Wilson, Frances (REPS)

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AUSFTA Submission to JSCOT.doc...

To the JSCOT Secretariat

A copy of my submission to the JSCOT Inquiry into the Australia-US Free Trade Agreement is attached.

Thank you for the opportunity to make this submission and please contact me if you have any queries,

Regards

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The Secretary
Joint Standing Committee on Treaties
Parliament House
Canberra ACT 2600

5 April 2004

Dear Madam

SUBMISSION TO THE JOINT STANDING COMMITTEE ON TREATIES INQUIRY INTO *THE AUSTRALIA-US FREE TRADE AGREEMENT*

I write to make a submission on one aspect of the Australia-US Free Trade Agreement (AUSFTA) – the resolution of investment disputes.

1. Investor-State Dispute Resolution

Investor-state dispute resolution mechanisms allow foreign investors to bring claims directly against the governments of the country in which they have invested for violation of their rights as investors. These mechanisms are common in bilateral investment treaties and one such mechanism is included in the investment chapter of the Singapore-Australia Free Trade Agreement at article 8.14.

The Committee is no doubt aware of the controversy that has resulted from the investor-state dispute resolution mechanism in chapter 11 of the North American Free Trade Agreement (NAFTA). This mechanism has allowed foreign companies to challenge and restrict the regulation-making power of the governments of the NAFTA parties. The concerns that have arisen as a result of investor-state dispute mechanisms have been the subject of much commentary and are discussed in more detail, for example, in the Senate Foreign Affairs, Defence and Trade References Committee report *Voting on Trade: The General Agreement on Trade in Services and Australia-USA Trade Agreement* (November 2003 at 131-135).

In what appears to be an attempt to avoid a NAFTA-like outcome, the investment chapter of the AUSFTA (chapter 11) contains some important differences to its counterpart in the NAFTA. For example, substantive investor rights under the AUSFTA will have a more defined application than they do under the NAFTA because the AUSFTA includes two annexes intended to aid in, and limit the boundaries of, the interpretation of chapter 11. In addition, the AUSFTA does not provide investors with a direct right to bring a claim against either party's government. The AUSFTA instead establishes an indirect mechanism for investor-state dispute resolution. Article 11.16(1) of the AUSFTA states:

> If a Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this Chapter and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other Party a claim regarding a matter within the scope of this Chapter, the Party may request consultations with the other Party on the subject, including the development of procedures

> that may be appropriate. Upon such a request, the Parties shall promptly enter into consultations with a view towards allowing such a claim and establishing such procedures.

In the National Interest Analysis (NIA) for the AUSFTA, the Department of Foreign Affairs and Trade (DFAT) describes the effect of this provision as follows:

> In recognition of the robust domestic legal systems in both countries, there is no provision for investors to use international arbitration to pursue concerns about government actions (Investor-State Dispute Settlement).

For the reasons set out below, it is my opinion that this statement does not accurately represent the impact of Article 11.16(1) and that it remains possible under the AUSFTA for an investor to bring a claim against the governments of either Australia or the USA.

2. Article 11.16 explicitly contemplates investor-state dispute resolution

Under article 11.16, an investor cannot bring a claim directly against the Australian or American governments. The AUSFTA therefore excludes direct investor-state dispute resolution. However, article 11.16 does not absolutely preclude the possibility of investor-state dispute resolution; rather, it requires that a number of conditions be fulfilled before any such claim can be made. These conditions are:

a) *there has been a change in circumstances affecting the settlement of disputes under the investment chapter*
The language here is vague and uncertain - it is not clear what kind of event might satisfy the required 'change in circumstances'. DFAT's 'Guide to the AUSFTA' describes this element as needing a change in circumstances 'regarding the Parties' economic and legal environments'. While change in these areas is very likely to trigger an investment dispute, the actual words of article 11.16 do not contain this limitation. Further, DFAT's explanation gives no indication of the nature of the change required; for example, must the change be a systemic transformation within Australian governance structures or is it enough that the change affects only one investor? If the change need only affect one investor, does the change have to have demonstrably harmed that investor in some way? Or is it enough simply that the change has occurred?

There needs to be much greater clarification about the language of this requirement and its meaning.

b) *as a result of the change in circumstances, Party A considers that one of its investors should be allowed to submit a claim against Party B to arbitration*
There is no objective standard, eg of a reasonable likelihood of success, against which a party must measure an investor's claim before deciding that the investor should be allowed to submit its claim to arbitration. Nor is there any requirement that each party reveal its criteria for deciding if an investor should be allowed to submit a claim. The decisions of the parties as to arbitration are thus open to influence by domestic political considerations, or by powerful individuals, corporations and other special interest groups. This undermines the purpose and credibility of a transparent and objective dispute resolution mechanism.

c) *Party A requests consultations with Party B on with respect to arbitration and, once requested, both parties enter into such consultations, with a view towards allowing the investor-state arbitration to occur and establishing procedures for its conduct.*
This part establishes that investors do not have a direct right to arbitration. Rather, arbitration can only occur if it is requested by either Australia or the USA. Once requested, consultations on the question of arbitration must ensue, but neither party is under an obligation to allow the actual arbitration to take place. This part of article 11.16 appears to

leave the final question about whether or not arbitration should occur to the discretion of the parties.

However, on one reading of article 11.16, investors can expect arbitration to be the natural consequence of a request from a party, except in unusual circumstances. When consultations are requested, article 11.16 requires that they be conducted 'with a view to allowing such a claim [for arbitration] and establishing such procedures [for arbitration]'. This language indicates a presumption that arbitration will almost always follow from a request and suggests that the primary purpose of the consultations is to determine the procedures to govern the arbitration. If article 11.16 is interpreted in this manner, then investors will in effect only have to satisfy the criteria listed in (a) and (b) above to engage either Australia or the USA in arbitration. As I have suggested, those criteria are vague and open to political manipulation.

3. Article 11.16 does not specify procedures to be used in an arbitration

The NIA notes that the AUSFTA does not allow investors to use international arbitration in relation to investment disputes. It is my opinion that investor-state arbitration under the AUSFTA could in fact be conducted under international arbitration rules, such as those of UNCITRAL.

Article 11.16 gives the parties the discretion to decide what rules of procedure are to govern the arbitration of an investment dispute. There are no limits on the kinds of rules the parties may adopt or the sources that they may use. The discretion arises in relation to each request for arbitration and the parties could, in theory, adopt different rules of procedure for every different investment dispute. There is, therefore, nothing in the text of 11.16 that prevents the parties from adopting international rules of procedure for arbitration.

Chapter 21 of the AUSFTA sets out the procedures to be adopted in the resolution of other, non-investment related, disputes under the agreement. Disputes are to be resolved first through consultations and then by an arbitral panel. Under article 21.8, the parties agree to establish model rules of procedure to govern the arbitrations. In practice, it is possible that these model rules would also be used in investor-state arbitration, but there is no requirement that this occur. There is therefore nothing in article 21 that prevents the parties from adopting international arbitration rules for the resolution of investment disputes.

4. *Conclusion*

Article 11.16 allows investors still to engage in arbitration against the government of either Australia or the USA, but requires first that the investor's home government act as a vetting system for the investor's claim. Given the importance of the US alliance to the Australian government and given the differences in bargaining power between the two countries, it is reasonable to wonder about the circumstances, if any, in which Australia would be able to resist a US request for arbitration or in which Australia would be able to press for arbitration against a reluctant US government. It may be that, despite DFAT's assurances otherwise, the AUSFTA effectively enshrines a mechanism for investor-state dispute resolution in Australia.

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