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Committee Secretary
Senate Foreign Affairs, Defence and Trade Legislation Committee
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**Submission to the Foreign Affairs, Defence and Trade Legislation Committee Inquiry into the provisions of the Customs Amendment (China-Australia Free Trade Agreement Implementation) Bill 2015 and the Customs Tariff Amendment (China-Australia Free Trade Agreement Implementation) Bill 2015**

Lexbridge is a legal practice and consultancy, specialising in public international law and its broader implementation in justice systems. We are the first specialist public international law firm in the Asia-Pacific region.

Lexbridge provides legal advice, supports negotiations and supports litigation in all areas of public international law. This includes specialist services in international trade, investment, environment, maritime and aviation, security and human rights. We also provide training and capacity-building connected with these areas. Our clients are governments, international organisations, and businesses in the Asia Pacific and around the world.

Our submission focuses not on the content of the Bills themselves but rather on the China – Australia Free Trade Agreement (ChAFTA) Investment Chapter, including investor-state dispute settlement (ISDS).

Much of the debate related to the inclusion of ISDS provisions in FTAs including ChAFTA has focused on the potential impact of ISDS on legitimate government regulation. There is inevitably some degree of risk associated with agreeing to ISDS in terms of a potential challenge to government action or regulation. However, in recognising this risk it is also necessary to recognise that the exposure varies between agreements and depends on the specific provisions in each agreement. A proper assessment of the risk of ISDS therefore requires a detailed examination of the relevant agreement, including the scope of ISDS and any applicable safeguards. In this submission we review the ChAFTA ISDS provisions in terms of their scope and key safeguards for government regulation. In our view, an examination of these factors leads to the conclusion that the exposure under ChAFTA – in terms of a challenge to government regulation – is significantly less than the vast majority of Australia's agreements containing ISDS.

We make this submission to assist the Committee to make a balanced assessment of the ChAFTA investment and ISDS provisions and hope that the Committee finds it useful.

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## 1. Scope of the Investment Chapter

The ChAFTA Investment Chapter is unusual as it contains a relatively limited set of provisions. It does not contain standard investment protections such as expropriation or fair and equitable treatment. These protections are left for a future review and future work program.[1]

The key substantive provisions in the ChAFTA Investment Chapter are National Treatment and Most-Favoured-Nation Treatment (MFN). Both these obligations are concerned with protecting foreign investors and investments from discrimination, or more precisely, from less favourable treatment. Australia and China have made commitments on these obligations in different ways in ChAFTA. While Australia has included detailed schedules of commitments, for China, the conclusion of detailed schedules is left to a future work program.

### *1.1 National Treatment*

The National Treatment obligation protects foreign investors and investments from "less favourable treatment" than that accorded, in like circumstances, to domestic investors and their investments.[2] It is generally understood to protect against discrimination on the basis of nationality. The National Treatment in ChAFTA is unusual as it is asymmetrical. For Australia it applies to all stages of investment, including the 'pre-establishment' stage where an investor is seeking to make an investment. However for China, the National Treatment obligation only applies to the 'post-establishment' stage, which is after an investment has been made.

In practical terms, this difference, while significant, may not be as great as first appears as Australia has exercised its ability to 'carve-out' existing measures and policy space from the National Treatment obligation. For Australia the most significant treatment at the pre-establishment stage of investment is related to the review of investments which are required to be notified to the Foreign Investment Review Board (FIRB). The FIRB may refuse notified investments or approve them subject to certain conditions. In ChAFTA Australia, consistent with its standard practice, has carved out the key elements of the FIRB investment screening regime from the National Treatment obligation.[3]

Australia has carved-out a number of other existing measures and areas of policy space from the National Treatment obligation. These include preferences for Indigenous persons, privatisation measures, creative arts and cultural heritage, and social services including public health, public education, and public utilities.[4]

### *1.2 Most-Favoured-Nation Treatment*

The MFN obligation guarantees investors treatment no less favourable than any other foreign investors, in like circumstances.[5] Unlike National Treatment, the MFN obligation in ChAFTA

[1] ChAFTA Investment Chapter, Article 9.9.
[2] ChAFTA Investment Chapter, Article 9.3.
[3] See Annex III, Schedule of Australia, Section A, Entry 1.
[4] See Annex III, Schedule of Australia, Section B.
[5] ChAFTA Investment Chapter, Article 9.4.

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applies to all stages of investment, including where investors are seeking to make an investment, for both China and Australia. MFN is an important obligation in ensuring that the agreement remains up to date. It means – subject to any carve-outs or exceptions – that Australian or Chinese investors will get the benefit of any better commitments which the countries make in future agreements. Australia's commitments are subject to specific qualifications and carve-outs contained in detailed schedules. ChAFTA does not contain detailed schedules for China, these are left for the future work program.[6] In the absence of these detailed schedules China has taken a different approach and effectively imports the qualifications and carve-outs scheduled in other similar agreements.

The approach taken by China is less transparent however it is nonetheless a commitment to accord most-favoured-nation treatment to Australian investors and investments. ChAFTA also clarifies that if China agrees detailed schedules against MFN in more than one agreement – pending completion of the future work program – Australian investors and investments will benefit from the most favourable commitments.[7]

## 2. Scope of ISDS

As it currently stands ISDS in ChAFTA is limited to alleged breaches of the National Treatment obligation[8]. This is a very narrow scope of operation in comparison to the vast majority of Australia's agreements containing ISDS, which typically apply to any breach of an investment obligation.[9] The scope of ISDS in ChAFTA is significantly more limited than any of Australia's other FTAs which contain ISDS.

As noted above, the risk of successful challenges against Australia is further reduced by virtue of the fact that Australia has carved-out a number of measures – most notably the review of investments by the FIRB – and areas of policy space from the National Treatment obligation.

## 3. Nature of the ChAFTA ISDS provisions: safeguards

ChAFTA contains a number of kinds of provisions and safeguards which address the risk of a successful ISDS challenge. These include an innovative and unique 'filter mechanism' to protect against challenges to legitimate government regulation. ChAFTA also provides for a greater degree of control over the appointment of arbitrators and requires that they comply with a code of conduct.

[6] See ChAFTA Investment Chapter, Article 9.9.3(c).
[7] See ChAFTA Investment Chapter, footnote 4 to Article 9.5.
[8] ChAFTA Investment Chapter, Article 9.12.2.
[9] We note that the scope of ISDS in the Australia-China bilateral investment treaty is also relatively limited, applying only to "where the dispute relates to the amount of compensation payable under Article VIII" [Expropriation].

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### *3.1 Filter mechanism for non-discriminatory public welfare regulation*

The ChAFTA ISDS provisions include a filter mechanism to allow a respond Government to block an ISDS claim against a non-discriminatory public welfare measure at an early stage of the dispute. [10]

ChAFTA provides that "Measures of a Party that are non-discriminatory and for the legitimate public welfare objectives of public health, safety, the environment, public morals or public order shall not be the subject of a claim under this Section."[11] If an investor seeks to challenge a measure of this nature, the respondent Government Party can issue a "public welfare notice" which triggers a 90 day consultation period with the other Government Party.[12] This occurs at a very early stage – after receiving a request for consultations from a disputing investor, and before any arbitral tribunal has been established.

If Australia and China agree that a challenged measure is of this nature, ChAFTA provides that this is binding on a tribunal and any decision or award issued by a tribunal must be consistent with this.[13]

As the filter mechanism is an innovation, it has not been tested or applied. However, in practical terms, if there was a decision of this nature between Australia and China it would appear largely futile for an investor to proceed with the claim as any tribunal established would have no jurisdiction to determine the dispute. In the event that an investor did nonetheless seek to establish a tribunal the Government party could request the tribunal to dismiss the claim as a preliminary matter.

This mechanism could be seen as a response to concerns about claims being brought against public welfare regulation such as Australia's tobacco plain packaging measures or non-discriminatory environmental regulation.

No existing Australian agreement contains an equivalent safeguard. We are not aware of an equivalent mechanism in any existing investment agreement.

### *3.2 Arbitrators: Selection and Code of Conduct*

Some commentators have raised concerns about the role of arbitrators in ISDS cases, including allegations of bias and lack of expertise. The ChAFTA ISDS provisions address these concerns by (a) providing for the establishment of a roster of potential arbitrators; and (b) requiring arbitrators to comply with a Code of Conduct. Neither of these provisions appear in any other Australian agreement.

In the event that the parties to an ISDS dispute fail to appoint or are unable to agree on an arbitrator, ChAFTA requires the remaining arbitrators to be appointed from a list which is compiled by both of the (Government) Parties. This roster system gives Australia and China much

[10] ChAFTA Investment Chapter, Article 9.11.4 - 9.11.8.
[11] ChAFTA Investment Chapter, Article 9.11.4.
[12] ChAFTA Investment Chapter, Article 9.11.5-9.11.6.
[13] ChAFTA Investment Chapter, Article 9.18.3.

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greater control over the choice of arbitrators. It is not uncommon that the disputing parties in ISDS disputes are unable to agree on a presiding arbitrator, or Chair. In this event ChAFTA requires the Chair to be selected from a list of people who are jointly selected by both Australia and China. This ensures that any Chair would be acceptable to Australia.[14]

Further, under ChAFTA, all arbitrators are required to comply with a Code of Conduct.[15] The Code of Conduct requires arbitrators, among other things, to carry out their duties with independence and impartiality, avoid conflicts of interest and avoid any creating any perception of impropriety or bias.[16]

### *3.3 Other safeguards*

In addition to the innovative provisions discussed above ChAFTA contains a number of other ISDS safeguards which exist in other recent Australian Free Trade Agreements. These include:

- WTO-style general exceptions including for measures necessary to protect human, animal or plant life or health; or relating to the conservation of living or non-living exhaustible natural resources[17];

- An expedited process to dismiss frivolous claims as a preliminary matter[18];

- Providing that a joint interpretation of the (Government) Parties of a provision of ChAFTA is binding on any tribunal, and any decision or award issued by a tribunal must be consistent with that interpretation[19];

- A mechanism for the compulsory consolidation of multiple claims which arise out of the same events or circumstances[20];

These safeguards are commonly included in modern 'second generation' agreements, but are not contained in the vast majority of earlier, or more traditional investment agreements, including Australia's 21 bilateral investment treaties.

## 4. Conclusion on ChAFTA ISDS provisions

If ISDS is included in an agreement, there is inevitably some degree of risk to the (Government) Parties in terms of a potential challenge against government action or regulation. A proper assessment of the risk of ISDS in terms of a challenge to legitimate government regulation requires a detailed examination of the provisions of the agreement, including the scope of ISDS and any applicable safeguards.

[14] ChAFTA Investment Chapter, Article 9.15.3 – 9.15.7.
[15] ChAFTA Investment Chapter, Article 9.15.8.
[16] ChAFTA Investment Chapter, Annex 9-C.
[17] ChAFTA Investment Chapter, Article 9.8.
[18] ChAFTA Investment Chapter, Article 9.16.5 – 9.16.7.
[19] ChAFTA Investment Chapter, Article 9.18.2.
[20] ChAFTA Investment Chapter, Article 9.21.

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In the case of ChAFTA the scope of ISDS is much narrower than any other Australian FTA which includes ISDS and also much narrower than the vast majority of Australia's older bilateral investment treaties. ChAFTA contains a set of safeguards which are similar to those found in other recent agreements including the Korea-Australia FTA. In addition ChAFTA contains additional procedural safeguards which have not been included in any existing Australian agreement. Most notably, these include an innovative safeguard to block – and potentially prevent – claims against non-discriminatory public welfare regulation. Taken together, these factors lead to the conclusion that the exposure under ChAFTA – in terms of a challenge to legitimate government regulation – is significantly less than the vast majority of Australia's agreements.

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