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10 March 2016

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CRICOS Provider No. 00120C

Committee Secretary
Joint Standing Committee on Treaties
PO Box 6021
Parliament House
Canberra ACT 2600

Re: Inquiry into the Trans Pacific Partnership (TPP)

Dear Committee members,

The government argues the following three points in its summary of the investment chapter of the TPP (http://dfat.gov.au/trade/agreements/tpp/summaries/Documents/investment.PDF):

1. Investment rules are included in trade agreements such as the TPP because of the importance governments attach to guaranteeing the high standards of governance that are pivotal to **attracting and sustaining foreign investment**. By supporting a more predictable investment environment, investment rules play an important role in **facilitating inbound foreign investment**;

2. The TPP Investment Chapter balances the interests of governments and investors, by promoting foreign investment, while **recognising the inherent right of governments to regulate in the public interest**. The Chapter guarantees a set of basic protections to investors from TPP countries, while providing a range of **robust and effective safeguards to protect a state's right to implement public policy regulation**.

3. The Chapter will deliver important and meaningful benefits to Australia. **It will facilitate foreign investment into Australia**, and **provide important protections to Australian businesses investing abroad**.

This submission replies to these claims with the following arguments:

1. Investment is not a universal good. In a climate-constrained world, only investments that contribute to climate mitigation/adaption or 'do no harm' in climate terms should be actively promoted and protected by governments. However, even if one rejects this argument, there is **insufficient evidence** to support the government's contention that the TPP will help Australia to attract and sustain inbound foreign investment *in any sector*.

2. The TPP **does not balance the interests of governments and investors** and the **'safeguards' are problematic and untested in arbitration**. Other recent treaties have *gone much further* in addressing both procedural and substantive issues.

3. Australian businesses have not been significant users of ISDS and they have **other options to protect their investments** abroad. ISDS is **too expensive** and time-consuming for most **small and medium sized enterprises**.

I conclude that the Government has failed to provide a strong case for the inclusion of the investment chapter in the TPP and that, as currently worded, the chapter presents significant risks to Australia without corresponding benefits.

Please do not hesitate to contact me if you would like me to explain any of these issues further.

Yours sincerely,

Dr. Kyla Tienhaara

1. Promoting & Protecting Investment in a Climate-Constrained World

Not all investments are created equal. In some instances foreign direct investment (FDI) leads to substantial job creation, positive spill-over effects, and the introduction of novel and useful technologies. In other cases, FDI crowds out local investment, creates pollution and contributes little to nothing to the economy. This has always been the case, but in a climate-constrained world it is ever more apparent that FDI is *not an unmitigated good*.

In an article published in *Nature* last year, McGlade and Ekins determined that in order to have a reasonable chance of keeping to the 2°C 'guardrail' (which was formally adopted as the objective of the international community at the Paris Climate Conference in December), "globally, a third of oil reserves, half of gas reserves and over 80% of current coal reserves should remain unused from 2010 to 2050".[1] In other words, a substantial proportion of known fossil fuel deposits must be *left in the ground* and further exploration activities should not be undertaken.

In this context, the inclusion of an investment chapter in the Trans Pacific Partnership (TPP) that aims to protect and promote *all* forms of foreign investment, including investment in sectors that must eventually be rendered obsolete to prevent catastrophic climate change, is concerning. However, even if the privileges provided in the TPP's investment chapter were *limited to climate neutral or climate beneficial investments* it is not clear that its inclusion in the agreement should be supported. This is because there is insufficient evidence to suggest that investment treaties actually promote or facilitate flows of FDI *in any sector*, let alone specifically in sectors such as renewable energy, and because it is not apparent that providing protection to climate-friendly investments through investment treaties will facilitate a transition to a low-carbon economy.

Promoting Investment

The original rationalisation for *developing countries* to sign investment treaties was that it would help them to attract FDI. This was based on the logic that investment treaties allow states to overcome the 'credible commitment' problem.[2] In other words, governments are able to demonstrate in a meaningful way that they will not heedlessly alter the 'investment environment' after an investor has sunk capital into a project. However, numerous studies have employed econometrics to examine the question of whether there is a causal link between the existence of an investment treaty and increased flows of FDI. Many early studies that demonstrated a positive effect have been criticised on methodological grounds.[3] Some recent studies have addressed one 'endogeneity problem' (omitted variables) but none have accounted for the issue of reverse causality (i.e. that states might choose to sign treaties when they see that

[1] McGlade, C. and P. Ekins. 2015. "The Geographical Distribution of Fossil Fuels Unused When Limiting
[2] Guzman, A. 1998. "Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties," 38 *Virginia Journal of International Law* 639.
[3] Aisbett, E. 2009. "Bilateral Investment Treaties and Foreign Direct Investment: Correlation Versus Causation", in Sauvant, K. and L. Sachs (eds.) *The Effect of Treaties on Foreign Direct Investments* (Oxford University Press).

investment flows are increasing).[4] Studies that do address the former issue tend to find that treaties only have a minor impact, if any, on FDI flows.[5]

It is also worth noting that when researchers have taken into account different treaty designs they have found that the presence of market-access provisions correlates with increased FDI flows, particularly when they are included in a free trade agreement, *whereas investor-state dispute settlement (ISDS) provisions have no discernable impact.*[6]

To a lesser extent, qualitative studies have also been employed to address the relationship between investment treaties and FDI. Poulsen concludes that existing surveys of corporate executives suggest that "[f]or the vast majority of investors, [bilateral investment treaties] do not appear to be important – directly or indirectly – when determining where, and how much, to invest abroad."[7]

Finally, there is the case of Brazil—a country that has been very successful in attracting FDI and yet has *never ratified a treaty containing ISDS*.

In the Australian context, *ISDS is even less relevant for attracting FDI* than it is for developing countries. The Australian Government does not have a reputation for capricious or arbitrary behaviour in relation to business (although it must be said that the investment climate for renewables has hardly been stable or attractive in recent years). Furthermore, there is a high degree of judicial independence in Australia and the domestic courts are respected and regarded as efficient and effective in resolving disputes. The Productivity Commission has concluded:

> An examination of foreign investment trends with Australia's main foreign investment partners suggests that ISDS provisions are unlikely to have been relevant considerations in the investment decisions of Australian firms investing abroad or foreign firms investing in Australia.[8]

<u>Protecting Investment</u>

If the investment chapter of the TPP will not facilitate or promote FDI flows, what will it do? It will provide an *additional layer of protection* (supplementing investment insurance, investment contracts, and access to local courts, see further section 3) for primarily *large multinational firms* (that have the resources to engage in the expensive

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[4] For an overview of the literature see: UNCTAD. 2014. The Impact of International Investment Agreements on Foreign Direct Investment: An Overview of Empirical Studies 1998-2014, IIA Issues Note (working draft September 2014).

[5] Bonnitcha, J. 2014. *Substantive Protection under Investment Treaties: a Legal and Economic Analysis* (Cambridge University Press, 2014), p. 107.

[6] Berger, A. 2015. "Financing Global Development: Can Foreign Direct Investments be Increased through International Investment Agreements?", German Development Institute Briefing Paper 9/2015.

[7] Poulsen, L. 2010. "The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence" in Sauvant, K. (ed) *Yearbook on International Investment Law and Policy 2009/2010* (Oxford University Press), pp. 539-574 at 541. See also: Yackee, J. 2010. "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence", 51 *Virginia Journal of International Law* 397.

[8] Productivity Commission. 2015. *Trade & Assistance Review 2013-14*, at p. 80. http://www.pc.gov.au/research/recurring/trade-assistance/2013-14/trade-assistance-review-2013-14.pdf

ISDS process, see further section 3) when *governments take measures that have a negative impact on their investments*.

The number of ISDS cases launched in 2015 reached a record high of 70, bringing the total number of disputes launched to date to close to 700.[9] Of all of the disputes registered in one arbitration body (the World Bank's International Centre for the Settlement of Investment Disputes or ICSID), 26% concerned oil, gas and mining (more than any other sector) and another 15% concerned electric power & other energy resources.[10] In other words, *41% of all ICSID cases relate to the energy sector*.

Energy incumbents launch a majority of these cases. The ISDS system works best for incumbents because it is chiefly designed to resist policy change. This raises concerns in respect of the significant policy developments required to transition to a low carbon economy. As of yet, there are no known cases where an investor has taken the step of formally launching ISDS over the introduction of a carbon tax, emissions trading scheme or renewable energy incentive scheme. However, claims have certainly been contemplated, including over the Rudd Government's proposed emissions trading scheme in 2009.[11]

ISDS cases have arisen in response to a moratorium on gas fracking (a process with potentially significant climate impacts through methane releases as well as implications for groundwater) and the rejection of a proposal by TransCanada to build the Keystone XL pipeline to transport oil produced from Alberta's tar sands to various refineries in the US (based in part on the White House's desire to demonstrate leadership on climate change in the run-up to the Paris Conference). Neither case has concluded but a number of legal experts suggest that TransCanada (seeking US$15 billion in damages) has a strong case against the US, particularly in the wake of the recent decision in *Bilcon* v *Canada* (see further below).[12]

However, even if both Canada and the US eventually prevail in these cases, there may be a substantial cost to taxpayers in terms of the resources expended to defend the policies.[13] Also worth considering is the unquantifiable cost of *regulatory chill*. The regulatory chill hypothesis suggests that in some instances (not all, or there would be no ISDS cases) 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

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9 UNCTAD. 2016. "Record Number of Investor-State Arbitrations Filed in 2015", http://investmentpolicyhub.unctad.org/News/Hub/Home/460

10 ICSID. 2015. "The ICSID Caseload – Statistics", https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202015-2%20%28English%29.pdf

11 Miles, K. 2013. *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital.* Cambridge University Press.

12 Krugel, L. 2016. "TransCanada NAFTA challenge could break U.S. winning streak, experts say", *CTV News*, 7 January 2016, http://www.ctvnews.ca/business/transcanada-nafta-challenge-could-break-u-s-winning-streak-experts-say-1.2728344

13 An OECD study found that on average a case costs US$8 million but have known to be as high as $US30 million. See 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*, http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf

is severely diminished) as a result of concerns about ISDS.[14] Law firms actively advertise ISDS as a useful tool "to assist lobbying efforts to prevent wrongful regulatory change".[15] Given the amount of regulatory change required to transition to a low carbon economy and the amount of vested interests that are threatened by such change, providing fossil fuel companies with an additional lobbying aid is highly problematic.

Proponents of ISDS argue that governments can reasonably expect *bona fide* measures to survive any challenge and that everything else *should* be 'chilled'.[16] 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'– see further Section 2) 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, there are two scenarios one can envision. The first 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.

A second scenario in which 'chilling effects' could be in the public interest (in a climate-constrained world) is if the threat of ISDS was used to prevent government measures that would harm 'beneficial' investments (e.g. renewable energy). A scenario in which a government would want to harm a climate-friendly investment is, unfortunately, not at all fantastical in the Australian context. However, the key situation in which one can imagine a legitimate claim arising is if a government were to make changes to a renewable energy incentive scheme with retroactive effect. Under such circumstances, recourse to the TPP appears to be precluded by the fact that the Parties have specifically

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[14] 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.

[15] 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, http://www.steptoe.com/publications-9867.html

[16] 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.

carved out changes to subsidies from Articles 9.6 (on the Minimum Standard of Treatment) and 9.8 (on Expropriation).

Advocates of a clean energy transition should not lament this fact. Renewable energy technologies are experiencing a rapid decline in costs and, as such, subsidies will not be required to make investments in the sector profitable in the long-term. Furthermore, the cases involving renewable energy investments that have arisen to date are of dubious merit and demonstrate that while ISDS may help the bottom line of some individual companies, it is not going to facilitate the development of a low carbon economy. For example, Spain has been deluged by cases over changes to its feed-in-tariff, but many of the investments appear to have only been rendered *less profitable* by the government's measures, *not unprofitable*.[17] Some companies that have launched ISDS claims against Spain invested *after* the changes in the feed-in-tariff began (i.e. they were well aware of the situation).[18] The tribunal in the first solar ISDS case to be concluded found in favour of Spain, in part for these reasons.[19] Other cases, such as the wind energy dispute *Mesa* v *Canada* are straightforward instances of a company trying to use ISDS as a way to make the public pay for its own bad business decisions.[20]

2. Does the TPP Protect the Right to Regulate?

In order to respond to concerns both about the impact that ISDS cases have on the public purse and the potential for regulatory chill, governments have made attempts to tighten up the language in new investment treaties, leaving less scope for creative interpretation by arbitrators. In Australian policy circles, these textual additions/clarifications are typically referred to as 'safeguards'. In the following sections, each one of the main 'safeguards' included in the TPP's investment chapter is evaluated. It is concluded that the TPP's safeguards are open to interpretation and untested in arbitration. Overall, the chapter neither adequately protects the right to regulate nor does it balance the interests of investors with those of governments. Examples are provided of other agreements with stronger 'safeguards'.

National Treatment & Most Favoured Nation Treatment (MFN)

One would think that the clauses in investment treaties preventing governments from discriminating between investors on the basis of nationality would be fairly uncontroversial. Unfortunately, arbitral tribunals have read 'national treatment' and 'most favoured nation (MFN) treatment' clauses broadly as covering not only *de jure* discrimination but also *de facto* discrimination. In other words, there does not have to be evidence of *intent to discriminate* on the part of the state.

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[17] Olivet, C. and P. Eberhardt. 2014. "Profiting from Crisis: How Corporations and Lawyers are Scavenging Profits from Europe's Crisis Countries", Transnational Institute and Corporate Europe Observatory, http://corporateeurope.org/sites/default/files/profiting-from-crisis_0.pdf
[18] Ibid.
[19] Pilgrim, T. 2016. "Charanne B.V. and Construction investments S.A.R.L. v. The Kingdom of Spain (SCC Case No. 062/2012) Award: Case Report", School of International Arbitration, Queen Mary, University of London.
[20] Tienhaara, K. (forthcoming) "Does the Green Economy Need Investor-State Dispute Settlement?" in K. Miles (ed) *Research Handbook on Environment and Investment Law*. Cheltenham: Edward Elgar.

Some treaties, including the TPP, restrict the definitions of national treatment and MFN by including the qualifier that these provisions only apply to investors in 'like circumstances'. While, in theory, this approach offers a narrower scope for comparison than treaties with no qualifying language, in practice a large ambit for interpretation remains. Tribunals are free to determine the criteria on which to assess what investors/investments are in like circumstances; there is no requirement that a tribunal must consider issues such as the environmental impact of an investment activity, which from a state's perspective could provide a justifiable reason for differentiation.[21] If a tribunal is willing to consider the regulatory context (e.g. taking into account environmental and health policy objectives) they will likely place the burden on the state to show that the discrimination was "reasonable".[22] Furthermore, even where policy objectives are deemed reasonable, a tribunal may still find that the regulatory measures themselves are not if the same objectives could have been achieved in another way.[23]

Miles suggests that states that differentiate between investments on the basis of sustainability goals are at risk of facing investor claims of breach of the national treatment standard.[24] In the recent decision in *Bilcon* v. *Canada*, the tribunal determined that the decision of an independent environmental review panel constituted a breach of the national treatment standard because a higher standard of environmental review was applied than was the case for other investments in 'like circumstances'.[25] Canada's arguments that the other projects reviewed were of different scope, in different locations, and involving different concerns and therefore not 'in like circumstances' were rejected by the tribunal.[26]

The TPP contains a footnote that is intended to deal with this issue:

> For greater certainty, whether treatment is accorded in "like circumstances" under Article 9.4 (National Treatment) or Article 9.5 (Most-Favoured-Nation Treatment) depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.

However, this language will not be effective in preventing cases like *Bilcon* from arising under the TPP, because investors have proven their willingness to question the 'legitimacy' of government actions taken in the public interest before tribunals. As Johnson and Sachs point out, a much more effective 'safeguard' would have been to

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[21] Miles, K. 2011 "Sustainable Development, National Treatment and Like Circumstances in Investment Law", in M. Cordonier Segger, M. Gehring and A. Newcombe (eds.) *Sustainable Development in World Investment Law,* Kluwer, pp. 261-294 at 269-270.

[22] Wilensky, M. 2015. Reconciling International Investment Law and Climate Change Policy: Potential Liability for Climate Measures Under the Trans-Pacific Partnership", *Environmental Law Reporter* 45: 10683-10698.

[23] See Miles (note 21 above).

[24] Ibid.

[25] *Bilcon* v. *Canada*, Award on Jurisdiction and Liability, 17 March 2015, http://www.pcacases.com/web/sendAttach/1287

[26] Johnson, L. and L. Sachs. 2015. "The TPP's Investment Chapter: Entrenching, Rather than Reforming, a Flawed System", Columbia Center on Sustainable Investment Policy Paper, http://ccsi.columbia.edu/files/2015/11/TPP-entrenching-flaws-21-Nov-FINAL.pdf

"clearly specify that a foreign investor seeking to recover on a non-discrimination claim must establish that the government discriminated against it on account of its nationality".[27]

An additional problem that arises with the MFN provision in the TPP is its potential use by investors to access provisions in other investment treaties. In *Maffezini* v. *Spain*, the Tribunal decided that the MFN clause in the Spain-Argentina BIT could be applied to allow the claimant to have access to dispute resolution provisions in a BIT between Spain and Chile. The *Maffezini* decision prompted states to explicitly carve out ISDS provisions from the application of the MFN clause in more recent treaties. The TPP follows this trend.

However, investors have also successfully 'imported' the substantive provisions of other treaties through the application of MFN.[28] The Canada-EU Comprehensive Economic and Trade Agreement (CETA) attempts to deal with this issue, stating:

> Substantive obligations in other international investment treaties and other trade agreements do not in themselves constitute "treatment", and thus cannot give rise to a breach of this article, absent measures adopted by a Party pursuant to such obligations.

The 2015 Indian model bilateral investment treaty deals with the problem even more effectively by simply *excluding any mention of MFN* in the text (the country had been stung by the use of the MFN to import substantive obligations from another treaty in a case brought by an Australian investor).[29]

The TPP does not have an effective safeguard against the 'MFN loophole' and, as such, it is possible that investors will try to exploit it, thus rendering the other 'safeguards' in the TPP irrelevant. George Kahale III, chairman of Curtis, Mallet-Prevost, Colt & Mosle LLP (a leading arbitration firm) argues that including an MFN clause in the investment chapter of the TPP was a "major mistake" and it is "a dangerous provision to be avoided by treaty drafters whenever possible" because it can turn one bad treaty into protections "never imagined for virtually an entire world of investors".[30]

I do not agree with Prof Nottage's contention (in his submission to this inquiry) that Australia's Schedule in Annex II on Investment and Cross-Border Trade in Services closes the MFN loophole. The Annex states:

> Australia reserves the right to adopt or maintain any measure that accords more favourable treatment to any service supplier or investor under any bilateral or

[27] Ibid, at 10.
[28] For examples see Salomon C. and S. Friedrich. 2013. "How Most Favoured Nation Clauses in Bilateral Investment Treaties Affect Arbitration" *Practical Law Arbitration*, http://www.lw.com/thoughtLeadership/favoured-nation-clauses-arbitration
[29] Ranjan, P. 2012. "The White Industries Arbitration: Implications for India's Investment Treaty Program", *Investment Treaty News,* 13 April 2012, https://www.iisd.org/itn/2012/04/13/the-white-industries-arbitration-implications-for-indias-investment-treaty-program/
[30] Hill, J. 2015. "TPP's clauses that let Australia be sued are weapons of legal destruction, says lawyer", *The Guardian*, 10 November 2015, http://www.theguardian.com/business/2015/nov/10/tpps-clauses-that-let-australia-be-sued-are-weapons-of-legal-destruction-says-lawyer

> multilateral international agreement in force or signed prior to the date of entry into force of this Agreement.

The key words here are "adopt or maintain any measure…**under** any bilateral or multilateral agreement" (emphasis added). This does not appear to cover what is *in* any bilateral or multilateral agreement, which is the key issue for the MFN loophole. I find it hard to believe that this provision was ever intended to be used in the manner suggested by Prof Nottage.

The Minimum Standard & Fair and Equitable Treatment

The international minimum standard (MST) and fair and equitable treatment (FET) (which could be two distinct standards or one and the same depending on the treaty in question and the person interpreting it) are the most problematic standards in investment treaties from the perspective of the right to regulate. According to UNCTAD, MST/FET is the most likely provision to be invoked by an investor in an arbitral claim.[31]

The difficulty stems primarily from the fact that "the concepts 'fair' and 'equitable' are by themselves inherently subjective and therefore lacking in precision".[32] Following a review of arbitral awards, Westcott concluded that "ensuring stability of the business and legal framework is now an established element of fair and equitable treatment".[33] The International Law Association (ILA) International Law on Foreign Investment Committee goes even further with its suggestion that "certain elements of an emergent standard of review of administrative action appear to be taking shape" which reflect "contemporary approaches to good governance".[34] In the view of the Committee, fair and equitable treatment requires quite significant obligations on the part of the host state:

> it is now reasonably well settled that the standard requires a particular approach to governance, on the part of the host country, that is encapsulated in the obligations to act in a consistent manner, free from ambiguity and in total transparency, without arbitrariness and in accordance with the principle of good faith. In addition, investors can expect due process in the handling of their claims and to have the authorities act in a manner that is non-discriminatory and proportionate to the policy aims involved. These will include the need to observe the goal of creating favourable investment conditions and the observance of the legitimate commercial expectations of the investor.[35]

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31 UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (2007) UNCTAD/ITE/IIA/2006/5 at 32.

32 UNCTAD, 'Fair and Equitable Treatment', *Issues in International Investment Agreements* (1999) at 10-1.

33 Westcott, T. 2007. "Recent Practice on Fair and Equitable Treatment" 8 *Journal of World Investment and Trade* 409 at 425.

34 ILA International Law on Foreign Investment Committee. 2006. *International Law on Foreign Investment: First Report of the International Law Association*, at 16.

35 Ibid. Yannaca-Small identifies similar categories of obligation falling under the fair and equitable treatment standard including: the obligation of vigilance and protection; due process including non-denial of justice and lack of arbitrariness; transparency; and good faith (which could cover transparency and lack of arbitrariness). Yannaca-Small, C. 2004. "Fair and Equitable Treatment Standard in International Investment Law", *OECD Working Papers on International Investment* at 26. See also Behrens who lists good faith, non-discrimination, lack of arbitrariness, due process, transparency, consistency and proportionality as the key requirements of fair and equitable treatment. Behrens, P. 2007. "Towards the Constitutionalization of International Investment Protection" 45 *Archiv des Völkerrechts* 153 at 175.

It is clear that a very wide array of government actions, and indeed inactions, could fall within the purview of such a capacious standard. Governments have recognised this and have attempted to restrict the scope of interpretation by arbitrators. The most common 'safeguard' is to clarify, as the TPP does, that "fair and equitable treatment" does not "require treatment in addition to or beyond that which is required" under customary international law. Unfortunately, this 'safeguard' has proven ineffective in practice because some arbitrators view the decisions of past tribunals (who have broadly interpreted the standard) as now composing part of customary international law. The parties to the North American Free Trade Agreement (NAFTA) introduced the same 'safeguard' through a joint note of interpretation in 2001. This did not prevent the majority of the NAFTA tribunal in *Bilcon* v. *Canada* from determining that an alleged violations of Canadian domestic law amounted to a breach of customary international law. The other Parties to NAFTA (the US and Mexico) have criticized the *Bilcon* award in submissions filed in another arbitration for failing "to properly assess customary international law".[36]

A further 'safeguard' identified in the Government's summary of the TPP's investment chapter is the qualifier to MST/FET that: "[t]he mere fact that an action is taken that is inconsistent with an investor's expectations does not constitute a breach…even if there is loss or damage to their investment as a result of that action". Unfortunately, this language not only fails to act as a 'safeguard' it actually could expose governments to greater risk. First, no finding of an MST/FET violation has ever rested *solely* on the fact that an investor's expectations were not met. Todd Weiler, a Canadian lawyer/arbitrator and proponent of ISDS, has noted that he "can't recall any tribunal that, if you put this provision in that agreement, that the result would be different either way".[37]

Second, in the past, governments (including the US) have clearly asserted that an investor's 'expectations' are not to be considered *at all* in the determination of a breach of the MST. The TPP, by stating that a breach of an investor's expectations *does not alone* give rise to a claim, "implicitly recognizes that 'expectations' may in fact be relevant to establishing a violation of the FET standard".[38] Thus, the TPP "codifies – rather than corrects – problematic decisions such as the *Bilcon* award". [39]

The preferable option to 'safeguard' against expansive interpretations of the MST would be to exclude any mention of "fair and equitable treatment" in the TPP. This is the approach taken by India in its Model bilateral investment treaty (2015).[40]

Indirect Expropriation

The direct taking of foreign property has historically been one of the most significant risks to foreign investment. Outright takings are now considered rare in most parts of

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[36] See the Canadian Government's discussion of the case - http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/clayton.aspx?lang=eng

[37] "TPP Investment Language Aims To Tighten Standard For MST Breach" *Inside U.S. Trade*, 12 November 2015, Vol. 33, No. 44, http://insidetrade.com/inside-us-trade/tpp-investment-language-aims-tighten-standard-mst-breach

[38] See Johnson and Sachs (note 26 above) at 4.

[39] Ibid.

[40] Article 3.1. The full text of the Model is available at: http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_division/ModelBIT_Annex.pdf

the world. For the last twenty years, the key debate in academic and policy circles has been on the coverage in investment treaties of so-called indirect expropriation. Indirect expropriation falls short of actual physical taking of property but results in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor.[41] Indirect expropriations have variously been referred to in treaties by language such as measures having a 'similar' or 'equivalent' effect to expropriation or that are 'tantamount' to expropriation.

In establishing whether or not an indirect expropriation has occurred, tribunals have tended to adopt one of two basic approaches. Under the first approach, the tribunal focuses solely on the effect of the regulation on the investor.[42] In evaluating the effect of a measure, tribunals will likely examine both its economic impact and its duration. While outside of investment arbitration (e.g., in the European Court of Human Rights) there is indication that an investment must be rendered valueless or that the economic impact on it must be at least 'severe' or 'substantial' for a measure to qualify as an expropriation, investment tribunals place a stronger emphasis on the 'legitimate expectations' of the investor.

Those tribunals ascribing to the second approach will also examine the effect of a measure on an investor, but will additionally address its purpose. The tribunal will assess whether a measure was taken for a *legitimate* public purpose and may also evaluate whether the need to fulfil that purpose is proportional to the negative effect felt by the investor. Given the difficulty of drawing a 'bright line' between *bona fide* non-compensable regulation and a taking, many commentators and arbitrators suggest that such a determination can only be achieved on a case-by-case basis.[43]

'Safeguards' to prevent tribunals from adopting overly broad, investor-friendly interpretations of indirect expropriation that might interfere with the right to regulate have typically followed the US model (which is based on domestic case law on regulatory takings). This model relies on an annex that has two distinct elements. The first element is a three-part test that addresses the effect of a measure, its character, and the extent to which it interferes with the investor's 'reasonable expectations'. The second element is a statement that "except in rare circumstances" nondiscriminatory regulatory measures are not considered expropriations.

In some treaties, a provision (usually stated before the three-part test) is included that stipulates the level of deprivation that must have occurred for a measure to be considered a possible expropriation. For example, the Taiwan–New Zealand BIT (2013) states that "In order to constitute indirect expropriation, the Party's deprivation of the investor's property must be: (a) either severe or for an indefinite period." The Canada–Korea Free Trade Agreement (2014) states: "an action or series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right in an investment and *eliminates all or nearly all of its value*" (emphasis added).

[41] UNCTAD, 'Taking of Property', *Issues in International Investment Agreements* (2000) UNCTAD/ITE/IIT/15, Geneva.
[42] Fortier, Y. and S. Drymer. 2004. 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor' 19 *ICSID Review: Foreign Investment Law Journal* 293 at 300.
[43] Ibid, at 314.

In the treaty practice of countries such as Canada and Columbia, an additional note is included in the expropriation annex clarifying what "rare circumstances" might entail: "such as when a measure or series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith." Some other countries (e.g. Turkey) opt to exclude the "rare circumstances" language altogether.[44]

The TPP adopts the US model annex without any of these additional qualifications. The only amendment to the standard model is a footnote that explains that:

> whether an investor's investment-backed expectations are reasonable depends, to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector.

In some other treaties, this issue is dealt with by using the language "specific commitments" rather than "investment-backed expectations". The language "specific commitments" is narrower than "investment-backed expectations," although some investment law experts maintain (and I agree) that neither belongs in the analysis of whether a regulatory measure is an expropriation.[45]

What the TPP 'safeguard' achieves is a rejection of the sole effects approach to determining whether an indirect expropriation has occurred. However, it leaves open the door to a proportionality analysis, which Sornarajah argues has been imported into investment law from the trade context to "keep alive the idea that compensation is possible even in the case of regulatory expropriations."[46]

It is unclear what impact 3b (the 'rare circumstances' clause) will have in protecting the right to regulate. Some argue that there is a hierarchy between this clause and the one that precedes it; in other words, if a measure fits within the category of being a non-discriminatory measure taken in the public interest, it does not have to undergo the three-part test. However, others take the view that the two elements are non-hierarchical, and, thus, that a non-discriminatory public interest measure might still be considered an expropriation if it fails to pass the three-part test.[47]

In an intervention into a case brought under the Central American Free Trade Agreement (CAFTA) against Costa Rica, the US Government has made it clear that they do not view the relationship between these clauses as hierarchical, noting that the 'rare circumstances' paragraph "is *not an exception*, but rather is intended to provide tribunals with additional guidance in determining whether an indirect expropriation has

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[44] See further, Tienhaara, K. and T. Tucker (forthcoming). "Regulating Foreign Investment: *Methanex* Revisited" in C.L. Lim (ed) *Alternative Visions in the International Law on Foreign Investment: Essays in Honour of M. Sornarajah*. Cambridge University Press.

[45] Sornarajah, M. 2015. *Resistance and Change in the International Law on Foreign Investment*. Cambridge University Press.
[46] Ibid at 211.
[47] Edsall, R. 2006. "Indirect Expropriation Under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations" 86 *Boston University Law Review* 931 at 957.

occurred" (emphasis added).[48] This case, which arose over Costa Rica's move to establish a park to protect the nesting sites of endangered leatherback sea turtles, also demonstrates the willingness of investors to argue that their case is a 'rare circumstance'.

Other 'Safeguards'

Article 9.16 of the TPP states:

> 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. (emphasis added)

This 'safeguard' provides no real protection because the language 'otherwise consistent' renders it tautological. As Johnson and Sachs note, the provision can be contrasted with more specific carve-outs such as the removal of taxation from coverage by FET, which "evidences the state parties' unwillingness to trust ISDS tribunals with the broad powers such tribunals otherwise have to interpret that potentially expansive FET obligation."[49] Equally, the tobacco carve-out "implicitly recognizes that the TPP's investment protections and ISDS mechanism can be used to challenge good faith, non-discriminatory measures taken to address undeniably serious issues of public concern, despite the language in article 9.1[6]."[50]

Then there is Article 9.17, which reaffirms the importance of "encouraging enterprises" to "voluntarily incorporate" "internationally recognised standards, guidelines and principles of corporate social responsibility". Is this completely aspirational and entirely unenforceable provision meant to provide "balance" between the rights and obligations of investors and states?

The TPP has no 'general exception' that applies to the investment chapter as is the case in CETA and the China-Australia Free Trade Agreement (ChAFTA). However, in any event, the use of such exceptions (modelled on Article XX of the GATT 1994) is a recent development in international investment law and it is unclear whether it will have any impact in safeguarding the right of governments to regulate.[51]

Procedural Issues

Like most recent investment agreements, the TPP includes provisions to increase transparency in ISDS and allow for third-party participation in disputes. However, other

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[48] U.S. Article 10.20.2 Submission (2015) in *Spence* v *Costa Rica*, ICSID Case No. UNCT/13/2, para 31, http://www.state.gov/documents/organization/242886.pdf
[49] See note 26 above at 2.
[50] Ibid.
[51] Newcombe, A. 2008. "General Exceptions in International Investment Agreements," Draft Discussion Paper Prepared for BIICL Annual WTO Conference, 13-14 May 2008, London; Bernasconi-Osterwalder, N. and H. Mann. 2014. "A Response to the European Commission's December 2013 Document 'Investment Provisions in the EU-Canada Free Trade Agreement'" at 4, http://www.iisd.org/pdf/2014/reponse_eu_ceta.pdf

procedural issues have been given very little attention by treaty negotiators. In part, this may be because many of these issues are structural and would require a fundamental rethink of ISDS. 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.[52]

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.[53] 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 direct stake in the interpretation of IIAs.[54] The TPP envisions a Code of Conduct for arbitrators, but no details are provided. Furthermore, the code will be non-binding and arbitrators will largely be expected to police themselves.

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 are said to have no *stare decisis*. 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.[55]

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. In contrast, the EU is moving forward both with extensive changes to ISDS, including creating standing rosters of arbitrators, to address the issues of the independence and impartiality of arbitrators, and is also setting up and appeals process. While there are still problems with what is referred to as the Investment Court System (ICS)[56], it demonstrates that the European Commission has taken the critiques of ISDS far more seriously than the Parties to the TPP.

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52 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.

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

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

55 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.

56 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*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692122

3. Protecting the Interests of Australian Businesses Abroad

In 2010, the Productivity Commission issued a report on Bilateral and Regional Trade Agreements.[57] One of the Commission's recommendations was that the government should "seek to avoid" the inclusion of ISDS provisions in its trade agreements.[58] One of the key reasons the Commission came to this conclusion is that it found no evidence of the existence of a market failure relating to sovereign risk. Although it was acknowledged that the domestic court systems in some countries might not be as robust as Australia's, the Commission reasoned that in most instances the desire on the part of governments to retain a good reputation with foreign investors was sufficient to quell any impulse to expropriate.[59] The Commission also argued that there is no evidence that regulation (in Australia or abroad) is systematically biased against foreign investors—in fact the reverse may be true.[60]

Despite having found no evidence of a market failure, the Commission went on to assess whether, if such a market failure did exist, there were other options for addressing it. Their second key conclusion was that insurance and investor-state contracts were more appropriate mechanisms for dealing with political risk than international treaties.[61]

In practice, Australian businesses have not been significant users of ISDS. Investors from the US, Canada and several European Union countries are responsible for over 80% of all ISDS claims.[62] There are only 3 publicly known cases involving 'Australian' investors.[63] One dispute against the government of Pakistan involves Tethyan Copper Co, an Australian-incorporated subsidiary equally owned by Chilean copper miner Antofagasta PLC and Toronto-based Barrick Gold Corp.[64] Another case, against Indonesia, involves the Australian subsidiary of UK-based Churchill Mining. In other words, *only one company actually based in Australia* has utilised ISDS to date.

One of the reasons for this may be that Australian companies generally find investment insurance, investment contracts and access to domestic courts to be sufficient to protect their interests. However, another reason could also be that arbitration is incredibly costly and thus not a viable option for small and medium sized enterprises or individuals. An OECD survey shows that legal and arbitration costs for the parties in ISDS cases have averaged over US$8 million with costs exceeding US$30 million in some cases.[65] Small and medium sized enterprises in Germany are actively lobbying against ISDS for this reason.[66]

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57 Productivity Commission. 2010. Bilateral and Regional Trade Agreements: Research Report. http://www.pc.gov.au/__data/assets/pdf_file/0010/104203/trade-agreements-report.pdf.
58 Ibid, Recommendation 4c, p. xxxviii.
59 Ibid. at 269.
60 Ibid.
61 Ibid, at 270.
62 UCTAD. 2015. "Recent Trends in IIAs and ISDS", No. 1, February, http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf
63 According to the available data on UNCTAD's Investment Dispute Settlement Navigator, http://investmentpolicyhub.unctad.org/ISDS/
64 MacDonald, A. 2013. "Tethyan Drops Pakistan Project, Will Seek Damages", *Wall Street Journal*, 8 May 2013, http://www.wsj.com/articles/SB10001424127887324244304578471132363025400
65 Gaukrodger and Gordon (see note 13 above).
66 "German SMEs join protests against TTIP", *Deutsche Welle*, http://www.dw.com/en/german-smes-join-protests-against-ttip/a-19066010

Van Harten and Malysheuski have recently analysed data on the size and wealth of foreign investors bringing ISDS claims and have found that "the beneficiaries of ISDS, in the aggregate, have overwhelmingly been companies 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."[67]

4. Conclusions

There is nothing in the TPP's investment chapter that suggests that this is a 'high standard and balanced agreement'. Most neutral observers and even ISDS apologists admit that there is very little novel material here. UNCTAD describes the TPP investment chapter as "largely similar to the US model [bilateral investment treaty]".[68] Prof Luke Nottage notes in his submission to this inquiry that "[f]rom an Australian (treaty practice) perspective, this Chapter is mostly *more of the same*" (emphasis added).

While the *content* may be more of the same, the *context* is very different: this is a treaty with the US, i.e., the main source of investors launching ISDS cases. As such, the TPP represents a much greater threat to Australia's right to regulate than any previous treaty.

Based on an assessment of the 'safeguards' in the TPP and the complete absence of any evidence that the investment chapter will facilitate FDI or is necessary to protect Australian businesses abroad, I have to conclude, as others have, that in its current form, the TPP's investment chapter poses "significant potential costs to the domestic legal frameworks" of the TPP parties "without providing corresponding benefits."[69]

Although in the Australian political debate much has been made of the threat of ISDS to public health regulation, which is understandable in light of the Philip Morris case, I have highlighted in this submission that climate change policy is another area where substantial legal challenges are likely to arise in the near future. By providing energy incumbents with an additional tool to oppose the developments needed in order for a clean energy transition to occur, the TPP Parties have made meeting the emissions targets of the Paris Climate Accord more difficult and potentially much more costly.

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67 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

68 UNCTAD. 2016. "Taking Stock of IIA Reform", IIA Issues Note No.1 March, http://investmentpolicyhub.unctad.org/Upload/Taking_Stock_of_IIA_Reform_IIA_Issues_Note.pdf

69 Johnson and Sachs (note 26 above) at 1.