BOND UNIVERSITY
BRINGING AMBITION TO LIFE

FACULTY OF LAW
Bond University
Gold Coast, Queensland 4229
Australia

Toll free 1800 220 155
(within Australia)

Ph: +61 7 5595 2008
Fax: +61 7 5595 2036
(from overseas)

ABN 88 010 694 121
CRICOS CODE 00017B

26 February 2016

Australia-European Union Free Trade Agreement
Europe Division
Department of Foreign Affairs and Trade (DFAT)
R.G. Casey Building
John McEwen Crescent
Barton ACT 0221

Dear Sir/Madam

Protection of foreign investor's investments from expropriation – the desired standards within the future Australia-EU Free Trade Agreement (AEUFTA)

I am writing to express my support for pursuing a Free Trade Agreement (FTA) between the European Union and Australia. Whilst both the EU and Australia are active members of the World Trade Organisation (WTO), concluding a bilateral FTA between EU and Australia will serve Australia's economic interests since multilateral trading frameworks such as the WTO do not afford room for amendment or clarification in case of WTO obligations. However, Bilateral Investment Treaties (BITs) can prove to be more flexible, particularly with regards to areas of regulatory importance for Australia.

As an academic researching in the area of international trade and investment laws, I wish to highlight the importance of negotiating a robust expropriation clause that covers direct and indirect expropriation. Protecting foreign investor's investment is one of the key underlying factors behind negotiations of bilateral investment treaties or FTAs with investment chapters. Briefly, direct expropriation occurs where the host country cites lawful expropriation of foreign investments whereby the investors loses control over the investment asset and where the title to the investment asset is vested in the state or a nominated third party. Expropriation in itself is not illegal provided it is for a public purpose, it is conducted in a non-discriminatory manner and appropriate compensation is paid. Direct expropriation is a possibility but highly unlikely event given several positive indicators such as the strong trade and investment links between the EU and Australia and also due to stable socio-economic indicators in the two economies.

Indirect expropriation, however, is the emerging category of expropriation which in the recent past has resulted in a spike in investor-state disputes. Indirect expropriation occurs where the host country takes any measures that adversely affect the foreign investment even when the title to the investment asset vests in the foreign investor. Examples of indirect expropriation can include public health regulations, environmental regulations or public welfare laws. The difficulty with indirect expropriation is that it is not clearly defined and

resultantly any governmental regulatory measure that links with the foreign investment is looked upon as an act of indirect expropriation.

One possible solution is to adapt the language of the GATT Article XX exceptions (which allow WTO Members to derogate from their WTO obligations) and use that as the basis of foreign investment regulation.[i] However, adapting language of a macro-scale, multilateral treaty designed for state-to-state trading relations reveals several weaknesses including unsuitability in its application to a micro-scale scenario of a private party (investor) seeking redress against the government of a host country.[ii]

Clearly, in negotiating our future BITs and FTAs we must be mindful of the negative experience of ISDS outcomes and their potential in hindering public welfare regulation. We must also bear in mind that Australia has demonstrated an inconsistent approach to the question of ISDS in the recent past.[iii] For example, ISDS provisions are included in FTAs with Chile, Singapore, Thailand and South Korea but not in the FTAs with the US and New Zealand. Australia also agreed to ISDS in the Trans-Pacific Partnership (TPP) after initial period of opposition.

ISDS is what I would consider a "necessary evil." Until a new globally agreed, multilateral alternative to ISDS emerges (such as the formation of the world investment court along similar lines of the WTO Dispute Settlement Body), we would have to accept that ISDS represents the norm. Accordingly, I would advocate an approach based on 'carve outs' when times comes for negotiating the AEUFTA. Essentially, the 'carve out' approach is intended to create regulatory space for host countries. Typical examples of measures that can feature in the carve out are: public welfare orders, environmental protection measures, public health orders and national security imperatives. All of the afore-mentioned instances usually constitute grounds for ISDS claims based on expropriation.

The application of the 'carve out' approach is already observable in other FTAs and BITs. For example, the ASEAN Comprehensive Investment Agreement (ACIA), Annex 2, Paragraph 3 explains how indirect expropriation can be determined. It does so by listing a series of factors that can be used on a case-by-case basis. Paragraph 3 makes it clear that adverse economic effects due to governmental measures are not by itself illustrative of expropriation. Furthermore, the standard described in Paragraph 3 mentions whether the act of expropriation breaches a governmental undertaking or regulatory commitment to the investor along with consideration of whether the measure taken by the government is disproportionate to the stated public purpose. Paragraph 3 is then further supplemented by Paragraph 4 which provides that "legitimate public welfare objectives, such as public health, safety and the environment" do not constitute indirect expropriation.

The ACIA approach is based on clearly identifying of what amounts as indirect expropriation. Any future arbitration panels constituted under the ACIA are then constrained to hold a governmental regulatory decision as not amounting to indirect expropriation (provided the governmental decision meets the non-discriminatory standards and are taken in public interest to protect health, safety and the environment).[iv] Contrast the 'carve out' approach with the standard *Methanex* approach (so called because of the 2005 arbitration case *Methanex Corporation v. United States of America*). Adoption of the *Methanex* approach means drafting of an 'open' expropriation clause that plainly states that the government of the host country cannot expropriate except where the measures are for public purpose, the measures are non-discriminatory and adequate compensation is paid. Here, indirect expropriation is not defined. Therefore, ISDS arbitration panels will have more room to determine whether expropriation has occurred which clearly undercuts the ability of the

government of the host country to regulate in the public interest. If, however, the risk of indirect expropriation can be mitigated by specifying determining factors within the FTAs or BITs, then arbitration panels under ISDS can be 'starved' of the opportunity to determine whether expropriation has occurred simply because the parties to the FTA/BIT have already agreed to what amounts to an indirect expropriation.

One particular area where the aforementioned arguments may be applicable is the resources and mining sector. Since Australian economy is greatly dependent on resources and mining, it would be in the Australian national interest to ensure that the discretion of the governmental regulators is not unduly constrained especially with regards to issues such as acquisition of land, conservation of exhaustible natural resources, protection of our unique environment (including native title and heritage lands), public health and welfare. Adopting the carve out approach within the future AEUFTA will inject certainty to our understanding with the investors based in the EU and vice versa. Therefore, the *carte blanche* of arbitration panels can be restricted in the event of any investor-state dispute under the AEUFTA.

I agree to my submission being made public and would be more than happy to assist DFAT or any other government body with queries based on my submission.

Yours sincerely

Dr Umair Ghori

Assistant Professor,
Faculty of Law, Bond University
Robina QLD 4229
E-mail: ughori@bond.edu.au
Phone: 07 5595 1286
Fax: 07 5595 2036

REFERENCES

[i] See for example J. Chaisse, 'Exploring the confines of international investment and domestic health protections – is a general exceptions clause a forced perspective? (2013) 39 *American Journal of Law and Medicine,* 332.

[ii] Chaisse, Ibid.

[iii] See for example E. Kwan, 'Australia's Conflicting Approach to ISDS: Where to From Here?' , *Kluwer Arbitration Blog* (4 June 2015)

[iv] See for example discussion in Junianto James Losari, 'Comprehensive or BIT by BIT: The ACIA and Indonesia's BITs' (2016) 6 (1) *Asian Journal of International Law* 15, 34-35.