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Submission to the DFAT Review of Australia's Bilateral investment Treaties

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Summary and Recommendations

Although particular provisions of Bilateral Investment Treaties (BITs) vary, in general the aim is to encourage investment and to ensure a certain standard of treatment of investments in the territories of each party.

These include non-discriminatory treatment, fair and equitable treatment and protection and security under domestic law. They also include provisions against nationalisation or expropriation of property unless it is in the public interest, non-discriminatory, and fair compensation is provided.

The most controversial aspects of these investment treaties are the inclusion of Investor-State Dispute Settlement (ISDS) processes. ISDS has also been included in some of Australia's broader trade agreements over the last 20 years, but not in all of them. Current negotiations for the EU-Australia FTA and the Regional Comprehensive Economic Partnership with 14 Asia-Pacific countries do not include ISDS.

AFTINET welcomes the opportunity to make a submission to this review of Australia's BITs.

In the past, the Australian government has taken an ad hoc approach to BITs. We advocate that there should be a consistent approach, based on Australia's commitments to the right of governments to regulate in the public interest, UN human rights and ILO labour rights conventions, and UN agreements on environmental standards.

All trade agreements have government-to-government dispute processes. ISDS is controversial because it is an optional, separate dispute process that gives additional legal rights to a single foreign investor (rights not available to local investors) to sue governments for compensation in an international tribunal if they can claim that a change in law or policy will harm their investment. Because ISDS cases are very costly, they are mostly used by large global companies that already have enormous market power, including tobacco, pharmaceutical, agribusiness, mining and energy companies.

The number of reported ISDS cases has been increasing rapidly and is 1,023 as of December 2019.

Scholars have identified that ISDS has suffered a legitimacy crisis that has grown in the last decade, with lack of confidence in the system shared by both civil society organisations and by a growing number of governments.

Criticisms of the structure of the system include the power imbalance which gives additional legal rights to international corporations that already exercise enormous market power, the lack of obligations on investors and the use of claims for compensation for public interest regulation.

Arbitrators are not independent judges but remain practising advocates with potential or actual conflicts of interest. Criticisms of the process include lack of transparency of proceedings, length of proceedings, high legal and arbitration costs and lack of precedents and appeals leading to inconsistent decisions, Third Party funding for cases as speculative investments and excessively high awards based on dubious calculations of expected future profits.

There have been increasing numbers of claims for compensation for public interest regulation. These include regulation of public health measures like tobacco regulation, patents on medicines, environmental protection, reduction of carbon emissions and regulation of the minimum wage.

Developing countries have been burdened with legal costs and compensation payments amounting to billions of dollars, which can be equivalent to a large proportion of the government's budget. A

recent example is the award of US\$5 billion to Australian company Tethyan against Pakistan, when Pakistan was experiencing a severe economic crisis and had just received an emergency loan of about US\$5 billion from the IMF. This was also a forum shopping exercise, as the majority owner of the mine was a Canadian company that used its Australian subsidiary to sue because Australia, unlike Canada, has a bilateral investment agreement with Pakistan. The same Canadian mining company has used another Australian subsidiary to launch a case against Papua New Guinea.

Huge awards against developing countries and the use of Australian BITS in forum shopping contradict Australia's commitments to human rights, undermine its aid and development programs, and harm Australia's reputation and relationships with developing countries.

The Clive Palmer threat to use the Singapore-Australia FTA to sue the Australian government shows that current changes in ISDS provisions to prevent forum shopping are not adequate in preventing it.

Some governments are withdrawing from ISDS arrangements, the EU and the US are now negotiating trade agreements without ISDS, and the system is being reviewed by the two institutions which oversee ISDS arbitration systems.

Legal experts and UNCTAD, the body responsible for monitoring ISDS, have recognised the danger of ISDS cases against a wide range of governments' actions taken during the COVID-19 pandemic, and have recommended means of preventing such cases.

Current revised clauses in ISDS provisions are not effective in protecting the rights of governments to regulate since the exclusions only prevent cases in a narrow range of areas, omitting important public policy areas like the environment, workers' rights and Indigenous land rights.

Recommendations:

- 1. Australia should take a consistent approach to the review of its BITs, based on its commitments to the right of governments to regulate in the public interest and its commitments to human rights, labour rights and environmental standards as expressed in UN and ILO conventions and agreements.**
- 2. The review should recognise the impact on aid and development budgets and the harm to Australia's reputation of forum shopping and excessive awards made to Australian companies against developing countries, and take more effective steps to prevent this.**
- 3. The review should recognise that current revised clauses in ISDS provisions are not effective in protecting the rights of governments to regulate since the exclusions only prevent cases in a narrow range of areas, omitting important public policy areas like the environment, workers' rights and Indigenous land rights.**
- 4. The review should acknowledge the danger of ISDS cases being taken against a wide range of governments' actions during the COVID-19 pandemic, recognised by legal experts and by UNCTAD, the body responsible for monitoring ISDS cases. The Government should follow the advice of legal experts to make arrangements in the short-term with BIT partners to exclude cases against pandemic-related actions and to review BITS to exclude ISDS as per recommendation five.**
- 5. Australia should take a policy approach to BITS that involves investment promotion and facilitation rather than dispute resolution. Australia's existing BITS should be amended to exclude ISDS provisions, and should instead be enforced through state-to-state dispute processes. The Investment Cooperation and Facilitation Treaty between Brazil and India provides an example of this approach.**

Introduction

The Australian Fair Trade and Investment Network (AFTINET) is a national network of 60 community organisations and many more individuals supporting fair regulation of trade, consistent with democracy, human rights, labour rights and environmental sustainability.

AFTINET supports the development of fair trading relationships with all countries and recognises the need for regulation of trade through the negotiation of international rules.

AFTINET supports the principle of multilateral trade negotiations, provided these are conducted within a transparent and democratically accountable framework that recognises the special needs of developing countries and is founded upon respect for democracy, human rights, labour rights and environmental sustainability.

AFTINET advocates that non-discriminatory multilateral rules-based trade negotiations are preferable to preferential bilateral and regional negotiations that discriminate against other trading partners.

AFTINET welcomes the opportunity to make this submission to the DFAT inquiry into Australia's Bilateral Investment Treaties.

Rather than the *ad hoc* approach taken to the review of investment treaties so far, AFTINET believes that Australia should take a consistent approach to the review of its BITs, based on its commitments to the right of governments to regulate in the public interest and its commitments to human rights, labour rights and environmental standards as expressed in its ratification of UN conventions and agreements on human rights and environmental standards, and of International Labour Organisation conventions.

Australia has Bilateral investment Treaties BITs in force with the following 15 countries:

- (1) Argentina (date of entry into force: 11 January 1997);
- (2) China (date of entry into force: 11 July 1988);
- (3) Czech Republic (date of entry into force: 29 June 1994);
- (4) Egypt (date of entry into force: 5 September 2002);
- (5) Hungary (date of entry into force: 10 May 1992);
- (6) Laos (date of entry into force: 8 April 1995);
- (7) Lithuania (date of entry into force: 10 May 2002);
- (8) Pakistan (date of entry into force: 14 October 1998);
- (9) Papua New Guinea (date of entry into force: 20 October 1991);
- (10) Philippines (date of entry into force: 8 December 1995);
- (11) Poland (date of entry into force: 27 March 1992);
- (12) Romania (date of entry into force: 22 April 1994);
- (13) Sri Lanka (date of entry into force: 14 March 2007);
- (14) Turkey (date of entry into force: 29 June 2009);
- (15) Uruguay (date of entry into force: 12 December 2002)¹. (DFAT 2020b)

Purposes of Bilateral Investment Treaties

Although particular provisions of the treaties vary, in general the aim is to encourage investment and to ensure a certain standard of treatment of investments in the territories of each party.

These include non-discriminatory treatment as compared to both domestic investments and other international investments, fair and equitable treatment and protection and security under domestic law.

There are also provisions against nationalisation or expropriation of property unless it is in the public interest, non-discriminatory, and that fair compensation is provided.

The most controversial aspects of these investment treaties are the inclusion of Investor-State Dispute Settlement (ISDS) processes. ISDS has also been included in some of Australia's broader trade agreements over the last 20 years, but not in all of them. The Closer Economic Relations agreement with New Zealand, the Australia-US Free Trade Agreement and the Malaysia-Australia Free Trade Agreement do not include ISDS. Current negotiations for the EU-Australia FTA and the Regional Comprehensive Economic Partnership with 14 Asia-Pacific countries do not include ISDS.

The number of reported ISDS cases has been increasing rapidly in the last 20 years, from less than 10 in 1994 to 300 in 2007, to 1,023 as of December 2019 (United Nations Conference on Trade and Development (UNCTAD) 2020a). More evidence has come to light about the flaws in the ISDS system. Some governments are withdrawing from ISDS arrangements, and the EU and the US are now negotiating trade agreements without ISDS.

The two institutions which oversee ISDS arbitration systems, the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank International Centre for Settlement of Investment Disputes (ICSID), are conducting ongoing reviews which recognise that there are flaws in the system that need to be addressed.

Scholars have identified that ISDS has suffered a legitimacy crisis that has grown in the last decade, with lack of confidence in the system shared by both civil society organisations and by a growing number of governments (Bonnitcha *et al* 2017: v-vi, Langford *et al* 2020, Gleeson and Labonte 2020: 26-31).

ISDS Background and history

ISDS originated in the post-World War Two decolonisation period and was originally designed to compensate for nationalisation or expropriation of actual property, through bilateral investment treaties between industrialised and developing countries.

But over the last half century, the ISDS system has developed concepts like "indirect" expropriation, "minimum standard of treatment" and "legitimate expectations" which do not involve taking of property and do not exist in most national legal systems. These concepts enable foreign investors to sue governments for millions and even billions of dollars of compensation if they can argue that a change in domestic law or policy has reduced the value of their investment, and/or that they were not consulted fairly about the change, and/or that it did not meet their expectations of the regulatory environment at the time of their investment. There are now over 3,000 BITS, mostly between industrialised and developing countries.

While ISDS gives additional legal rights to international corporations that already have enormous market power, it places no obligations on those corporations to act in ways consistent with human rights or environmental standards. In this sense it is a fundamentally unbalanced system.

The World Trade Organisation does not recognise or include ISDS in its trade agreements, and it has only become a feature of broader regional and bilateral trade agreements since its inclusion in the North American Free Trade Agreement in 1994.

There have been increasing numbers of cases against health, environment and other public interest laws and policies, and a growth in the size of both compensation claims and awards.

Evidence of ISDS impacts on foreign direct investment is ambiguous

A recent comprehensive review by Bonnitche *et al* of the impacts of ISDS in BITS on Foreign Direct Investment (FDI) notes the complexity involved in measuring the impact of this single variable on foreign investment flows, which are impacted by many factors. They conclude that

The studies' results are mixed. A majority find that bilateral investment treaties have a positive and statistically significant impact on inward FDI in at least some circumstances. Amongst these the scale and impact varies remarkably with some reporting strong effects and others finding positive but only small effects. Among the studies reporting a positive effect of BITS on investment flows, some also come to apparently contradictory findings. Finally a sizeable minority of studies find there was no statistically significant effect of BIT adoption on FDI flows (Bonnitche *et al*, 2017: 159).

A 2018 study of official FDI statistics in five countries whose governments had terminated BITS – Ecuador, Bolivia, South Africa, Indonesia and India found that that “investment flows from former BIT partner countries were more likely to increase rather than decrease after BIT termination,” (Public Citizen, 2018: 1). and concluded that

While the findings do not suggest terminating BITs directly boosts investment inflows, they do point to an extremely weak or non-existent relationship between BITs and the magnitude of investment inflows (Public Citizen, 2018: 2)

Brazil's parliament has never endorsed BITs containing ISDS but it has experienced high levels of FDI (Filho, 2008)

ISDS Tribunals not independent, no precedents or appeals

Many experts including Australia's former High Court Chief Justice Robert French and investment law experts have noted that ISDS tribunals are neither independent nor impartial, and lack the basic standards of national legal systems (French 2014, Kahale 2014, Kahale 2018).

ISDS has no independent judiciary. Tribunals are organised by one of two institutions, the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank International Centre for Settlement of Investment Disputes (ICSID). Tribunals for each case are chosen by investors and governments from a pool of investment lawyers who can continue to practice as advocates, sitting on a tribunal one month and practising as an advocate the next. In Australia, and most national legal systems, judges cannot continue to be practising lawyers because of obvious conflicts of interest.

ISDS has no system of precedents or appeals, so the decisions of arbitrators are final and can be inconsistent. In Australia, and most national legal systems, there is a system of precedents which judges must consider, and appeal mechanisms to ensure consistency of decisions. While substantive decisions cannot be appealed, the ICSID tribunal system has an annulment procedure. Governments may apply for the annulment or review of amounts of compensation awarded by ICSID tribunals. However, the grounds for review are deliberately narrow and relate only to process, and annulments are seldom sought and are seldom successful (Asian International Investment Centre 2020).

ISDS not fit to arbitrate on public interest regulation

Leading international investment law expert and practitioner George Kahale criticized ISDS in an April 2018 lecture at the Brooklyn Law School titled “The wild, wild west of international arbitration law” (Kahale 2018).

Kahale uses examples from his own experience representing governments in ISDS cases to argue that the ISDS system based on commercial arbitration principles is not fit to arbitrate cases in which international companies seek compensation from governments for changes in health, environment or other public interest laws.

Kahale says, “It’s one thing to have party-appointed arbitrators negotiate a decision to settle a commercial dispute having no particular significance beyond the case at hand ... it is quite another to decide fundamental issues of international law and policy that affect an entire society” (Kahale 2018: 7).

Growth in ISDS awards and use of third-party speculative funding

Kahale states that “there really are no hard and fast rules” in ISDS claims for compensation. He cites examples of claims of billions of dollars based on false documents, methodologies for calculations of future lost profits which are unacceptable in World Bank accounting practice, and similar claims before different tribunals resulting in inconsistent decisions (Kahale 2018: 14).

Kahale also notes the growth of third-party funding of ISDS cases, in which speculative investors fund cases in return for a share of the claimed compensation, and argues they fuel the growth of “surrealistic” claims and are “more about making money than obtaining justice” (Kahale 2018: 17).

Legal scholars Bonnitcho and Brewin have also noted:

The possibility of large compensation awards has systemic implications. Investors with long-shot claims are more likely to proceed to arbitration if they expect to receive a large payout should their case succeed. The possibility of a large award also encourages third-party funding (Bonnitcho and Brewin:2).

These findings have been reinforced by the increasing numbers of awards of billions of dollars against governments which are a substantial proportion of their national budgets and can damage their ability to provide essential services. There is no general right of appeal for substantive ISDS decisions. However, for ICSID tribunal decisions only, governments can apply to have the award annulled or reduced. This is rarely successful.

As of October 2019, there were 46 cases of awards over UD\$100 million, and 10 cases of awards over US\$1 billion (Bonnitcho and Brewin 2019: 1).

Some examples of excessive awards and attempts at annulment are listed below.

In 2012, an ISDS tribunal determined that the Republic of Ecuador had breached the US-Ecuador BIT, following a dispute about whether mining company Occidental Petroleum had breached Ecuadorian law. The Tribunal awarded damages of US\$2.3 billion including interest. Ecuador is a small developing country with a population of 17 million people, with 24% living in poverty. The award was equivalent to 6.8 per cent of Ecuador’s US\$26 billion government budget in 2012 and almost equivalent to the Ecuadorian Ministry of Health’s budget in the same year (Rosert 2014: 3).

Ecuador applied for annulment but the amount was reduced in 2015 by only 40%, still leaving an award of over US\$1 billion, or about half of the Ecuadorian health budget (Jones and Thomas 2015). Ecuador subsequently withdrew from ISDS arrangements.

The largest award to date is Yukos vs the Russian Federation for US\$50 billion awarded by an ICSID tribunal in 2014. This amounted to about 12 per cent of the government's revenue in 2014 (Rosert 2014: 3). The Russian Federation applied for annulment in 2016 but the award was confirmed in 2020 (Paulsson 2020).

The second-largest compensation claim of US\$5.8 billion against Pakistan was made to Australian mining company Tethyan in July 2019. Tethyan was indirectly owned by two other mining companies, Barrick Gold Corporation of Canada and Antofagasta PLC of Chile (Antofagasta 2020). Neither Canada nor Chile has an investment treaty with Pakistan, but Australia does have a BIT which came into force in 1998. The Australian subsidiary appears to have enabled them to engage in a forum shopping exercise to lodge the claim.

The award is more than 25 times the US\$220 million the company invested in the project and includes an unknown payout for 'lost future profits.' It is 16 per cent of the entire Pakistan Budget for 2018-19, and almost equivalent to the US\$6 billion emergency loan from the International Monetary Fund (IMF) granted just before the award (Sherwood 2019, Tienhaara 2019).

Commentators have noted that there are fundamental flaws when the government of a developing country qualifies for an emergency loan from the IMF to prevent economic collapse, but an ICSID tribunal under the auspices of the World Bank determines that equivalent funds must then be paid to a global corporation for a dubious calculation of future lost profits, thereby nullifying any benefit to the population from the IMF loan (Bonnitcha and Brewin 2019: 2, Tienhaara 2019).

These excessive awards based on flawed methodology have prompted calls for ISDS provisions for awards to be limited to the actual value of investments (Bonnitcha and Brewin:26-27).

Impact on aid and development policies and reputational risk from forum shopping and excessive awards made to Australian companies against developing countries

The DFAT discussion paper asks if ISDS claims are of benefit to Australian investors, but this should not be the only factor in evaluating BITs.

The seven claims by Australian companies recorded to December 2019 in the UNCTAD ISDS database have been from mining companies against various regulation or licensing decisions (UNCTAD 2020).

The \$US\$5 billion awarded for lost future profits to Australian company Tethyan, a subsidiary of Canadian company Barrick Gold, when Pakistan was facing economic collapse and had received an IMF loan of approximately the same amount, has implications far beyond the benefit to that company.

The Australian government should consider the implications of such awards which divert resources in low income countries away from essential services and can impact on Australia's aid and development budget and its international reputation.

More recently, in a case not yet recorded in the UNCTAD data base, the same Canadian company Barrick Gold announced on July 10, 2020, that its Australian subsidiary, Barrick (PD) Australia Pty Ltd,

was using the ISDS provisions of a bilateral investment treaty between Papua New Guinea (PNG) and Australia to claim compensation for the PNG government's refusal to grant an extension of the company's expired 30-year lease at the controversial Porgera Joint Venture gold mine in the PNG highlands (Barrick Gold 2020).

Canada does not have a BIT with PNG, so again Barrick's use of an Australian subsidiary appears to be an exercise in forum shopping.

There is a documented record of decades of environmental and human rights abuses at the Porgera mine (Amnesty International 2010) There have also been recommendations from human rights experts that the company should address these claims (Jungk *et al* 2018). Despite this record, Barrick is seeking compensation because its lease has not been extended after its expiration. Based on the Tehthyan case, there could be claims for loss of expected future profits.

The Australian government should be concerned that such a claim, if successful, could impact on PNG's budget and Australia's aid and development program, and its relations with our largest Pacific Island neighbour. This adds to the reputational risk for Australia of the perception that its BITS are being used repeatedly for forum shopping that enables excessive claims on developing country governments.

Recent ISDS cases on medicines, environment, carbon emissions reduction, Indigenous land rights, minimum wage

There are growing numbers of cases against health, environment (including laws to address climate change), Indigenous land rights and other public interest laws, which have contributed to the crisis of credibility for ISDS described above. Recent cases include the following:

- The US Philip Morris tobacco company shifted assets to Hong Kong and used ISDS in a Hong Kong investment agreement to claim billions in compensation for Australia's plain packaging law. It took over four years and \$24 million in legal costs for the tribunal to decide that Philip Morris was not a Hong Kong company, and the case was an abuse of process; and another two years to decide on costs, but the government only recovered half of the legal and arbitration costs (Ranald 2019a).
- US Pharmaceutical company Eli Lilly used the ISDS provisions of NAFTA to claim compensation for a Canadian Supreme Court decision that found a medicine was not sufficiently different from existing medicines to deserve a patent, which gives monopoly rights for at least 20 years. Canada has a higher standard of patentability than the US and some other countries. The Canadian government won the case after six years and \$15 million in costs, but the tribunal decision was ambiguous on some key points about Canada's right to have distinctive patent laws (Baker 2017).
- The US Bilcon mining company won \$US7 million in compensation from Canada because its application for a quarry development was refused for environmental reasons. The Canadian government unsuccessfully sought annulment of this decision on the grounds that it undermined Canadian environmental law (UNCTAD 2019c, Withers 2019).
- The US Westmoreland mining company is suing the Canadian government over the decision by the Alberta province to phase out coal-powered energy as part of its emission reduction strategy (UNCTAD 2019d).

- The Canadian Bear Creek mining company won \$US26 million in compensation from the government of Peru because the government cancelled a mining license after the company failed to obtain informed consent from Indigenous land owners about the mine, leading to mass protests. The tribunal essentially rewarded the company despite the fact that it had violated its obligations under the ILO Convention on Indigenous Peoples to which Peru is a party (International Centre for Settlement of Investment Disputes (ICSID) 2017).
- The French Veolia Company sued the Egyptian Government over a local government contract dispute in which they claimed compensation for a rise in the minimum wage. This claim eventually failed but it took seven years and the costs to the Egyptian government have not been made public (Breville and Bulard 2014, UNCTAD 2019e).

Note that these examples include cases against court decisions and government laws and policies at national, state and local levels.

ISDS cases cost governments millions to defend, even if they win

Companies and governments fund the arbitration costs and their own legal costs. ISDS arbitrators and advocates are paid by the hour, which prolongs cases at government expense. A 2012 OECD Study found ISDS cases last for three to five years and the average cost to governments for defending cases was US\$8 million per case, with some cases costing up to US\$30 million. A more recent UNCITRAL paper indicated that ISDS costs are still a major concern (OECD 2012, UNCITRAL 2018).

ISDS tribunals have discretion about whether they decide to award some or all costs to the winning party, and applying for costs to be awarded often prolongs the duration and costs of the case.

This differs from national systems. The Australian Government defeated the Philip Morris tobacco company's High Court claim for billions in compensation, and the High Court ordered the company to pay all of Australia's costs. The case and costs decision took less than a year.

Contrast this with the ISDS experience. The Australian government also won the 2011 Philip Morris ISDS case against its plain packaging law in 2015, but the costs were not awarded until 2017. Only half of Australia's almost A\$24 million in legal and arbitration costs were awarded to Australia, despite the fact that the tribunal found that Philip Morris had abused the process (Ranald 2019a).

The Australian experience of ISDS and previous Australian policy

After a public debate about the experience of US companies using ISDS to sue Canada and Mexico in the North American Free Trade Agreement, the Howard Coalition government did not include ISDS in the US-Australia Free Trade Agreement in 2004.

In 2010 a Productivity Commission study found that ISDS gives additional legal rights to foreign investors not available to domestic investors and lacked evidence of economic benefits. The study recommended against the inclusion of ISDS in trade or investment agreements on the grounds that it poses "considerable policy and financial risks" to governments (Productivity Commission 2010:274). The then ALP government developed a policy against ISDS during the years 2011-2013 and did not include it in trade negotiations

A June 2015 Productivity Commission study of ISDS confirmed the findings of its 2010 study (Productivity Commission 2015).

The Philip Morris case against Australia's tobacco plain packaging law and the regulatory freezing effect

The US Philip Morris tobacco company use of ISDS in a Hong Kong-Australia investment agreement against the Australian government's plain packaging has been described above. It took the tribunal almost five years to decide that Morris was not a Hong Kong company and another two years to decide on costs, only half of which were awarded to Australia.

The substantive issue of whether the company deserved billions of dollars of compensation because of the legislation was not tested.

Even so, the case had a freezing effect on other governments' introduction of plain packaging legislation. The New Zealand government delayed introducing its own legislation pending the tribunal decision (Johnston 2015).

International corporations are well aware of this freezing effect and use ISDS to attempt to prevent public interest regulation. The Canadian Chevron Company has lobbied for ISDS to be included in EU trade agreements as a deterrent against environmental protection laws (Nelson 2016).

In short, ISDS is an enormously costly system with no independent judiciary, precedents or appeals, which gives increased legal rights to global corporations which already have enormous market power, based on legal concepts not recognised in national systems and not available to domestic investors. ISDS has been used to claim compensation for new public interest regulation and to deter governments from introducing such regulation, including regulation to address climate change and to improve the minimum wage. Many developing country governments, including Ecuador, India, South Africa and Indonesia have reviewed and/or cancelled their ISDS commitments (Filho 2007, Biron 2013, Mehdudia 2013, Bland and Donnan 2014, Public Citizen 2018).

EU and US governments are retreating from ISDS

Both the EU and the US governments have in the past been major proponents of ISDS. However, recently there have been increasing numbers of cases taken against changes to EU and US government laws and policy decisions, and there has been growth in public opposition to ISDS. Opposition has been expressed by legal experts, state and provincial governments, court decisions and the general public. Both the EU and the US are now retreating from ISDS in trade negotiations.

The EU

The use of ISDS in a BIT by the Swedish company Vattenfall to sue the German government over the phasing out of nuclear energy, and the inclusion of ISDS in proposed trade agreements with Singapore, Canada and the US prompted fierce public debate. In 2014, the European Commission launched an online public consultation on ISDS. The consultation received over 150,000 submissions, the majority of which were critical of ISDS (European Union 2014).

The ongoing debate about ISDS has led to EU court cases in which national governments have challenged the ability of the EU to make collective commitments on ISDS on behalf of national governments without such commitments being subject to democratic processes in each country.

On 16 May 2017, the Court of Justice of the European Union issued a landmark opinion on the Investment and ISDS clauses in the EU-Singapore free trade agreement. It found that most of the

agreement fell under the EU's powers, and that the EU could ratify it on behalf of member countries, except for some investment provisions, including ISDS. The court found that EU Member States' national and regional parliaments and the European Parliament must vote on provisions regarding investors, particularly ISDS (Court of Justice of the European Union 2017).

In March 2018, in a separate case brought by the government of Slovakia, the Court of Justice found that ISDS between EU governments is incompatible with EU law. The Court found that damages awarded to a Dutch private health insurance company against Slovakia by an ISDS tribunal breached EU law (Court of Justice of the European Union 2018).

The 28 EU member states decided in January 2019 to terminate all BITs between themselves by December 6, 2019 (EU Member States 2019). On 5 May 2020, 23 EU member States signed the agreement for the termination of intra-EU BITs containing ISDS (EU Member states 2020).

Following the court decisions, the European Commission has developed a "fast track" process for agreements without ISDS for non-EU countries, which would enable them to be approved by the European Commission alone, without seeking approval from national parliaments. Such agreements cannot include ISDS (Von der Burchard 2017).

The EU-Australia FTA now being negotiated does not include ISDS.

The EU is pursuing longer-term but equally controversial proposals for a Multilateral Investment Court. While this would address some procedural issues, it does not address the substantive power imbalance which enables global corporations to seek compensation for public interest regulation by democratically elected governments (Van Harten 2016).

The US

Over the last three years, there has also been strong public opposition expressed in the US to the inclusion of ISDS in trade agreements from state governments and legal experts, which has influenced state and national governments.

In February 2016 the National Conference of State Legislatures declared that it "will not support Bilateral Investment Treaties (BITs) or Free Trade Agreements (FTAs) with investment chapters that provide greater substantive or procedural rights to foreign companies than U.S. companies enjoy under the U.S. Constitution. Specifically, NCSL will not support any BIT or FTA that provides for investor/state dispute resolution. NCSL firmly believes that when a state adopts a non-discriminatory law or regulation intended to serve a public purpose, it shall not constitute a violation of an investment agreement or treaty, even if the change in the legal environment thwarts the foreign investors' previous expectations" (National Conference of State Legislatures 2016).

In October 2017, more than 200 prominent law professors and economists signed an open letter arguing that ISDS undermines the rule of law and urging the US government to oppose ISDS in its renegotiation of the North American Free Trade Agreement (NAFTA). Signatories included Nobel Laureate Joseph Stiglitz, former Labor Secretary Robert Reich, former California Supreme Court Justice Cruz Reynoso and Columbia University professor and UN Senior Advisor Jeffrey Sachs (Public Citizen 2017).

The US and Canada have since excluded ISDS cases between themselves from the revised US Mexico Canada Agreement (International Institute for Sustainable Development 2018).

ISDS not included in the Regional Comprehensive Economic Partnership (RCEP)

According to the summary on the DFAT website, ISDS has been excluded from the final text of the 15-member Regional Comprehensive Economic Partnership between Australia, New Zealand, Japan, China, South Korea and the 10 ASEAN countries (DFAT 2019).

United Nations criticism of ISDS: not compatible with human rights

In September 2015, United Nations Human Rights independent expert Alfred de Zayas launched a critical report on ISDS (de Zayas 2015).

The Report says ISDS is incompatible with human rights principles because it “encroaches on the regulatory space of States and suffers from fundamental flaws including lack of independence, transparency, accountability and predictability”.

In April 2019, six UN special rapporteurs on human rights wrote an open letter identifying similar fundamental flaws in the ISDS system, and arguing for systemic change (Deva et al, 2019).

Ongoing reviews conducted by ISDS institutions reflect community concerns about ISDS

Growing community and government concern about ISDS has had an impact on the two institutions that oversee ISDS arbitration systems, the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank International Centre for Settlement of Investment Disputes (ICSID), both of which are conducting ongoing reviews of the system.

In October 2016, the Secretariat of ICSID initiated a consultation with its Member States, which identified some similar areas of concern to the UNCTAD review. The review is not public but is reportedly ongoing (ICSID 2016).

As a UN process the UNCITRAL review submissions, papers and proceedings are public. The November 2017 discussion paper for the UNCITRAL review involving member states, identified the following issues:

“(i) inconsistency in arbitral decisions, (ii) limited mechanisms to ensure the correctness of arbitral decisions, (iii) lack of predictability, (iv) appointment of arbitrators by parties (“party-appointment”), (v) the impact of party-appointment on the impartiality and independence of arbitrators, (vi) lack of transparency, and (vii) increasing duration and costs of the procedure. These concerns ... have been said to undermine the legitimacy of the ISDS regime and its democratic accountability” (UNCITRAL 2017: 6).

UN Human Rights Rapporteurs and hundreds of civil society groups have made submission to the UNCITRAL review criticising the fundamental imbalance of power in the ISDS system, as have sixty-five academics from around the globe (Deva *et al* 2019, Civil Society Groups 2019, Academics 2019).

A recent paper from the South Centre says there is a growing international consensus to fundamentally reform ISDS, and that developing countries are under-represented in the UNCITRAL process (South Centre 2019).

The UN Conference on Trade and Development also recognises that there is a new trend to limit companies' access to ISDS, by omitting ISDS from trade and investment treaties altogether, limiting treaty provisions subject to ISDS and excluding policy areas from ISDS coverage (UNCTAD 2020c).

ISDS enables cases based on government actions during the COVID-19 pandemic

ISDS rules could result in cases from global companies claiming compensation for government actions during the COVID-19 pandemic that reduced their profits but were essential to save lives.

Peru cancelled road tolls to facilitate internal transport of essential goods during the pandemic, and has been threatened with an ISDS case by private road toll operators (Sanderson 2020).

Legal firms specialising in ISDS are already advising corporations on possible cases. An international arbitration law firm has told its clients:

While the future remains uncertain, the response to the COVID-19 pandemic is likely to violate various protections provided in bilateral investment treaties and may bring rise to claims in the future by foreign investors...While States may invoke *force majeure* and a state of necessity to justify their actions, as observed in previous crises that were economic in nature, these defences may not always succeed (Aceris Law 2020).

An Australian legal firm is advising global corporations that:

Governments the world over have introduced COVID-19 prevention measures such as hard border closures, city and regional lockdowns, suspension of construction, production and mining...Almost certainly, these measures will be tested by international investors across a number of industries, alleging breaches of bilateral investment treaties and free trade agreements (Coors 2020).

Legal scholars critical of ISDS have confirmed that after the pandemic governments could face claims for compensation from global corporations. They have called for all governments to withdraw consent from ISDS rules to avoid an avalanche of cases relating to the pandemic (International Institute for Sustainable Development 2020).

UNCTAD, the UN body which monitors ISDS cases, has also acknowledged this danger (UNCTAD 2020b: 11-12). Prominent global economists and lawyers led by Jeffrey Sachs have called for a moratorium on ISDS claims relating to government actions during the pandemic (Columbia Centre on Sustainable Investment 2020). Over 400 civil society groups have written to governments about the dangers of such cases, asking them to withdraw from ISDS arrangements (Civil Society Organisations 2020).

“Modern” ISDS clauses do not effectively protect government rights to regulate and have limited exclusions

The retention of ISDS in Australia's BITs would be a continuation of a fundamentally imbalanced process which gives additional legal rights to global corporations which already have enormous market power.

The DFAT discussion paper recognises that Australia's BITs were negotiated before recent public debates and that reviews have exposed the failings of ISDS. The paper recognises that these older BITs

were entirely focused on investor rights and had no measures to protect the rights of governments to regulate in the public interest.

The paper lists some of the recent attempts to address some of these issues through “modern” changes to ISDS provisions in the CPTPP and recent bilateral FTAs.

Unfortunately, these changes do not effectively protect the democratic rights of governments to regulate in the public interest, and the exclusions for particular policy areas are limited.

For example the right of governments to regulate in the public interest is heavily qualified by the inclusion of the words highlighted in the following paragraph in article 9.16 of the CPTPP and replicated in some recent bilateral FTAs:

Nothing in this chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure ***otherwise consistent with this chapter*** that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental health or other regulatory objectives” (DFAT 2015 Article 9.16).

Associate Professor Amokura Kawharu of Auckland University has commented that this is circular language which “appears to provide no additional protection, and only affirms the right to regulate in a manner consistent with the other terms of the investment chapter” (Kawharu 2015: 9). Other trade law experts have since reinforced this point (Gleeson and Labonte 2020: 28-29).

Another clause in the CPTPP investment chapter which is replicated in some recent bilateral FTAs attempts to limit the definition of indirect expropriation for which foreign investors can claim compensation:

“Non-discriminatory regulatory actions by a Party that are designed and applied to protect ***legitimate public welfare objectives***, such as public health, safety and the environment, do not constitute indirect expropriations, ***except in rare circumstances***” (DFAT 2015 Annex 9-B 3b).

This has large legal loopholes, as it does not prevent companies from launching cases in which they can argue that the measures are not legitimate, and that the circumstances are rare.

Neither of these clauses actually prevents claims from being brought against governments. They only provide some possible arguments governments can use in defending cases. Governments would still have to spend time and legal costs defending cases.

The DFAT discussion paper notes that some public health measures have been excluded from ISDS claims in some recent bilateral trade agreements, although the provisions vary from only excluding tobacco regulation in the CPTPP to exclusion of public health measures relating to Medicare, the Pharmaceutical Benefits Scheme, the Therapeutic Goods Administration and the Gene Technology Regulator in some more recent FTAs.

However, there are no exclusions from ISDS claims for other important public interest regulation, which have been the subject of ISDS claims in the examples provided above. These include environmental regulation, including measures to reduce carbon emissions and address climate change, regulation of workers’ rights and regulation of the rights of indigenous peoples, including land rights.

The DFAT discussion paper also notes procedural changes in recent FTAs that seek to limit forum shopping by global or local companies, allow claims to be dismissed at a preliminary stage, permit

publication of proceedings and outcomes, and attempt to address arbitrator conflict of interest. These are all welcome changes, but they do not address the fundamental imbalances that enable global corporations to claim compensation for public interest regulation.

The current procedural changes do not include proposals that would limit excessive claims like the \$US5 billion awarded against Pakistan to Australian company Tethyan.

Clive Palmer ISDS threat shows that current provisions against forum shopping may not prevent it

The clauses intended to prevent forum shopping in the 2017 revisions of the Singapore free trade agreement have not deterred Clive Palmer from moving some assets to Singapore and threatening an ISDS case over legislation passed by the W.A. Parliament (Hondros 2020).

Regardless of the merits of the legislation, it is an absurd situation when an Australian company can launch a claim against the Australian government from Singapore. The Singapore FTA has denial of benefits clauses and clauses which enable claims to be dismissed at a preliminary stage, but they do not prevent cases from being launched. If the case proceeds the Australian government will still have to spend time and legal fees arguing that the company is not a Singaporean company.

Conclusion and recommendations: BITS should exclude ISDS and guarantee the right to regulate in the public interest

The DFAT discussion paper notes that:

There are various models and approaches that different countries take in relation to international investment agreements. For instance, some models are concerned with investment facilitation rather than dispute resolution.

The Brazil model BIT is concerned with investment facilitation rather than investor-state dispute resolution.

Despite not being a party to any traditional BITS, Brazil is one of the world's top recipients of foreign direct investment, reinforcing the evidence that traditional BITS alone are not decisive in attracting foreign investment. Brazil has developed a model BIT which does not include ISDS.

The Investment Cooperation and Facilitation Treaty between Brazil and India provides an example of a BIT which promotes investment, safeguards the rights of investors and the rights of governments to regulate in the public interest and is enforced through state-to-state disputes procedures, not through ISDS (UNCTAD 2020d).

Recommendations

- 1. Australia should take a consistent approach to the review of its BITs, based on its commitments to the right of governments to regulate in the public interest and its commitments to human rights, labour rights and environmental standards as expressed in UN and ILO conventions and agreements.**
- 2. The government should be concerned about the impact on aid and development budgets and the harm to Australia's reputation of forum shopping and excessive awards made to Australian companies against developing countries.**
- 3. The review should recognise that current revised clauses in ISDS provisions are not effective in protecting the rights of governments to regulate and the exclusions only**

prevent cases in a narrow range of areas, omitting important public policy areas like the environment, workers' rights and Indigenous land rights.

4. The review should acknowledge the danger of ISDS cases being taken against a wide range of governments' actions taken during the COVID-19 pandemic, recognised by legal experts and by UNCTAD, the body responsible for monitoring ISDS cases. The Government should follow the advice of legal experts to make arrangements in the short-term with BIT partners to exclude cases against pandemic-related actions and to review BITS to exclude ISDS as per recommendation five.
5. Australia should take a policy approach to BITS that involves investment promotion and facilitation rather than dispute resolution. Australia's existing BITS should be amended to exclude ISDS provisions, and should instead be enforced through state-to-state dispute processes. The Investment Cooperation and Facilitation Treaty between Brazil and India provides an example of this approach.

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