THE AUSTRALIAN APEC STUDY CENTRE
Asia-Pacific Economic Cooperation

In partnership with RMIT UNIVERSITY

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Bilateral Investment Treaty Reform Coordinator
Regional Trade Agreements Division
Department of Foreign Affairs and Trade (DFAT)
RG Casey Building, John McEwen Crescent Barton ACT 0221

RE: Review of Australia's Bilateral Investment Treaties

The Australian APEC Study Centre at RMIT University welcomes the opportunity to make a submission to the Department of Foreign Affairs and Trade (DFAT) on the Government's Review of Australia's Bilateral Investment Treaties.

The Australian APEC Study Centre develops policy-oriented research and capacity building programs to promote trade and investment in the Asia Pacific region. The Centre has contributed to regional investment analysis, facilitation and policy through its roles as the Secretariat for the Regional Investment Analytics Group, the Asia Pacific Infrastructure Partnership, and the APEC Business Advisory Council respectively. The Centre has worked with DFAT and international experts to develop capacity building programs on investment policy and treaty commitments for APEC government officials. Centre staff have also participated in deliberations of the APEC Investment Experts Group on topics including sustainable investment.

This submission relates to the questions posed in the Discussion Paper on:

- 'which clauses should be included in a renegotiated agreement?'
- 'various models and approaches that different countries take in relation to international investment agreements'

The Centre supports the view in the Discussion Paper that Australian Bilateral Investment Treaties (BITs) contain broadly drafted provisions and lack the explicit safeguards found in modern agreements. With regard to investor-state dispute settlement (ISDS) provisions, the Centre finds that vaguely worded agreements have led to an explosion in investor-state disputes internationally, unpredictable outcomes, skyrocketing costs, excessive awards and interference in governments' ability to legislate legitimately in the national interest on public policy issues. Concerns with ISDS provisions are discussed in more detail in the Appendix below.

The Centre supports the findings of the Productivity Commission[1] that:

- "There does not appear to be an underlying economic problem that necessitates the inclusion of ISDS provisions within agreements. Available evidence does not suggest that ISDS provisions have a significant impact on investment flows." (Finding 14.1)
- "Experience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions." (Finding 14.2)

[1] Productivity Commission 2010, Bilateral and Regional Trade Agreements, Research Report, Canberra.

Recommendation 1: The Australian Government should refrain from including in renegotiated or future investment agreements ISDS provisions which grant foreign investors greater substantive or procedural rights than those already provided by the Australian legal system.

The Productivity Commission (2010) also points out that if concerns about a foreign country's legal system are discouraging investment, it would be more beneficial for that country to improve its legal system on a non-preferential basis rather than create a 'preferential legal system' for Australian investors. The Productivity Commission suggests that developed countries could assist developing countries through 'legal capacity building to develop stable and transparent legal and judicial frameworks.'

One dimension in which the investment environment could be improved is through developing institutional mechanisms to address investor concerns. A few such approaches are discussed below. Some of these originally arose in the context of preventing disputes from escalating to formal arbitration. However, even in the absence of ISDS provisions, they can help create a stable and predictable investment environment.

Mediation: A neutral third-party assists disputants in negotiating a settlement without the need for formal arbitration. The approach is voluntary, and both parties must consent and co-operate throughout the process since decisions are not legally binding. Mediation provides a greater degree of flexibility as parties are able to generate creative solutions that are not restricted to legal interpretations of treaty provisions. The role of the mediator is typically to identify common interests, reframe positions and identify a range of possible solutions to help move the parties towards an agreement. Mediators often pay particular attention to maintaining the relationship between investor and host state by ensuring there is effective communication and mutual understanding.

Ombudsman: A one-stop-shop for aggrieved investors is established to raise concerns and ask for an administrative review. This allows governments to receive an early warning of a potential dispute and sufficient time and flexibility to respond to those concerns before it escalates or the investor withdraws.[2]

Institutional reforms: The World Bank, in collaboration with the International Finance Corporation, has developed the **Systemic Investment Response Mechanism (SIRM)**, an early warning and tracking mechanism to help identify and respond to investment-related complaints or issues that arise from government conduct.[3] There is no standard model for SIRM as it is designed to be adapted to the circumstances of each economy. However, there are several common elements of an effective SIRM:

- **Empowerment of a Lead Agency**: A Lead Agency should be designated with the authority to implement SIRM, including coordinating with national, sub-national and sector-specific agencies.
- **Early Alert Mechanism & Tracking Tool**: An early alert mechanism identifies problems as soon as they arise, allowing the Lead Agency to react. A tracking tool monitors the status of a problem, the investment at risk, and investment retained/expanded through its resolution.
- **Problem Solving Methods**: Lead Agency is empowered to use different problem-solving methods as appropriate to find a solution with the agencies involved. Methods can range from exchanges of information, consultation to peer pressure to legal advisory opinions.
- **Political Decision Making**: Sometimes the Lead Agency may not be able to recommend a solution or to discipline a peer agency. In this case, the problem is elevated to higher political levels (e.g. Ministerial Cabinet or Councils chaired by the President/Prime

[2] UNCTAD (2011). Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru.
[3] World Bank-IFC, 'Increasing investment retention and expansion through timely identification and resolution of investor problems: Systemic Investment Response Mechanism (SIRM)'.

Minister). Once a higher-level decision is taken, the Lead Agency monitors and tracks resolution, positive or negative, and impact on investment.

Recommendation 2. The Australian Government should complement its BIT reform efforts with support for capacity building of government officials in developing countries to implement investor response mechanisms.

As Australia and other countries unwind investment treaty commitments, Australia has an opportunity to play a leading role in the region by promoting institutional reforms and investor response measures while preserving the ability of governments to legislate in the national interest on key public policy issues.

We welcome the opportunity to discuss these recommendations further with the Government and look forward to the outcomes of the review.

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Appendix. Emergent Concerns with ISDS[4]

There are valid **concerns** that ISDS may interfere with a country's ability to legislate on legitimate public policy issues. The multiplication of disputes, unpredictability of interpretations and increase in costs and financial awards have created cause for concern. The large costs involved and limited technical capacity to manage disputes make this process particularly onerous for developing countries. Some of the key issues of concern are discussed in more detail below.

- **Financial awards to investors**

The total amount awarded to investors can run into several hundred million dollars. The average amount awarded to investors in cases from 1987 to 2016 was $545 million and the median was $20 million. Several prominent cases have resulted in very large awards. An ICSID tribunal awarded $877 million to a Czech bank in a claim against the Slovak republic. In 2007 alone Argentina was required to pay over $600 million to investors. In a high-profile case the Russian government was required to pay $50 billion to the majority shareholders of Yukos, an oil company, under the Energy Charter Treaty. The award was overturned on appeal by The Hague District Court whose judgment was later reversed by The Hague Court of Appeal in 2020. The large amounts and uncertainty involved can nevertheless put strain on national budgets and divert funding from important public issues such as infrastructure, education, health and other public goods.

- **Costs of arbitration**

In addition to the amounts awarded to winners, arbitration can also incur substantial costs for legal fees, experts, witnesses and the administration of the arbitration itself. These costs can run into the millions of dollars for which it is difficult to budget as the allocation of costs and fees is at the discretion of the arbitrators. Even a favourable award to a host country can entail significant legal costs. For example, in *Pey Casado vs Chile* (ICSID Case No. ARB/98/2) the claimant's legal costs totalled $11 million while for the respondent it amounted to $4.3 million.

- **Length of time**

Although it was hoped that international arbitration would provide the parties concerned with a speedy resolution, in practice the average time taken for claims to be settled can be quite substantial. One finding suggests that it takes 392 days on average between the hearing of merits and issuance of final awards. Cases are often delayed as parties resort to bifurcation (separating jurisdiction from merits), annulment and other set-aside procedures.

- **Ambiguity**

The rise of ISDS cases has led to concerns that claims are often frivolous or vexatious. These concerns arise from the fact that the older generation of treaties often used vague language which could be interpreted in inconsistent ways. The proliferation of agreements with overlapping commitments also adds to the complexity of resolving disputes. International arbitration often has the effect of destroying the long-term relationship between investor and state to the detriment of both parties.

These issues have made ISDS and IIAs a matter of public concern as the legitimacy of the system is undermined by the lack of appeal processes and judicial safeguards.

[4] Based on research prepared by the Centre for a DFAT-funded workshop on 'Approaches to Implementing Investment Commitments' held on 7 - 8 December, 2017.