CLIFFORD
CHANCE

Client briefing
June 2011

Australia says good-bye to neutral investor-state dispute resolution

Key issues

Australia's trade/investment agreements

Investors protection

What does this mean for inbound investment into and outbound investment from Australia?

The Australian Government's recent announcement[1] of its intention to no longer include neutral investor-state dispute resolution (**ISDR**) provisions in its trade/investment agreements is a curious and some may say retrograde stance for a country that has never been the subject of an ISDR claim. In this bulletin, we summarise the ISDR provisions in Australia's existing trade/investment agreements and then consider what the Government's Announcement might mean for foreign investors investing into Australia and Australian investors who are intending to invest outside Australia.

Australia's trade/investment agreements

Historically, Australia entered into bilateral investment treaties (ie agreements with one other State). These treaties were narrow in scope and focused on encouraging investments between States by providing reciprocal protections to be afforded to the foreign investors (as detailed further below). To date, Australia has entered into over 20 bilateral investment treaties[2].

In recent times, the trend has been towards Free Trade Agreements (**FTAs**), of which Australia has now concluded five such agreements (with Chile, US, Thailand, Singapore, NZ).[3] Australia is currently pursuing FTA negotiations with China, Japan, Malaysia, Republic of Korea, and Indonesia, and is considering an FTA with India. These FTAs are broader than the traditional investment treaties in that they not only cover investment, but also commonly have chapters dealing with, amongst other things, preferential tariffs on goods trade, rules of origin, customs administration, technical barriers to trade, services, and competition.

If you would like to know more about the subjects covered in this publication or our services, please contact:

Diana Chang +61 289228003

Tim Grave +61 28922 8028

Cameron Hassall +852 2825 8902

Ben Luscombe +61 892625511

Audley Sheppard +44 207006 8723

Nish Shetty +65 6410 2285

Patrick Zheng +86 10 6535 4998

Julia Dreosti +65 6506 2783

Antony Crockett +44 207006 2332

To email one of the above, please use firstname.lastname@cliffordchance.com

www.cliffordchance.com

[1] Trade Policy Statement issued on 12 April 2011.

[2] Argentina, Chile (- now replaced by the ACIFTA), China, Czech Republic, Egypt, Hong Kong SAR, Hungary, India, Indonesia, Lao PDR, Lithuania, Mexico, Pakistan, Papua New Guinea, Peru, Philippines, Poland, Romania, Sri Lanka, Uruguay, and Vietnam.

[3] Australia-Chile Free Trade Agreement (ACIFTA) – 2009, Australia-United States Free Trade Agreement (AUSFTA) – 2005, Thailand-Australia Free Trade Agreement (TAFTA) – 2005, Singapore-Australia Free Trade Agreement (SAFTA) – 2003, Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) - 1983 and the Protocol on Investment to the ANZCERTA (16 February 2011 – not yet in force).

In 2010, Australia entered into a plurilateral free trade agreement with the ASEAN countries and New Zealand (**AANZFTA**). It is also in the process of negotiating a number of similar agreements, namely the Trans-Pacific Partnership Agreement, the Pacific Agreement on Closer Economic Relations - PACER Plus, and with The Gulf Cooperation Council (Saudi Arabia, Qatar, Bahrain, Oman, Kuwait, United Arab Emirates).

Investors protector

Typically, these trade/investment agreements afford protections to qualifying 'investors' who make a qualifying 'investment', against improper interference from the host State. Common protections include:

- **National Treatment:** qualifying foreign investors to be treated no less favourably by the host State than its domestic investors.
- **Most Favoured Nation Treatment**: qualifying foreign investors to be treated at least as favourably as the **investors from other States.**
- **Fair and Equitable Treatment:** the meaning of this protection continues to evolve, but is generally defined by reference to meeting the legitimate expectations of the investor, and has in some circumstances been extended to include an obligation on a host State to maintain a stable legal and business environment. This standard is commonly linked with another standard of non-impairment by arbitrary and unreasonable measures.
- **Full Protection and Security:** the host State must afford a foreign investor full protection and security, which has been construed by some tribunals to extend beyond physical security to include legal protection.
- **Expropriation/nationalisation:** commonly the treaties will provide expressly for compensation to be paid in the event of expropriation (which is broader than just the physical seizure of assets).
- **Umbrella clauses:** these clauses require States to observe any specific obligations they have entered into with an investor (e.g. which may include some contractual obligations).

Such standards of protection are construed in accordance with international law.

Trade/investment agreements also typically include an ISDR provision that allows the investor to bring international arbitration proceedings against the host State for violation of one or more of the standards of protection and to claim damages. The ISDR provisions commonly provide for a staged approach commencing with conciliation/negotiation between the parties during a specified "cooling off period", then by international arbitration. Most treaties allow the investor to choose arbitration under the rules of the International Centre for the Settlement of Investment Disputes (**ICSID**), based in Washington, or the United Nations Commission on International Trade Law (**UNCITRAL**) Arbitration Rules. The right of foreign investors to refer disputes to international arbitration is what the Australian Government has announced it will not include in future trade/investment agreements. Whether or not this is a blanket prohibition or whether exceptions will be made in certain circumstances is yet to be seen.

What does this mean for inbound investment into and outbound investment from Australia?

This policy statement has no impact on existing trade/investment agreements (with ISDR provisions) and investors from and Australian investors into those contracting States will be able to continue to avail themselves of the protections and ISDR provisions therein,[4] which includes the ASEAN countries under the AANZFTA.

In respect of all other countries with which Australia may enter into a trade/investment agreement in the future, even though an investor may be a qualifying investor under a new style treaty which may have no ISDR provision for arbitration, it will most likely then have to pursue its claim against the host government through diplomatic channels or before the national courts under national law (rather than through international arbitration under international law).

Although an investor's preference would understandably be to have a dispute heard in a neutral forum and under a neutral law, Australia does boast a well established legal and court system and an independent and highly regarded

[4] The protections vary across the trade/investment agreements. Note in particular that there is no ISDR provision in the AUSFTA (at Australia's insistence).

judiciary. Australian administrative law also includes some protections against interference and/or arbitrary decision making by the government.

However, it is Australian companies investing off-shore that will perhaps suffer most from the Australian government's new approach, particularly if they are investing in non-ASEAN emerging markets with unstable political climates and less developed legal systems. Unfortunately, in some countries, judicial bias and corruption is not unknown.

The Policy Statement makes clear that Australian investors must assess (and protect against) the risk for themselves:"*[i]f Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in these countries.*"

Investors may be able to obtain some protection through political risk insurance, however this often only protects against expropriation and not failure to afford other protections, such as fair and equitable treatment.

The remedy of "diplomatic protection", whereby the investor's home State can bring a claim on behalf of the investor against the host State before the International Court of Justice, is still available, but it is very rarely used by States.

In addition, where the agreement is with the government, investors may try to include a stablisation clause, which provides that the government must pay compensation in the event of a material change in the law.

But none of these options is as useful as a trade/investment agreement with an ISDR provision for arbitration.

Conclusion

Australia's new policy is a confident statement that it can attract investment without the need for ISDR provisions in trade/investment agreements, but it also means that Australian investors abroad will not benefit from a suite of Australian treaties with such provisions.

Inbound and probably more importantly, Australian outbound investors, should try to structure their investments in order to avail themselves of the protections prescribed under existing treaties with ISDR provisions (for example, by using a holding company in a country that has such a treaty with the host State - the Netherlands is a very popular choice). In addition, where the agreement is with the government, they should include a stabilisation clause, and also investigate taking out political risk insurance.