OUT IN DAMAGES IF THEY LOSE?

The majority of awards for damages in ISDS cases are for between USD 1-499.9 million.[39] A small number of awards are for less than USD 1 million and a small number are for more than USD 500 million. The largest known award was for USD 50 billion, although the respondent (Russia) has so far refused to pay and efforts by the claimants to enforce the ruling in the Dutch courts recently failed.[40]

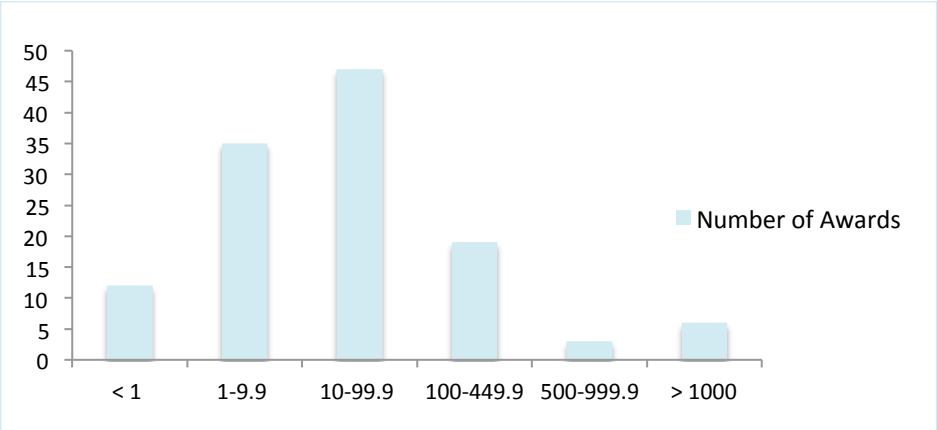

Figure 4: Damages in USD millions (Global Data) (Source: UNCTAD)

[37] UNCTAD. 2010. "Investor–State Disputes: Prevention and Alternatives to Arbitration", UNCTAD Series on International Investment Policies for Development, available at: http://unctad.org/en/docs/diaeia200911_en.pdf

[38] "Big tobacco loses High Court battle over plain packaging", Sydney Morning Herald, 15 August 2012, available at: http://www.smh.com.au/federal-politics/political-news/big-tobacco-loses-high-court-battle-over-plain-packaging-20120814-247kz

[39] UNCTAD, Investment Dispute Settlement Navigator: Amount of Compensation, available at: http://investmentpolicyhub.unctad.org/ISDS/FilterByAmounts

[40] "US$50 billion awards against Russia in Yukos cases are set aside by Dutch court", *Investment Treaty News*, 16 May 2016, available at: https://www.iisd.org/itn/2016/05/16/us50-billion-awards-against-russia-in-yukos-cases-are-set-aside-by-dutch-court/

Canada's Experience

While the global picture is informative, many of the largest awards in ISDS are for major contractual disputes, typically in the resources sector. While it is not out of the question that Australia could become embroiled in this type of dispute, the cases of most concern to Australians tend to be the types of regulatory cases that have emerged in Canada, which are typically of a lower degree of magnitude in terms of the size of the awards.

Canada has had 8 cases with disclosed losses or settlements (2 further settlements are undisclosed and 1 case is still pending an award on damages) totaling **CAD 216.7 million**.[41] This is an average payout of **CAD 27 million**. However, it should be noted that two cases are outliers - the settlement with AbitibiBowater for CAD 130 million at one end of the spectrum and the settlement with Dow Chemical involving no payment of compensation at the other end. The average without these cases included in the calculation is **CAD 14.5 million**.

Table 1: Compensation Payments Made by Canada in ISDS Cases

	Losses in Arbitration		Settlements	
	Case	*Payment (CAD)*	*Case*	*Payment (CAD)*
	S.D. Myers	7,400,000	Ethyl	19,500,000
	Pope & Talbot	870,000	St. Mary's	15,000,000
	Mobil & Murphy	18,960,678	AbitibiBowater	130,000,000
	Windstream	25,000,000	Dow	0
Total		**52,230,678**		**164,500,000**
Average		**13,057,670**		**41,125,000**

2.4 HOW OFTEN DO STATES LOSE?

As one ISDS expert has pointed out, "most observers acknowledge [that] states never win; they only do not lose".[42] This is because only investors can launch ISDS disputes and claim damages.

UNCTAD has produced statistics on wins and losses based on available data. This is summarized in Figure 5.[43] This data suggests that states win more often (36%) than investors (26%). However, there is some controversy about how state 'wins' are portrayed. Some experts have argued, with good reason, that decisions on

[41] This value is based on information provided in Sinclair, S. 2015. "NAFTA Chapter 11 Investor-State Disputes to January 1, 2015", available at: https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/01/NAFTA_Chapter11_Investor_State_Disputes_2015.pdf and the Government of Canada's summaries of NAFTA disputes on their website: http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng

[42] Mann, H. 2015. "ISDS: Who Wins More, Investors or States?", *Investment Treaty News*, available at: http://www.iisd.org/itn/wp-content/uploads/2015/06/itn-breaking-news-june-2015-isds-who-wins-more-investors-or-state.pdf

[43] UNCTAD 2016, see note 29.

jurisdiction and the merits should be disaggregated. One expert has calculated that states win only 28% of decisions on jurisdiction and 40% of decisions on the merits.[44] This means that investors win most of the time: 72% of the decisions on jurisdiction, and 60% of cases decided on the merits (see Figures 6 and 7).

Additionally, these statistics only concern cases that actually proceed all the way through arbitration. Equally important (when one is concerned about regulatory implications and the impact of compensation payments on the public purse) are settlements. The global data suggests that more than one quarter of cases (26%) are settled.

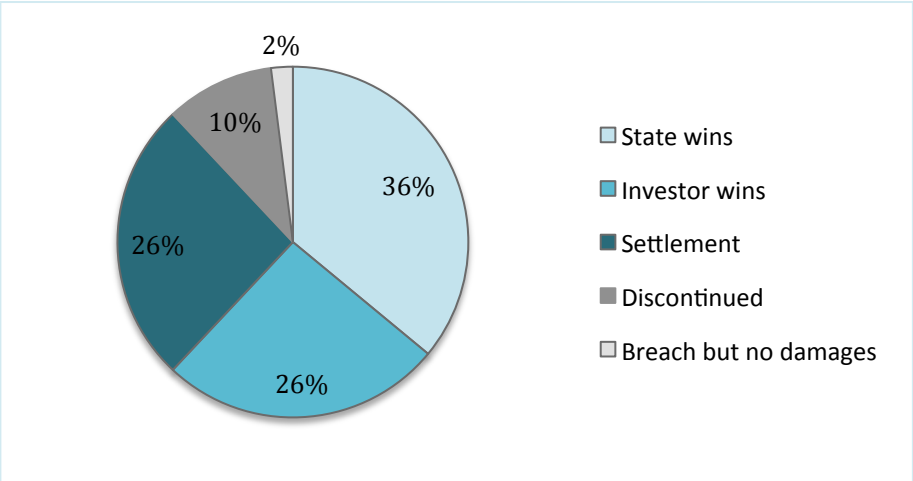

Figure 5: Outcomes of ISDS Cases Globally (Source: UNCTAD)

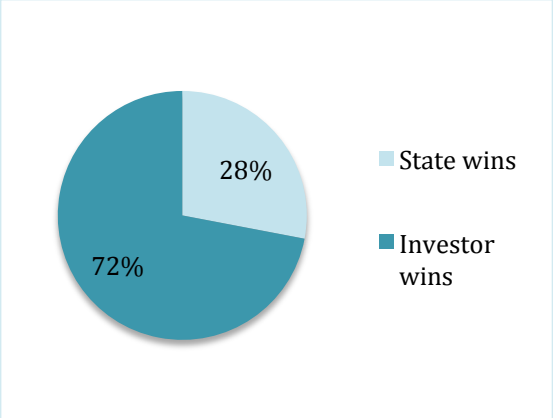

Figure 7: Decisions on Jurisdiction (Source: IISD)

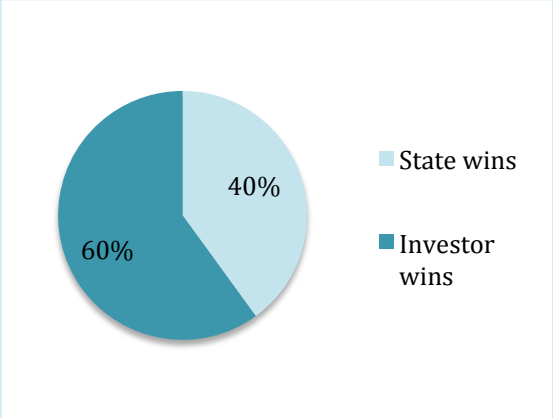

Figure 6: Decisions on Merits (Source: IISD)

Canada's Experience

Canada has settled or lost 11 cases and won 6 (1 on jurisdiction and 5 on the merits). One further case was discontinued when the claimant failed to pay its portion of the deposit for arbitration fees. If settlements are considered loses this is a success rate of only 35%.

[44] Mann 2015, see note 42.

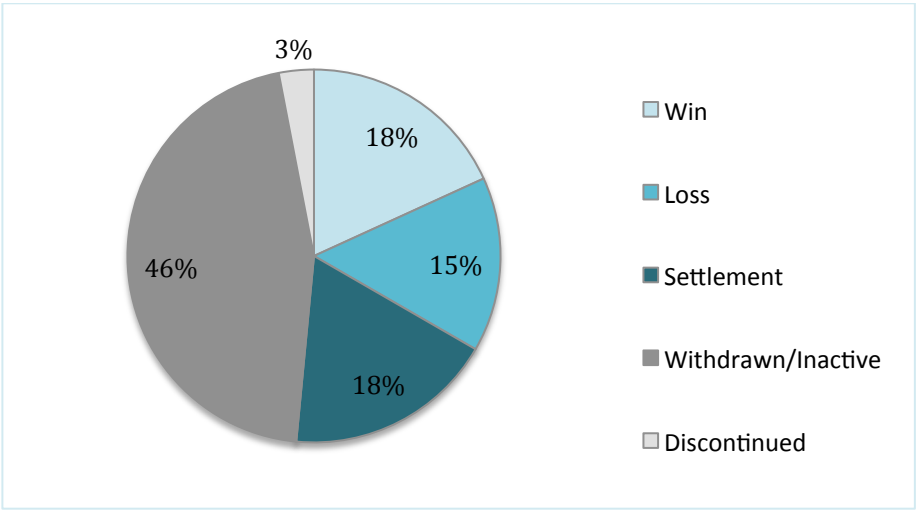

Figure 8: Canada's ISDS Record

SECTION 3: UNQUANTIFIABLE COSTS

3.1 REGULATORY CHILL

While risking the loss of hundreds of millions of dollars in return for no benefit is problematic, the bigger concern for many is that the TPP has an unquantifiable cost through *regulatory chill*. The regulatory chill hypothesis suggests that in some instances governments will fail to enact or enforce regulatory measures (or modify measures to such an extent that their original intent is undermined or their effectiveness is severely diminished) as a result of concerns about ISDS.[45] Law firms actively advertise ISDS as a useful tool "to assist lobbying efforts to prevent wrongful regulatory change".[46]

The key word here is 'wrongful'. Proponents of ISDS argue that governments can reasonably expect *bona fide* measures to survive any challenge and that everything else *should* be 'chilled'.[47] In terms of the former proposition, it is important to keep in mind that regulators are subject to bounded rationality: they experience time and resource constraints and there are serious limitations on their ability to predict the outcomes of legal cases. This is particularly true in ISDS because the ambiguous nature of the provisions found in investment treaties (e.g. the requirement to provide 'fair and equitable treatment') leaves significant scope for arbitrators to interpret the law and because awards rendered in investment arbitration are only binding on the parties involved in the dispute (there is no precedent). In this environment of uncertainty, governments may have a *distorted perception of their chances of success* in arbitration and may also be *reluctant to risk a negative outcome* because the stakes involved in ISDS are very high.

In terms of the notion that some regulatory actions *should* be chilled, what ISDS proponents are thinking of here is when a government frames a regulatory measure that was designed solely with discrimination or protectionism in mind as an environmental or public health measure. The 'chilling' of such measures can viewed less pejoratively as 'compliance' with international law, as this is what trade agreements were originally intended to prevent. However, in practice, regulation is a messy business and governments frequently have multiple motivations for adopting policy measures. The extant case law demonstrates that the various actors involved in ISDS cases have held widely diverging opinions on where the line between *bona fide* and illegitimate measures should be drawn.

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[45] Tienhaara, K. 2011. "Regulatory Chill and the Threat of Arbitration: A View from Political Science" in C. Brown and K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press), 606-627.

[46] Coleman, M., Low, L., Norton, P., Davidson, S., Pryce, J., Aldridge, H. and T. Innes. 2014."Foreign Investors' Options to Deal with Regulatory Changes in the Renewable Energy Sector", 23 September 2014, available at: http://www.steptoe.com/publications-9867.html

[47] Coe, J. and N. Rubins. 2005. 'Regulatory Expropriation and the *Tecmed* Case: Context and Contributions" in T. Weiler (ed.), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*. London: Cameron May, pp. 597, 599; Schill, S. 2007. "Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?" 24 *Journal of International Arbitration* 469.

There is a growing body of evidence documenting regulatory chill.[48] Keeping with the Canadian comparison, this report takes a closer look at the concerns about regulatory chill that have emerged in the context of two concluded cases against Canada (*Ethyl* and *Clayton/Bilcon*) as well as a pending case (*Lone Pine*) that has particular relevance in the Australian context.

SECTION 3.2: THE STORY OF ETHYL V. CANADA

In 1997, the Canadian Government banned the import and interprovincial trade[49] in Methyl-cyclopentadienyl manganese tricarbonyl (MMT) - a fuel additive used to increase the level of octane in unleaded gasoline. The automotive industry has long argued that use of MMT results in deposits of manganese residues, which disrupt the proper functioning of emission control and monitoring systems in cars, leading to increased emissions of air pollutants. The combustion of MMT releases airborne respirable manganese and unburned MMT into the atmosphere.[50] Manganese is a potent neurotoxin when inhaled but the health effects of MMT are disputed. The Canadian MMT ban was classic example of regulation based on the precautionary principle.

An American company - Ethyl Corporation was the developer and sole importer of MMT into Canada at the time of the ban. Ethyl launched an ISDS case under NAFTA (before the ban even came into effect) asking for USD 201 million in compensation. Canada objected to the tribunal's jurisdiction over the case, but lost this challenge.[51] Canada announced a settlement with Ethyl less than one month after the decision on jurisdiction.[52] The Government agreed to reverse the ban on MMT, to pay Ethyl USD 13 million in legal fees and damages and to issue a statement declaring that current scientific information did not demonstrate any harmful effects of MMT to health or automotive systems.

Since the settlement, MMT has remained controversial and scientific evidence increasingly indicates that Canada was correct in its original precautionary approach. In 2003, the American Academy of Paediatrics stated that "to permit addition of

[48] See Tienhaara 2011 (note 44) and Bonnitcha 2014 (note 19) for examples. Also see the recent four-part report on ISDS by Pulitzer Prize winning reporter Chris Hamby: https://www.buzzfeed.com/globalsupercourt

[49] As MMT is not produced in Canada, the ban ensured the removal of MMT from all Canadian gasoline. The particular approach of a trade ban was adopted by the government because it had been determined that MMT did not meet the requirements for prohibition under the Canadian Environmental Protection Act.

[50] *Ethyl Corporation* v. *Government of Canada*, Statement of Defence, 27 November 1997.

[51] *Ethyl Corporation* v. *Government of Canada*, Preliminary Award on Jurisdiction, 24 June 1998, reproduced in 38 ILM (1999): 700, available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/ethyl-08.pdf

[52] Van Harten and Scott quote an interviewee that was a high-level policy advisor in the federal government at the time of Ethyl stating that the government was "spooked" by the decision. Van Harten, G. and D. Scott. 2016. "Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study from Canada, Osgoode Hall Law School Legal Studies Research Paper Series No 26, Volume 12, Issue 6, available at: http://ssrn.com/abstract=2700238

MMT to the US gasoline supply would not be prudent," and recommended that, "prevention of exposure to the most toxic additives to gasoline, such as tetraethyl lead, MMT, [and others] is best achieved by government regulation or phasing out of these compounds." [53] In 2006, experts at an international workshop on the Prevention of the Neurotoxicity of Metals issued a Declaration, stating:

> The addition of organic manganese compounds to gasoline should be halted immediately in all nations. The data presented at the Brescia Workshop raise grave concerns about the likelihood that addition of manganese to gasoline could cause widespread developmental toxicity similar to that caused by the worldwide addition of tetraalkyllead to gasoline. In light of this information, it would be extremely unwise to add manganese to gasoline.[54]

In terms of the impacts on emissions systems, a 2015 report from the Coordinating Research Council (a non-profit organisation supported by the petroleum and automotive equipment industries) found that "there is credible evidence that under certain operating conditions" use of MMT in certain types of cars can "contribute to catalyst plugging, thereby impairing emissions control performance".[55] All major manufacturers selling vehicles in the US recommend in their vehicle owner manuals that owners not use any fuels containing MMT.[56] In response to the concerns of automakers, many oil refiners have voluntarily eliminated MMT from gasoline in the US and Canada. Since 2004, at least 95% of fuel in Canada has been MMT-free.[57]

In other jurisdictions, such as the Czech Republic and Germany, MMT is banned. In New Zealand, manganese in fuel has been restricted to 2 mg/L since 2002. As a minimum of 8 mg/L is typically necessary for the additive to perform, this is effectively a ban on MMT. The EU adopted the same approach in 2014, after winning a case brought by Afton Chemical (a subsidiary of the same corporation that owns Ethyl) in the courts of England. In his decision against Afton, the High Court of Justice of England and Wales stated:

> Where it proves to be impossible to determine with certainty the existence or extent of [an] alleged risk because of the insufficiency, inconclusiveness or imprecision of the results of studies conducted, but the likelihood of real harm to public health persists should the risk materialise, the precautionary principle justifies the adoption of restrictive measures…In those circumstances, it must be acknowledged that the European Union legislature may, under the precautionary

[53] Minjares, R. and M. Walsh. 2009. "Methylcyclopentadienyl Manganese Tricarbonyl (MMT): A Science and Policy Review", The International Council on Clean Transportation, available at: http://www.theicct.org/sites/default/files/publications/MMT_dec08.pdf

[54] The Declaration of Brescia on the Prevention of the Neurotoxicity of Metals, Brescia, Italy, 17-18 June 2006, available at: http://www.unep.org/transport/pcfv/PDF/Brescia-Declaration.pdf

[55] Broch, A. and S. Hoekman. 2015. "Effects of Organometallic Additives on Gasoline Vehicles: Analysis of Existing Literature", CRC Report No. E-114, available at: http://www.crcao.com/reports/recentstudies2015/E-114/Final%20Report.pdf

[56] US Environmental Protection Authority. 2014. Control of Air Pollution from Motor Vehicles: Tier 3 Motor Vehicle Emission and Fuel Standards Summary and Analysis of Comments, available at: https://www3.epa.gov/otaq/documents/tier3/420r14004.pdf

[57] Minjares and Walsh 2009, see note 53.

> principle, take protective measures without having to wait for the reality and the seriousness of those risks to be fully demonstrated.

In summary, **Canadians were exposed to unnecessary emissions of manganese and potentially other air pollutants (through damage to vehicle emissions controls) for six years** (from the reversal of the ban in 1998 to the voluntary phase-out in 2004) as a result of regulatory chill. The cost of this to the public is significant, even if it is unquantifiable. The same could happen in Australia under the TPP.

SECTION 3.3: THE STORY OF CLAYTON/BILCON V. CANADA

This case begins in a small corner of the Province of Nova Scotia on the Eastern Coast of Canada in a place called Digby Neck. The Bay of Fundy, in which Digby Neck sits, is a UNESCO designated biosphere reserve.[58] The small local community that lives there largely depends on fishing and tourism, particularly whale watching expeditions.

In 2002, Bilcon—the Canadian arm of Clayton Concrete Block and Sand, a large New Jersey-based aggregate producer—proposed to establish one of the largest quarries in Canada at Whites Point on Digby Neck. The plan was to export 40,000 tons of aggregate each week, which was more than any existing quarry on the Neck produces in a year.[59] To facilitate transport of the aggregate by ships, Bilcon also proposed to build a marine terminal.

Before Bilcon could proceed with its investment, it had to go through an environmental impact assessment. Because there was a marine terminal involved, the company's proposal fell under the jurisdiction of both the Province of Nova Scotia and Fisheries and Oceans Canada – a federal agency. This triggered what is known as a Joint Review Process. In 2004, a Joint Review Panel was set up to determine the environmental impacts of the project and make recommendations to both the Federal and Provincial authorities.

The Joint Review Panel conducted 3 years of work, including extensive community consultations. Objections to the quarry that the panel heard included concerns that the lobster and scallop fishery, the region's lifeblood, would be fundamentally damaged by the project; that whales—specifically the endangered right whale—would be killed or injured by an increase in marine traffic; and that local flora and fauna including the human inhabitants in the area would be adversely affected by the noise, dust, augmented road traffic, and prospect of diminished groundwater.[60]

The overwhelming evidence was that the majority of people in the area did not want the quarry—the Digby town council, the rural Municipality of Digby, Digby's elected

[58] See 'Fundy Reserve', available at: http://www.fundy-biosphere.ca/en/
[59] Richler, N. 2007. "Rock Bottom", *The Walrus*, available at: https://thewalrus.ca/rock-bottom/
[60] Environmental Assessment of the Whites Point Quarry and Marine Terminal Project, Joint Review Panel Report, Executive Summary, October 2007, available at: https://www.novascotia.ca/nse/ea/whitespointquarry/WhitesPointQuarryFinalReportSummary.pdf

representatives at the Provincial and Federal level, the Digby Neck Community Development Association, the Western Valley Development Authority, and the Municipality of Annapolis all spoke out against it.[61]

The environmental review Panel, in its final decision, expressed concern about a number of the environmental issues raised in the course of the hearings, particularly the impact of the project on whales. However, it also made reference to the impact that the project would have on the "core values" of the community in Digby Neck.[62] The panel report wasn't binding, but both the Provincial and Federal authorities decided to proceed with the panel's recommendation and accordingly rejected Bilcon's project.

On 5 February 2008, members of the Clayton family and their company Bilcon of Delaware filed a claim for arbitration under Chapter 11 of NAFTA. Over the course of the case the investors argued that: their project should not have been subjected to a joint provincial/federal environmental review; the review process was seriously flawed and biased against the project; the review process was excessively onerous and lengthy; and that the basis for the rejection of the project by the review panel was outside the scope of its mandate because it emphasised the impact that the quarry and marine terminal would have on 'core community values' in the area. Through the faulty environmental review process, they argued, Canada violated Articles 1105, 1102 and 1103 of NAFTA on the minimum standard of treatment (including fair and equitable treatment), national treatment and most favoured nation treatment respectively. They requested damages in the sum of not less than USD 188 million.

The claimants argued that, in accordance with the national treatment and most-favoured nation treatment standards, the tribunal should compare the treatment of their investment with the treatment of any other investor that has undergone an environmental review in Canada. A lengthy section of the company's Memorial describes nine projects (some are quarries but others are in completely different sectors) in an attempt to show that Canada treated the investors in those projects more favourably.[63] In its Counter-Memorial, Canada argued that the Claimants' approach is "ill-founded and ultimately unsustainable".[64] The government noted that every environmental assessment process is determined by a specific set of environmental, economic, social and policy factors unique to a given project. If every project that undergoes an environmental assessment were considered to be 'in like circumstances' then "the environmental assessment process would not be an 'assessment' or a 'process' at all"; every project would have to be treated the same in spite of differences in size, sector and expected impacts on the environment and

[61] Richler 2007, see note 59.
[62] Joint Review Panel Report, see note 60.
[63] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware* v *Government of Canada*, Memorial of the Investors, 25 July 2011, available at: http://www.pcacases.com/web/sendAttach/1721
[64] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware* v *Government of Canada*, Counter-Memorial of Canada, 9 December 2011, available at: http://www.pcacases.com/web/sendAttach/1722

society.[65] However, Canada also argued that even if the Claimant's definition of 'like circumstances' was accepted by the Tribunal, the picture painted in the Memorial is an inaccurate one; the Claimants ignored examples of projects that were rejected after undergoing an environmental assessment just as their project was. Canada depicts the Claimants as "ill-informed and ill-prepared" investors that did not take the Canadian environmental assessment process seriously. [66] Simplistic and inaccurate statements made in the Claimants' Memorial such as "A quarry is simply a hole in the ground, with minimal environmental impact" lend credence to this characterisation.[67]

In one of the more controversial decisions in recent history, the majority of the panel in the Clayton/Bilcon case decided in favour of the company.[68] In terms of the national treatment standard, the tribunal determined that a higher standard of environmental review was applied to Bilcon's project than was the case for other investments in 'like circumstances' and thus was a breach of NAFTA. The tribunal rejected Canada's arguments that the other projects put forward by Bilcon as evidence were of different scope, in different locations, and involving completely different concerns and therefore not 'in like circumstances' with the Whites Point project.

In the case of the minimum standard of treatment, the majority of the tribunal first argued that that there was a very high threshold to breach standard and then proceeded to actually apply a very low threshold. In the view of the majority, Canada had breached the standard by failing to meet the investor's 'legitimate expectations'. The tribunal's reasoning was that Bilcon had been encouraged by local officials to invest in the area and furthermore had a legitimate expectation that the environmental review panel would not consider 'core community values' in its determination on whether the project should proceed. To do so was, according to the majority, outside of the environmental review panel's purview. The process was also deemed unfair because the environmental review panel failed to examine whether there were steps that Bilcon could have taken to mitigate the harm caused by the project.

There was a significant dissent in this case by Professor Donald McRae, who was Canada's chosen arbitrator.[69] He makes a number of critical points in his dissent, one being that 'core community values' are not outside the scope of a properly conducted environmental review process. He also argues that regardless of whether one believes that the review panel operated in line with Canadian environmental law, the fact remains that a potential breach of domestic law does not equate to an

[65] Ibid
[66] Ibid.
[67] Memorial of the Investors, see note 63.
[68] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware* v *Government of Canada*, Award on Jurisdiction and Liability, 17 March 2015, available at: http://www.pcacases.com/web/sendAttach/1287
[69] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware* v *Government of Canada*, Dissenting Opinion of Professor Donald McRae, 17 March 2015, available at: http://www.pcacases.com/web/sendAttach/1288

actual breach of NAFTA. McRae highlights that by siding with the investors in this case, the majority of the tribunal is opening up the possibility that investors will be able to seek compensation for breaches of Canadian law when such a remedy is not actually possible in the domestic courts.

The fact that this was not the intention of the NAFTA parties when they drafted Chapter 11 is borne out by the responses of the US and Mexico to the Bilcon award. In a separate NAFTA dispute in which an investor tried to use the Bilcon decision to bolster its case against Canada, the governments of both Mexico and the US intervened to argue that, in their view—as the negotiators and signatories of NAFTA—the Bilcon tribunal had got it wrong with respect to the interpretation and application of the minimum standard.[70]

The US has also criticised the Bilcon Award's finding on National Treatment, stating that:

> the tribunal failed to adequately address nationality-based discrimination when determining whether the Claimants were in like circumstances with alleged comparators. The foreign investor or foreign-owned investment should be compared to a domestic investor or domestically owned investment that is like in all relevant respects but for nationality of ownership. Instead, the tribunal provided an overly broad interpretation of like circumstances…The tribunal also improperly placed the burden on Canada to justify the "differential and adverse treatment accorded to Bilcon[.]"[71]

While this is a very recent case (the final award on damages has yet to be released) and it would be therefore very difficult to measure any chilling impact, McRae concludes his dissenting opinion that this is what will occur:

> a chill will be imposed on environmental review panels which will be concerned not to give too much weight to socio-economic considerations or other considerations of the human environment in case the result is a claim for damages under NAFTA Chapter 11. In this respect, the decision of the majority will be seen as a remarkable step backwards in environmental protection.[72]

In June 2015, Canada filed a notice of application with the Federal Court of Canada seeking to set aside the Bilcon award on the grounds that the tribunal exceeded its jurisdiction and that the award is in conflict with the public policy of Canada. This request to set aside is possible because the site of arbitration was in Canada and under the UNCITRAL rules of arbitration a review of an arbitral award can take place in the courts where the arbitration occurred. But there is a very limited scope for

[70] *Mesa Power Group LLC* v *Government of Canada*, Second Submission of the United States of America as a Non-Disputing Party, 12 June 2015, http://www.pcacases.com/web/sendAttach/1455; *Mesa Power Group LLC* v *Government of Canada*, Second Submission of Mexico as a Non-Disputing Party, 12 June 2015, available at: http://www.pcacases.com/web/sendAttach/1454

[71] Second Submission of the United States, see note 70, p.3.

[72] McRae 2015, see note 69.

review and this shouldn't be mistaken for an appeals process, which is lacking in ISDS.

SECTION 3.4: THE STORY OF LONE PINE V. CANADA

Hydraulic fracturing or 'fracking', as it is commonly referred to, is a process to inject water, sand and various chemicals into the ground at a high pressure in order to fracture shale and coal bedrock formations to release the natural gas stored inside them. The process is highly controversial, with concerns ranging from the potential for groundwater contamination to the fact that it can trigger earthquakes.[73] The climate change implications of shale gas are the subject of debate. While some argue that gas is an appropriate 'bridging fuel' because it has lower carbon content than coal or petroleum, others point out that methane, an extremely potent greenhouse gas, can escape during the fracking process.[74] Furthermore, there are concerns that in addition to displacing coal power, shale gas also displaces renewable energy production.[75]

The Government of Québec has been studying the impacts of potential hydrocarbon (including shale gas) development in the province for over a decade. In particular, a number of strategic environmental assessments have been carried out to study the possible consequences of exploiting offshore resources within the maritime estuary basin and Gulf of the St. Lawrence River.[76] The conclusion drawn from these studies is that the area is a complex and sensitive environment and it is not an appropriate site for the development of hydrocarbon activities. Some of the reasons for this include the fact that the noise caused by seismic surveys can impact marine life and that the effects of spills on wildlife as well as fishing, tourism and recreation in the area could be devastating. The Government of Québec has also commissioned assessments specifically of the shale gas industry, which have concluded that fracking presents significant risks to the environment, particularly with respect to water resources.

In 2010, with increasing public disquiet over the fracking, the Government of Québec began to tighten regulations for the sector and adopted an inspection program for wells that had been drilled in the farmyards in the St. Lawrence Lowlands. This inspection program revealed the existence of gas leaks in a significant proportion of

[73] "Do fracking activities cause earthquakes? Seismologists and the state of Oklahoma say yes", CBC News, 28 April 2016, available at: http://www.cbc.ca/news/canada/edmonton/fracking-debate-earthquakes-oklahoma-1.3554275

[74] McJeon, H. et al. 2014. "Limited Impact on Decadal-Scale Climate Change from Increased use of Natural Gas", *Nature* 514, 482–485.

[75] 'Golden age of gas' threatens renewable energy, IEA warns", *The Guardian,* 30 May 2012, available at: https://www.theguardian.com/environment/2012/may/29/gas-boom-renewables-agency-warns

[76] This summary is based on information provided in: *Lone Pine Resources Inc.* v *Government of Canada*, Claimant's Memorial, 10 April 2015, available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC5878_En&caseId=C4406; *Lone Pine Resources Inc.* v *Government of Canada*, Government's Counter-Memorial (French), 24 July 2015, available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC7452_Fr&caseId=C4406

existing wells. In November 2010, the government took the step of issuing a moratorium on shale gas development in and around the St. Lawrence. This was followed up with the revocation of all mining rights in the area, including exploration permits, in 2011.

Lone Pine Resources, an American firm, had a working interest in a Canadian company (Junex Inc.) that had received exploration permits for petroleum, natural gas and underground reservoirs in Québec prior to the moratorium. Subsequently, Junex's exploration license under the St. Lawrence was revoked. In September 2013, Lone Pine Resources filed an ISDS case under NAFTA. Initially, the company asked for CAD 250 million in compensation but they later lowered the damages sought to USD 118.9 million (about CAD 168.5 million).[77] Lone Pine alleges that the revocation of Junex's river licence violates Canada's obligations under articles 1105 (minimum standard of treatment) and 1110 (expropriation). Lone Pine contends that Québec had instituted the moratorium in response to public opposition to fracking rather than an objective scientific assessment of the environmental issues at stake.

There are some obvious parallels between this case and the Bilcon dispute. In both cases, the argument from the investors appears to be that even in the presence of scientific evidence showing that a development presents a significant risk to the environment, governments should not be permitted to take into account any public opposition to a proposed project. In this view, making a decision that is in line with the public sentiment is 'political' and contrary to the terms of NAFTA. Essentially, if tribunals agree with this view, the result will be that local communities lose the right to 'say no' to controversial developments in their area without having to pay compensation to prospective investors.

If Lone Pine is ultimately successful in this case, this could have a significant chilling effect on similar regulatory efforts elsewhere in Canada and other parts of the world—including Australia where fracking is highly controversial. This appears to be what large energy companies are hoping for and why they lobby for ISDS to be included in agreements like the TPP. For example, the minutes of an April 2014 meeting between unnamed Chevron executives and European commission officials (obtained by *The Guardian* under access to information laws) note that Chevron (a company with several shale gas projects in Eastern Europe) believes "that the mere existence of ISDS is important as it acts as a deterrent".[78] In a submission to the US Trade Representative in 2013, the firm similarly argued that the existence of ISDS panels "increases the likelihood" of disputes being settled outside them.[79]

[77] Claimant's Memorial, ibid.

[78] "TTIP: Chevron lobbied for controversial legal right as 'environmental deterrent'", *The Guardian*, 26 April 2016, available at: https://www.theguardian.com/environment/2016/apr/26/ttip-chevron-lobbied-for-controversial-legal-right-as-environmental-deterrent

[79] Letter from Edward B. Scott, Vice President and General Counsel, Chevron Upstream Oil and Gas to Mr. Douglas Bell, Chairman Trade Policy Staff Committee, Office of the US Trade Representative, 7 May 2013, available at: https://assets.documentcloud.org/documents/1237936/ttip-lobbybrief-chevron.pdf

SECTION 4: CONCLUSIONS

When the Government of Canada signed onto NAFTA it had no idea what it was getting itself into. It is widely accepted that both Canada and the US believed that Chapter 11 would provide protection for their investors operating in Mexico. Neither government anticipated that the regulatory measures that they adopted in pursuit of the public interest would ever be challenged under the regime. In fact, at the time, ISDS cases against developed countries were unheard of. Australia is not entering the TPP in the same position—it has ample opportunity to learn from the past. Canada is Australia's canary in the coalmine.

Canada, of course, is also a party to the TPP. However, comparatively, the country has less to lose from Chapter 9 as it is already bound to ISDS under NAFTA with the largest single source of litigious investors—the US. When Australia signed an agreement with the US in 2005, it appeared to have heeded the warning signs and refused to include ISDS in AUSFTA. Since then, things have only gotten worse in the ISDS universe—more cases than ever are being launched, and there is no greater certainty about what vague provisions such as the requirement to provide investors 'fair and equitable treatment' actually mean.

While some observers may argue that the quantifiable costs detailed in this report are not substantial enough to be concerned about, in a time of 'budget austerity' it seems appropriate that the Australian public at least be aware of what the government is signing up to. Furthermore, in light of the complete absence of any public benefit of ISDS, the costs associated with it appear to be a completely unnecessary draw on the public purse. Finally, while it is impossible to put a price on the most significant risks of ISDS—the delaying or abandonment of public interest regulatory measures as a result of a chilling effect—this does not mean that they should be ignored in an analysis of the overall cost of the TPP.

ANNEX I:

Canada's NAFTA Chapter 11 Cases[80]

[80] See note 41 for information on sources.

	Case	Dates	Industry	Issue	Level of Gov't	Amount Claimed	Outcome	Award	Cost to Government
1	Signa SA	1996	Pharmaceuticals	Pharmaceutical patents	Federal	CAD 50 million	Withdrawn	None	Unknown
2	Ethyl Corp	1997-1998	Chemicals	Ban on trade in fuel additive	Federal	USD 250 million	Settled	Jurisdiction	USD 13 million in compensation, rollback of regulation, unknown legal costs.
3	S.D. Myers	1998-2002	Waste disposal	Ban on export of hazardous waste	Federal	USD 53 million	Investor win	Merits	CAD 6.05 million in compensation, see legal cost estimates in Annex 2
4	Sun Belt Water Inc.	1998	Transport/Water	Ban on export of bulk water	Provincial	USD 10.5 billion	Inactive	None	Unknown
5	Pope & Talbot	1998-	Forestry	Lumber export quota	Provincial	USD 508 million	Investor win	Merits	CAD 870,000 in compensation, see legal cost estimates in Annex 2
6	United Parcel Service (UPS) of America	2000-2007	Postal delivery	Public postal service	Federal	USD 160 million	State win	Merits (Dissent)	See legal cost estimates in Annex 2
7	Ketcham Investments	2000-2001	Forestry	Lumber export quota	Provincial	USD 30 million	Withdrawn	None	Unknown
8	Trammel Crow Co.	2001-2001	Postal delivery	Public postal service	Federal	USD 32 million	Settled	None	Unknown
9	Chemtura Corp.	2001-2010	Chemicals	Ban of pesticide	Federal	USD 83 million	State win	Merits	See legal cost estimates in Annex 2
10	Albert J. Connolly	2004	Mining	Natural heritage protection	Provincial	Not available	Inactive	None	Unknown
11	Contractual Obligation Productions LLC.	2004	Entertainment/ Television	Tax credits/ immigration rules	Federal	USD 20 million	Inactive	None	Unknown
12	Peter Pesic	2005	N/A	Work visa	Federal	Not available	Withdrawn	None	Unknown

13	Great Lake Farms and Carl Adams	2006	Agriculture	Dairy export/ quota rules	Federal and Provincial	USD 78 million	Inactive	None	Unknown
14	Merrill and Ring Forestry, L.P.	2006-2010	Forestry	Lumber export restrictions	Provincial	USD 25 million	State win	Merits	See legal cost estimates in Annex 2
15	V.G. Gallo	2006-2011	Waste Disposal	Ban on a type of municipal waste disposal	Provincial	CAD 105 million	State win	Jurisdiction	See legal cost estimates in Annex 2
16	Mobil Investments & Murphy Oil Corporation	2007-	Oil & Gas	Research and development requirements for energy companies	Federal	USD 60 million	Investor win	Merits	CAD 14.3 million in compensation, see legal cost estimates in Annex 2
17	Gottlieb Investors Group	2007-2008	Finance	Tax treatment of energy income tax trusts	Federal	USD 6.5 million	Inactive*	None	Unknown *NAFTA provides that in the case of a claim involving taxation measures, the national tax officials can vet the claim. In this case they found it was not an expropriation, precluding the continuation of the case on the basis of such a claim.
18	Clayton/Bilcon	2008-2015	Mining	Environmental Impact Assessment	Federal and Provincial	USD 101 million	Investor win	Merits	Award on damages/costs pending.
19	Georgia Basin Holdings	2008	Forestry	Lumber export restrictions	Federal and Provincial	USD 5 million	Inactive	None	Unknown
20	Centurion Health Corp	2008-2010	Health	Restrictions on private health services	Federal and Provincial	USD 4.7 million	Terminated *	None	Unknown *Because the claimant had not paid the deposit to cover its share of arbitration fees

21	Dow Agro Sciences LLC	2008-2011	Chemicals	Ban on pesticide for cosmetic purposes	Provincial	USD 2 million	Settled	None	Unknown (no compensation was paid but the case would still have cost the government in terms of legal resources)
22	William Jay Greiner and Malbaie River Outfitters Inc.	2008-2011	Tourism	Salmon conservation measures	Provincial	USD 8 million	Settled	None	Unknown
23	Shiell Family	2008	Transportation	Bankruptcy proceedings	Federal (and judiciary)	USD 21.3 million	Inactive	None	Unknown
24	David Bishop	2008	Tourism	Salmon conservation measures	Provincial	USD 1 million	Inactive	None	Unknown
25	Christopher and Nancy Lacich	2009	Finance	Tax treatment of energy income tax trusts	Federal	USD 1,178.14	Withdrawn	None	Unknown
26	Abitibi-Bowater	2009	Pulp & Paper	Legal expropriation of timber and water rights	Provincial	USD 467.5 million	Settled	None	CAD 130 million in compensation, other costs unknown
27	Detroit International Bridge	2010-2015	Construction	Canada's plans to build a second bridge between Windsor and Detroit	Federal	USD 3.5 billion	State win	Jurisdiction	See legal cost estimates in Annex 2
28	John R. Andre	2010	Tourism	Caribou conservation	Territorial	USD 4 million	Inactive	None	Unknown
29	St Mary's VCNA, LLC	2011-2013	Mining	Zoning of agricultural land	Provincial	USD 275 million	Settled	None	CAD 15 million in compensation (from Government of Ontario), unknown legal costs.

30	Mesa Power	2011-2016	Electricity	Feed-in-tariff for renewable energy	Provincial	USD 775 million	State win	Merits	See legal cost estimates in Annex 2
31	Mercer International	2012	Pulp & Paper	Biomass co-generation	Provincial	CAD 250 million	Pending		Unknown
32	Eli Lilly	2012	Pharmaceuticals	Pharmaceutical patents	Federal and Judiciary	CAD 500 million	Pending		Unknown
33	Lone Pine Resources	2012	Oil & Gas	Ban on hydraulic fracturing	Provincial	CAD 250 million	Pending		Unknown
34	Windstream Energy	2012	Electricity	Moratorium on offshore wind projects	Provincial	CAD 550 million	Investor win	Merits	CAD 25 million in compensation and CAD 2.9 million in investor's legal costs, other costs unknown at time of writing.
35	J.M. Longyear	2014-2015	Forestry	Tax incentives for sustainable forest management	Provincial	CAD 12 million	Withdrawn	None	Unknown
36	Mobil Investments Inc.	2014	Oil & Gas	Research and development requirements for energy companies	Federal	CAD 20 million	Pending		Unknown
37	Murphy Oil Corporation	2014	Oil & Gas	Research and development requirements for energy companies	Federal	CAD 5 million	Pending		Unknown
38	CEN Biotech	2015	Pharmaceuticals	Medical marijuana licencing	Federal	USD 4.8 billion	Pending		Unknown
39	Resolute Forest Products	2015	Pulp & Paper	Government aid (for a competing firm)	Provincial	CAD 70 million	Pending		Unknown

Annex II:

Canada's Known and Estimated Costs for Participation in NAFTA Chapter 11 Cases[81]

[81] Some data on costs can be found in the case documents, which are available through the Government of Canada's website (http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng). Where data is unavailable, estimates are provided in italics. The author would like to thank Scott Sinclair for reviewing the numbers in an early draft of this report. Any errors are the sole responsibility of the author.

Case	Duration	Canada's costs (CAD)	Arbitration Fees (USD)	Winner	Costs Award	Canada Pays (CAD)
S.D. Myers	4 years	Information NA *Est. 3,793,376.28*	956,885.00	Investor	Canada pays CAD 500,000 of claimant's costs + CAD 1,105,347.50 of arbitration fees	500,000 + 1,105,347.50 + *3,793,376.28* = ***5,398,723.78***
Pope & Talbot	4 years	3,953,231.22	1, 474,359.50	Investor	Canada pays USD 870,000 of arbitral fees, parties bear own legal costs	1,380,952.38[82] + 3,953,231.22 = **5,334,183.60**
UPS	7 years	Information NA *Est. 6,638,408.49*	950,000.00	Investor	Parties split arbitration fees and pay own legal costs	510,752.69[83] + *6,638,408.49* = ***7,149,161.18***
Chemtura	5.5 years	5,778,467.60	668,219.00	Canada	Claimant pays arbitration fees and ½ Canada's legal costs	**2,889,233.50**
Merrill and Ring	3.5 years	Information NA *Est. 3,319,204.24*	959,500	Canada	Parties split arbitration fees and pay own legal costs	489,540.82[84] + *3,319,231.22* = ***3,808,772.04***
V.G. Gallo	4.5 years	Information NA *Est. 4,267,548.32*	900,006.00	Canada	Claimant pays arbitration fees, parties bear own legal costs	***4,267,548.32***
Mobil & Murphy	7.5 years	5,363,229.70	1,050,000.00	Investor	Parties split arbitration fees and bear own legal costs.	656,250+ 5,363,229.70 = **6,019,479.70**
Detroit Int. Bridge	4 years	3,453,015.95	300,672.00	Canada	Claimant pays 1,777,706.30 of Canada's legal costs and all arbitration fees	**1,675,309.65**
Mesa	5 years	6,109,001.95	2,230,425.64	Canada	Claimant pays 1,832,701 of Canada's legal fees and all arbitration fees	**4,276,300.95**
TOTAL (EST.)						***40,818,712.70***
COST PER CASE (AVG EST.)						***4,535,412.52***

[82] Conversion using exchange rate at the time of CAD 1 = USD 0.63
[83] Conversion using exchange rate at the time of CAD 1 = USD 0.93
[84] Conversion using exchange rate at the time of CAD 1 = USD 0.98