

Australia-United States Free Trade Agreement (FTA)
SUBMISSION TO THE SENATE SELECT COMMITTEE

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Introduction

I submit that chapter 11 of the FTA should be amended by deleting the provisions on compensation payable by the Australian Government for direct and indirect expropriation of investments made by US investors. These provisions amount to a significant and enduring diminution of Australian Parliaments' law making and regulatory powers.

The provisions in chapter 11 of the FTA diminish the powers of the Australian Parliament "to make laws for the peace, order and good government" of the Commonwealth as provided for in section 51 of the Constitution. They similarly diminish the powers of State Parliaments and Local Governments.

The investment provisions in this FTA, and other free trade agreements - as it may be assumed that similar provisions will find their way into proposed free trade agreements with other countries - will change the institutional balance of government in Australia. The act of the executive in signing the FTA will diminish the powers of the legislature as provided in the Constitution, without referendum or significant public debate. The FTA is thereby in a category quite different to human rights treaties which do not have effect in Australia upon ratification. Human rights treaties have effect only when Parliament passes laws for this purpose, laws that may be amended or repealed at any time without liability for payment of compensation to adversely affected parties.

The investment provisions will elevate free trade agreements to the status of quasi constitutional documents that must taken into account by Parliaments when laws are made to enable them to determine whether the laws may adversely affect the economic value of foreign investments and thus give rise to claims to compensation against the Australian Government. The possibility of such claims for compensation, which Canadian experience referred to later shows may be substantial, will significantly diminish the law making powers of the Australian Government. Moreover, the diminution will be enduring; it is unlikely that the US would agree to let Australia off this hook in the foreseeable future.

The investment provisions give to US investors rights to compensation from the Australian Government that are not possessed by Australian investors.

Chapter 11: Investment

Chapter 11 of the FTA sets out certain rights of nationals and enterprises of Australia and the United States which wish to invest in the territory of the other party. Article 11.3, for instance, provides that one party must accord to investors of the other party "treatment no less favourable than that it accords, in like circumstances, to its own investors" in respect

of a wide range of enumerated matters, such as the acquisition, operation and sale of investments. The fact is, however, that foreign investors have rights under chapter 11 that are greater than the rights of local investors.

Of particular concern is article 11.7.1 which provides in part:

Neither Party may expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (“expropriation”), except:

- (a) for a public purpose;
- (b) in a non-discriminatory manner;
- (c) on payment of prompt, adequate, and effective compensation; and
- (d) in accordance with due process of law.

“Investment” is broadly defined in article 11.17.4 to include an enterprise, shares, bonds, futures, constructions contracts, intellectual property rights, and so on.¹ It appears, therefore, that protection from expropriation is given, not only to US businesses established in Australia, but also to US shareholdings in Australian businesses.

The effect of paragraph (c) is that the Australian Government must pay “prompt, adequate, and effective compensation” if it makes a law that is deemed to amount to expropriation.

The meaning of expropriation is (partly) defined in Annex 11-B articles 3 and 4 as follows:

- 3. Article 11.7.1 addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.
- 4. The second situation addressed by Article 11.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
 - (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
 - (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
 - (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
 - (iii) the character of the government action.
 - (b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party

¹ Anomalously, however, it does not include certain financial products, such as managed investment products.

that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.

The meaning of expropriation is unclear. It involves an adverse economic effect from government action, together with other elements such as “reasonable investment-backed expectations” and “the character” of the government action, whatever that means. In the event of a dispute relating to a claim for compensation by a US investor, the FTA provides that compensation is determined by a panel of experts pursuant to a process established under chapter 21 of the FTA, not in the courts. As the FTA presently stands, claims cannot be brought directly by investors, although article 11.16 provides for that possibility in the future.

Article 11.7.1 resembles Article 1110(1) of the North America Free Trade Agreement (NAFTA) which provides:

No Party may directly or indirectly nationalise or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalisation or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

Article 1110(1) has been the subject of considerable public discussion and concern, especially in Canada where enormous claims have been made.² It has been interpreted to entitle a foreign investor to claim from the host government compensation for loss of future profits on its investment arising from the operation of statutes, judicial decisions and administrative policies intended to protect the public interest. Article 1110(1) permits foreign investors to claim compensation for losses arising from government measures to protect public health and the environment.³

In an article published in the *Columbia Journal of Transnational Law*, Samrat Ganguly has said that the most serious challenge to the power of a government to regulate in the public interest, be it in the area of public health, environment or labour, is the ability of an investor to bypass host country courts and have the law of a NAFTA-type agreement applied to the claim.⁴ There are many other areas of law, too, that may give rise to a claim that bypasses courts, such as laws affecting human rights.

² *NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy*, published by Public Citizen (in 2002, says at page 4 that in the first seven years of NAFTA, \$13 billion has been claimed by corporations in their initial filings. See www.citizen.org/publications/release.cfm?ID=7076. The actual awards to date have been less, but nonetheless significant.

³ For a brief summary of cases see *NAFTA Chapter 11 Investor-to-States Cases: Bankrupting Democracy* by Public Citizen, at www.citizen.org/publications/release.cfm?ID=7076

⁴ Samrat Ganguly, “The Investor-State Dispute Mechanism (ISDM) and a Sovereign’s Power to Protect Public Health”, *Columbia Journal of Transnational Law*, (1999) 38:113.

Direct expropriation

The prohibition on the direct expropriation or nationalization of US investments is unnecessary and should be deleted.

Section 51(xxxi) of the Australian Constitution already provides that property may be acquired by the Commonwealth only on “just terms” and similar obligations apply to other levels of government in Australia. If a US investment is expropriated by the Australian Government other than on just terms, an adequate remedy is available through the courts which provide substantive justice in a transparent manner. Australian enterprises and individuals have relied on this entitlement for over one hundred years.

It is not possible for the protection of US investors’ rights to just terms of compensation under section 51(xxxi) of the Constitution to be removed because an alteration to the Constitution may be effected only if approved by referendum, and it is inconceivable that section 51(xxxi) will be amended by referendum. The Constitution protects US investors from direct expropriation or nationalization of their investment.

Indirect expropriation

The prohibition on the indirect expropriation or nationalisation of US investments is unclear in its scope and undesirable in policy and should also be deleted.

If Article 11.7 is retained in the FTA insofar as it provides protection against indirect expropriation, US investors may argue that future Australian laws or other measures which are designed to protect the public interest, but which adversely affect the economic value of US investments and have other ill-defined characteristics found in Annex 11-B.4(b), would be tantamount to indirect expropriation of their investment. Accordingly, such laws or measures would give rise to a claim by US investors for compensation to be paid by the Australian Government. The costs of meeting claims for compensation and, in some cases, the mere possibility of having to meet claims for compensation, would be an enduring restriction upon the power of future Australian parliaments to make laws for peace, order and good government.

Article 4(b) of Annex 11-B provides a limited, but unsatisfactory, carve-out from indirect expropriation:

Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.

This carve-out provides an inadequate basis for the exercise of legislative or other regulatory power because of its lack of clarity.

The opening words “Except in rare circumstances” create uncertainty. What are the rare circumstances when the carve-out will not apply? Guidance on the operation of these words is essential.

In addition, the regulatory actions that are the subject of the carve-out are narrowly and vaguely expressed. They must have “legitimate public welfare objectives, such as the protection of public health, safety, and the environment”.

The meaning of “legitimate public welfare objectives” is far from clear. What does “legitimate” add to “public welfare objectives”. Are some public welfare objectives illegitimate and if so, how does one distinguish between objectives that are legitimate and those that are not? Is welfare to be given a narrow or broad meaning; is it confined to aiding the disadvantaged or do other measures, such as to protect and advance human rights, also have “legitimate public welfare objectives”? Would an amendment of the *Native Title Act 1993* (Cth) that enlarges native title come within the carve-out as having a legitimate public welfare objective? If not, it would give rise to claims under the FTA by US land holder investors whose property interests were thereby affected. Would laws requiring that asylum seekers held in detention centres were to be treated less harshly - potentially increasing the costs of contractors operating the detention centres and reducing the economic value of their investment – come within the carve-out as having a legitimate public welfare objective or would such laws give rise to claims under the FTA by US detention centre investors? The experience of Canada in dealing with claims by US enterprises under the NAFTA suggests that great care must be taken in defining and limiting rights to compensation. The examples of public health, safety and the environment in Article 4(b) of Annex 11-B provide little clarification.

Conclusion

I submit that chapter 11 of the FTA should be amended to ensure that:

- the FTA does not provide for compensation to US investors for direct expropriation of their investment by laws that reduce the investment’s economic value because adequate compensation for expropriation through the Australian court system is entrenched by section 51(xxxi) of the Constitution; and
- the FTA does not provide for compensation to US investors for indirect expropriation of their investment by laws that reduce the investment’s economic value because such a provision would amount to an undue restriction on the power of parliament to make laws for peace, order and good government. In addition, it would provide a right to compensation to US investors that is not available to Australian investors for “indirect expropriation” of their investments in Australia.

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28 April 2004.

