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

By email: BITreformsubmissions@dfat.gov.au

Submission to the Review of Australia's Bilateral Investment Treaties

Dr Elizabeth Sheargold and Associate Professor Markus Wagner , University of Wollongong[1]

We refer to the Discussion Paper: Review of Australia's Bilateral Investment Treaties (BITs) and the invitation for submissions circulated by the Department of Foreign Affairs and Trade (DFAT). We welcome the opportunity to provide our input to the BIT Reform project currently being undertaken by DFAT.

Our submission is focussed on how Australia's BITs can be modernised to ensure that the promotion and protection of investments is balanced against the need to safeguard policy space for legitimate public-welfare measures or 'regulatory autonomy'. This discussion responds primarily to Question 4 of the questions for consideration outlined in the DFAT Discussion Paper, by providing our views on clauses that should be included in any renegotiated BITs or other investment agreements negotiated by Australia in the future.

I. Sectoral Carve-Outs from Investor-State Dispute Settlement (ISDS)

As noted in the DFAT Discussion Paper, one of the safeguards for regulatory autonomy that are included in some of Australia's modern Free Trade Agreements (FTAs) are exclusions of ISDS claims for certain public health measures. For example, several Australian FTAs or related investment agreements exclude ISDS claims relating to tobacco control measures[2] or to measures which are part of the Pharmaceutical Benefits Scheme (PBS).[3] The strength of these carve-outs is the precision and clarity with which the measures that are excluded from ISDS are identified, which provides both treaty parties and investors with a high degree of confidence about which measures cannot be the subject of ISDS claims. This clarity can be achieved by making reference to specific government regulatory schemes (such as the PBS), or by comprehensively defining the kinds of measures which will be covered by the carve-out. For example, the SAFTA definition of a tobacco control measure explicitly refers to measures relating to the 'production, consumption, distribution, labelling, packaging,

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[1] Further biographical information about the authors is available on the University of Wollongong website. See Dr Elizabeth Sheargold: https://scholars.uow.edu.au/display/elizabeth_sheargold and Associate Professor Markus Wagner: https://scholars.uow.edu.au/display/markus_wagner.

[2] See, eg, Singapore - Australia FTA (SAFTA) chp 8, art 22 (as amended in 2016); Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) art 29.5 (we note that the CPTPP exclusion operates as a denial of benefits provision which must be utilised by each treaty party); Australia - Hong Kong FTA Investment Agreement, sec C, fn 14.

[3] See, eg, Australia - Hong Kong FTA Investment Agreement, sec C, fn 13; Indonesia - Australia Comprehensive Economic Partnership Agreement (IA-CEPA), art 14.21.1(b), fn 21.

advertising, marketing, promotion, sale, purchase, or use' of tobacco products, as well as fiscal measures such as internal taxes and excise taxes, and enforcement measures, such as inspection, recordkeeping, and reporting requirements, and provides an objective definition of 'tobacco products' by reference to the Harmonised System of tariff classification.[4]

The corollary of these ISDS exclusions being so clearly defined is that these carve-outs usually only have a narrow coverage which is targeted only at a specific sector or regulatory scheme. We note that Article 14.21.1(b) of the Indonesia - Australia Comprehensive Economic Partnership Agreement (IA-CEPA) seeks to exclude all public health measures from the scope of ISDS. The intent of this exclusion is commendable, however in our view seeking to exclude such a broad range of measures from the scope of ISDS is likely to be ineffective. Aside from those regulatory schemes that are specifically defined in the clause as being public health measures,[5] such as Australia's PBS, the provision offers no guidance on which measures are 'designed and implemented to protect or promote public health'. As a result, tribunals will have to adjudicate whether a measure is actually designed and implemented to address a public health issue, and investors could argue that this requires consideration of whether the measure is reasonable, necessary for or proportionate to its public health goal. This would require potentially complex litigation and the consideration of detailed technical evidence about the design and effects of a measure. While the potential for the IA-CEPA Article 14.21 exclusion to be adjudicated as a preliminary issue on an expedited time frame could lead to shorter litigation,[6] this clause lacks the precision and clarity which is necessary for treaty parties to be confident that a measure will fall within the scope of the exclusion.

Because the measures that are to be excluded from the scope of ISDS are defined in the treaty text, such carve-outs only cover those sectors or regulatory schemes which have been identified as high-risk for ISDS claims at the time at which the treaty is drafted. As Australia's current BITs demonstrate, these treaties may still be in force decades into the future. Their provisions will need to be able to adapt to changing regulatory priorities and public interests that have not yet been foreseen. For example, the exclusion of claims relating to tobacco control measures from ISDS mechanisms may prevent a repeat of the investor-state arbitration brought by Philip Morris under the former Hong Kong - Australia BIT, but it does not protect regulatory autonomy in relation to other products that pose health risks, such as foods or beverages which are high in fat, salt, sugar or alcohol, which governments may seek to regulate more stringently in the future.

Sectoral carve-outs may provide confidence for the treaty parties that certain clearly defined categories of measures cannot be subject to ISDS claims, but these provisions are only an appropriate safeguard for regulatory autonomy with respect to particularly sensitive industries or sectors. Consequently, in our view these sectoral carve-outs should be used sparingly, and only in addition to the broader protection of regulatory autonomy that is achieved by a careful tailoring of substantive obligations and the inclusion of justificatory provisions that allow the defence of legitimate public welfare measures.

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[4] SAFTA, chp 8, art 22, fn 19.

[5] IA-CEPA, art 14.21.1(b), fn 21.

[6] Under the expedited procedure for preliminary objections, a tribunal may still take 210 days from the date of a request before issuing a decision on the application of the carve-out. See IA-CEPA, arts 14.21.2 and 14.30.

II. Tailoring Substantive Obligations

The careful tailoring of substantive obligations is one of the most important safeguards for regulatory autonomy that can be included in any renegotiated Australian BITs. Exceptions can play a useful role in allowing a host state to defend a public welfare measure, but the first line of defence for regulatory autonomy should be to ensure that the investor protections contained in BITs or other investment treaties are clearly and adequately defined. In this submission we focus in particular on two of the most ubiquitous provisions found in BITs: fair and equitable treatment (FET) and the obligation not to expropriate property without compensation. Australia's modern FTA drafting practice for each of these provisions has been refined considerably when compared to older BITs. However contemporary treaty practice with regard to these obligations is not homogenous, and the variations in how these treaty provisions are drafted can have important implications for the scope of the obligations.

A. Narrowing the Scope of FET

In many of Australia's older BITs, the FET obligation is vague and undefined, as was typical of BIT drafting at the time. For example, the Australia - Philippines BIT simply states that:

> Each party shall ensure that investments are accorded fair and equitable treatment.[7]

Like most other countries, in Australia's recent treaty practice the FET obligation has been further defined and limited in scope through three main techniques: (i) linking the treaty standard to the customary international law minimum standard of treatment of aliens; (ii) clarifying that FET 'includes the obligation not to deny justice' in accordance with the principle of due process; and (iii) stating that certain forms of government conduct will not, on their own, constitute a failure to accord FET (such as breach of another legal obligation or failure to meet an investor's expectations).[8] These are all valuable refinements of the FET obligation, but they still leave many questions about the scope of conduct that will violate the standard to the discretion of tribunals. For example, some recent arbitral awards have suggested that examining whether a measure is proportionate to its purpose - including an assessment of the relative weight of the public interest involved and the harm the measure caused to the investor - is part of the FET standard.[9]

To prevent tribunals engaging in expansive definitions of FET that may significantly curtail regulatory autonomy, we suggest that in any BIT renegotiations Australia consider including an exhaustive definition of the kinds of government conduct that will violate the FET standard. This was the approach adopted in the EU - Canada Comprehensive Economic and Trade Agreement (CETA), which provides a list of wrongful government actions that will breach the FET standard, such as denials of justice, breaches of due process, manifest arbitrariness or targeted discrimination.[10] Unlike Australia's recent FTA practice, which typically states that FET *includes* the obligation not to deny justice, the CETA definition of FET is an *exhaustive* list of the

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[7] Australia - Philippines BIT, art 3.2.

[8] See, eg, SAFTA, chp 8, art 6; IA-CEPA, art 9.6 and Annex 9-A; Australia - Hong Kong FTA Investment Agreement, art 8.

[9] See, eg, *Hydro Energy and Ors v Spain*, Decision on Jurisdiction, Liability and Directions on Quantum, ICSID Case No. ARB/15/42, 9 March 2020, [573]-[574]; *SolEs Badajoz GmbH v Spain*, Award, ICSID Case No. ARB/15/38, 31 July 2019, [328], [462]; *Electrabel v Hungary*, Award, ICSID Case No. ARB/07/19, 25 November 2015, [179].

[10] CETA, art 8.10.2.

forms of government conduct that will violate the standard.[11] This ensures that those forms of egregious government conduct which the treaty parties wish to protect their investors from are covered by the provision, while limiting the discretion of tribunals to invoke broad concepts such as proportionality or the need for a stabile regulatory framework as the basis for finding a failure to accord an investor FET.

B. Defining 'Indirect Expropriation'

In its modern FTA practice Australia includes an annex to its investment chapters / agreements which clarifies the scope of the expropriation obligation. These annexes provide tribunals with important guidance about which measures will constitute indirect expropriations, and include a clarification that:

> 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 expropriation, except in rare circumstances.[12]

This clarification is an important safeguard for regulatory autonomy, which clearly directs tribunals to consider the purpose of a measure in their analysis of whether it constitutes an indirect expropriation. It provides a basis for a host state defending an ISDS claim to argue that their measure is not an expropriation, if it is non-discriminatory and properly adapted to achieving its public welfare objective.

However, the extent to which this provision protects regulatory autonomy will depend upon how tribunals interpret the key phrase 'except in rare circumstances'. In Australia's FTA practice this phrase is not usually defined, and it is therefore left to the discretion of arbitral tribunals to determine what the 'rare circumstances' might be in which a non-discriminatory public welfare measure could constitute an indirect expropriation. This issue can be addressed by defining what the 'rare circumstances' might be in the treaty text, such as 'when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive'.[13] Alternatively, any reference to the possibility of 'rare circumstances' in which a non-discriminatory public welfare measure may constitute an indirect expropriation can be omitted from the treaty provision. This approach, which was taken in the Malaysia - Australia FTA,[14] provides a stronger safeguard for regulatory autonomy, but is still counterbalanced against investor interests by requiring that the measures be non-discriminatory and 'designed and applied' for a legitimate public welfare objective.

III. Justifications for Public Welfare Measures

Many contemporary international investment agreements have included justificatory clauses as an additional safeguard for regulatory autonomy. Although these exceptions can take a wide variety of forms, the most common is based on language from the World Trade Organization (WTO) agreements, particularly Article XX of the General Agreement on Tariffs and Trade 1994 (GATT) and Article XIV of the General Agreement on

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[11] The CETA treaty parties can also review the content of the FET obligation and add to the list of prohibited forms of conduct through the CETA Committee on Services and Investment and the CETA Joint Committee: CETA art 8.10.3.
[12] SAFTA, Annex 8-A, para 3(b) (footnote omitted).
[13] CETA Annex 8-A, para 3.
[14] Malaysia - Australia FTA, Annex on Expropriation, para 4.

Trade in Services (GATS). While we believe that justificatory clauses for public welfare measures can play a useful role in any BITs renegotiated by Australia, their use and drafting must be carefully considered.

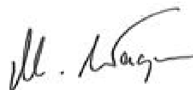
In particular, we wish to highlight how the inclusion of such justifications in a treaty can influence how arbitral tribunals interpret substantive obligations. Tribunals may defer any consideration of the purpose or justification for a measure until the application of such clauses, rather than considering these issues in the application of the substantive obligation.[15] Where justificatory clauses are drafted narrowly to prevent abuse - through an exhaustive list of legitimate public interests, the inclusion of necessity tests or the non-discrimination requirements of Article XX GATT / Article XIV GATS 'chapeau' - this could potentially lead to a reduction of regulatory autonomy. This risk can be offset by directing tribunals to consider the purpose of a measure where relevant to the application of a substantive obligation. For example, the national treatment and most-favoured-nation treatment obligations of the SAFTA are accompanied by a note stating that whether there are 'like circumstances' 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'.[16] The risk of justificatory clauses leading to narrow interpretations of substantive obligations may also be minimised by excluding some obligations from the scope of the exception. For example, where a BIT contains an annex clarifying that non-discriminatory public welfare measures do not constitute indirect expropriations, it is unnecessary for a justificatory clause to also apply to that obligation.[17]

Conclusions

The review of Australia's BITs is a timely and important exercise, which provides a valuable opportunity to consider how best to modernise these agreements by balancing the desire to promote and protect foreign investment with safeguards for regulatory autonomy. We believe that this is best achieved through a combination of treaty clauses, which should include well-tailored substantive obligations and general exceptions to justify public welfare measures. Although sectoral carve-outs from ISDS provisions provide a high-level of assurance that certain measures cannot be challenged by foreign investors, given the narrow range of measures typically covered by the carve-outs we believe that these clauses should only be used sparingly to protect regulatory autonomy in relation to sensitive sectors and regulatory schemes.

We are happy to provide further information on any aspect of this submission, or to discuss these issues with members of the Regional Trade Agreements Division.

Yours faithfully,



Dr Elizabeth Sheargold
Email: elizabeth_sheargold@uow.edu.au

Associate Professor Markus Wagner
Email: markus_wagner@uow.edu.au

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[15] See, eg, *Bear Creek Mining v Peru,* Award, ICSID Case No. ARB/14/21, 30 November 2017, [473]-[474].
[16] SAFTA, chp 8, fn 8.
[17] See, eg, CETA, art 28.3.1-2 (which incorporates general exceptions only in relation to obligations concerning establishment of investment and non-discriminatory treatment of investors).