1 December 2003

US FTA Task Force
Office of Trade Negotiations
Department of Foreign Affairs and Trade
BARTON ACT 0221

Dear Sir/Madam

Australia-US Free Trade Agreement

The Australian Network of Environmental Defender's Offices wish to express a number of concerns about the proposed Australian-US Free Trade Agreement (AUSFTA).

1 Compensation: distinguishing between acquisition (or nationalisation) and regulation (or expropriation)

We understand that at present it is intended that an investment chapter will be inserted into the AUSFTA based on Chapter 11 in the North American Free Trade Agreement (NAFTA), a trade agreement between Canada, Mexico and the USA. Of particular concern is Article 1110, which provides:

> *Article 1110: Expropriation and Compensation*
>
> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
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> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation

A clear distinction has long been held in Australian law between compensating property owners for the acquisition of their property (the domestic equivalent of nationalisation) and not providing compensation where mere restrictions are imposed (the domestic equivalent of expropriation). The language and interpretation of Article 1110 undercuts this distinction, with far-reaching consequences for environmental protection (in practice, it is apparent that environmental regulations have almost exclusively been the subject of challenge under NAFTA).

(i) The position under Australian law

It is first necessary to trace the position under Australian law.

Section 51(xxxi) of the *Commonwealth Constitution* gives the Commonwealth the power to acquire property from any State or person for any purpose for which Parliament has the power to make laws. Such acquisition must be on just terms.

The High Court in Australia has defined "property" expansively to include every species of valuable right and interest. This definition will therefore encompass real and personal property, and include rents and services, rights of way, and rights of profit or use in land of another.

Cases considering section 51(xxxi) of the Constitution have thus focussed on the notion of what constitutes "acquisition" of property. The application of section 51(xxxi) was considered by the High Court in *Commonwealth v Tasmania* (the *Tasmanian Dams* case). Three of the four judges who dealt with the issue, determined that there was no acquisition by the Commonwealth as it had not acquired a proprietary interest in the land. As Mason J said:

> to bring the Constitutional provision into play it is not enough that legislation adversely affects or terminates a pre-existing right that an owner enjoys in relation to his property; there must be an acquisition whereby the Commonwealth or another acquires an interest in property, however slight or insubstantial it may be.

The restrictions on use were irrelevant to the question of acquisition. Subsequent cases have talked about the Commonwealth acquiring an "identifiable benefit or advantage": per Kirby in *Commonwealth v Western Australia*.

This principle was distinguished in the case of *Newcrest Mining (WA) v Commonwealth*. The case concerned mining leases acquired by Newcrest at Coronation Hill adjacent to Kakadu National Park. The Coronation area was incorporated into the National Park through proclamations under the (CTH) *National Parks and Wildlife Conservation Act 1975*, which banned operations for the recovery of minerals.

The Court held that, a mining company, had been denied the exercise of its rights under the mining tenements it had been granted and that "there was an effective sterilisation of the rights constituting the property in question" (per Gummow J at 634). In this respect, a distinction was explicitly drawn between "sterilisation" and "mere impairment" where, for example, other uses were available (per Gummow J at 634).

Despite the wide view of the term "property" in the cases, the High Court took the view in *Health Insurance Commission v Peverill* that if the rights that are diminished or terminated are purely statutory entitlements, not based on antecedent common law rights in property, compensation will not be payable.

On this reasoning, in *Commonwealth v WMC Resources Pty Ltd* there was found to be no acquisition where a Commonwealth law extinguished an exploration permit over part of the continental shelf between Australia and East Timor. This was distinguished from the position in *Newcrest* because the Commonwealth had no underlying common law interest in the shelf (as compared to *Newcrest* where the tenements were not just created by statute, but a modification to the Commonwealth's pre-existing common law title).

Similarly, in *Minister for Primary Industries v Davey*, fishing units established under the (CTH) *Fisheries Act* 1952 were accepted as property rights, but as statutory entitlements were subject to the valid amendment of the relevant management plan under which they were issued. In this case, the making of amendments to the management plan that affected the rights to take fish under the fishing units was not an acquisition or other dealing with property according to the High Court. Instead, it was an exercise of powers inherent to the Commonwealth under the statute. Such statutorily based property rights are said, therefore, to be defeasible interests.

In summary, these cases, taken together, arguably signal a move by the High Court to find acquisition in two circumstances. First, where there has been a formal acquisition of a property right that is supported by an antecedent proprietary right recognised by the common law. Second, where there has been an indirect (or de facto) acquisition – that is, where a property right has been "sterilised".

(ii) NAFTA and US domestic law

By contrast, the history in relation to provisions such as Article 1110 has seen a blurring of the distinction between acquisition and mere regulation. For example, in *Metalclad v Mexico* (1997) the NAFTA tribunal awarded the US-based Metalclad corporation US$16.7 million in compensation after they were denied the right by Mexico to operate hazardous waste facility in a "special ecological zone". Furthermore, a Canadian corporation, Methane Corporation, is presently suing the US for $970 million after a ban by California and other states on the fuel additive methanol. Similarly, in the current case of *Sun Belt Water v Canada*, a US corporation has sought US$10.5 billion from the Canadian Government for loss of expected profits following British Columbia's decision to ban the bulk export of water. This is despite the fact that the US corporation has never actually exported water from Canada.

These examples mirror the position under USA constitutional and domestic law where the distinction between compensation for acquisition but not for regulation (or takings) has not been preserved. The Fifth Amendment provides that private property shall not be ***taken*** for a public use, without just compensation. In *Tulare Lake Basin Water Storage District v United States*, a group of California water users averred that they were owed compensation under the Fifth Amendment Takings Clause when their water rights were abridged by the Federal Government. The Court ruled that they were owed compensation.

(iii) The implications of dissolving the distinction

The decision to grant compensation in cases where a Government is using its regulatory powers has widespread implications in practice. **First**, compensation for restrictions on land clearing or reductions in water use entitlements may create a climate whereby Governments are hesitant to regulate properly and effectively for fear of the financial repercussions. In the rare cases where regulation has given rise to compensation under Australian law (possible as there is no constitutional rule at a State level), this has been the experience.

Furthermore, in the US case of *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency* (which preceded *Tulare*) Justice Stevens echoed a concern about "reluctant regulation". His Honour noted that land use regulations are ubiquitous and most of them impact upon property values in some tangential way -- often in completely unanticipated ways. Treating them all as *per se* takings (restrictions requiring compensation) would transform government regulation into a luxury few governments could afford.

Second, adoption of the investment Chapter in its current form may potentially involve the Australian Government and community in complex and costly litigation over what regulations require compensation. Again, this has occurred under domestic law in the USA with Court decisions made on an *ad hoc* basis amidst what would seem to be an increasingly acrimonious, divisive and ideologically-driven public debate. If Australia goes down this path, the security and certainty sought under AUSFTA may prove illusory.

Third, as Professor Jan McDonald from Griffith University has observed, these different constitutional provisions and interpretations would have unconscionable and inequitable implications for Australia. In effect, it would mean that an expropriation provision would allow for a US investor to claim for a regulatory expropriation, while an Australian company would be prevented from so doing under s 51(xxxi).

It is thus submitted that, should an investment chapter be included, the rules should clearly state that compensation is only payable on the nationalisation of property, a position in conformity with the Australian law regarding compensation for acquisition. This would at least ensure a degree of equity between the parties on this point.

2 Compensation: enforcement of environmental regulations

It is noted that Chapter 11 of NAFTA (under Article 1114) contains provisions designed to protect the environment (as well as public health and safety) and the right of States to regulate these activities.

> *Article 1114: Environmental Measures*
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> 1. 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 concerns.
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> 2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

There are, however, a number of problems with such provisions. **First**, a provision such as Article 1114 is patently unenforceable. While the aspiration contained within it is laudable, it should be strengthened considerably to ensure that (present and prospective) environmental and public health and safety laws are not compromised in the name of investment.

Second, it is unlikely that one party would complain if the other party sought to encourage investment. For example, if Australia was to induce US investors through lowering its standards

(environmental or otherwise), it seems a fanciful scenario that the US would seek to invoke the consultation provisions.

Third, it is also apparent that the AUSFTA does not even have the safeguards built around NAFTA. NAFTA at least has side accords (separate non-trade agreements) on labour and the environment, together with mechanisms for complaining where there is a failure to enforce environmental laws. In a joint report, the International Institute for Sustainable Development and the United Nations Environment Program contended that it is this context which allowed the US to accept the terms of the Agreement.

One means of strengthening the present agreement and resolving these problems would be to explore the establishment of similar parallel agreements with concomitant safeguards. The environmental agreement signed by Canada, Mexico and the US provides a good starting point. This agreement created the Commission for Environmental Cooperation, which promotes environmental cooperation among the three countries, and by which dispute settlement provisions can be invoked if a country persistently fails to enforce environmental laws that have conferred a trade benefit. Part of the mandate of the Commission is to help harmonize standards upwards and to oversee the enforcement of existing laws. It is also charged with, among other things, monitoring the environmental effects of NAFTA.

3 Barriers to trade: the ambit of the Agreement

Water and water related services have not been excluded from the AUSFTA. This means that water and water services would fall within the terms of the agreement, and that the regulation of new allocations could be challenged as barriers to trade, being a market access restriction (raising the compensation issues noted above).

Similar considerations would apply to other areas such as the regulation of genetically modified organisms (including labelling laws) and Australia's high quarantine standards. These could be challenged if new regulations were sought to be imposed. Throughout much of the 1990s, Australia and Canada were at odds over laws restricting the importation of Canadian Salmon designed to protect native salmon stock. The Canadian Government challenged such laws as a barrier to trade and the challenge was upheld by the World Trade Organisation. Australia had to change its regulations, posing a danger to local salmon stock.

The present trade and investment provisions thus have the potential to undermine the ability of Australian Governments (Federal, State, Local) to regulate an array of environmental and other services. It is imperative that Australia maintains control over the management of its own natural resources and in accordance with an evidence-based regulatory framework, not one based on the fear of potential compensation claims.

4. Relationship between international instruments

The relationship between international instruments has been a source of continuing concern, particularly for the World Trade Organisation. NAFTA dealt with this by explicitly elevating a number of international Conventions (such as the Montreal Protocol and CITES) over NAFTA in the case of disagreement. However, such an arrangement is only possible where all parties are signatories to the relevant instruments. This is not the case here as, for example, the US has not yet ratified the *Convention on Biological Diversity 1992*.

Moreover, if the NAFTA model is to be followed, it requires that the domestic laws resulting from the international conventions must be those "least inconsistent with the other provisions of [NAFTA]." Such a restriction curtails the ability of Governments to make laws fully in accordance with the environmental tenets and objectives of the particular international Convention.

The existence of AUSFTA may also affect Australia's ability to sign such agreements at a future date. For instance, the *Cartagena Biosafety Protocol 2000* requires that a party implement a domestic regulatory framework that is consistent with the Protocol. Amongst other things, the Protocol provides that risks should be assessed in accordance with sound scientific practice (Article 15) and that parties should establish and maintain procedures to minimise risk (Article 16). If Australia was to enter into an agreement that affects the transboundary movement of genetically modified organisms then they must ensure that the agreement does not have a lower level of protection than that provided by the Protocol.

Likewise, neither the US or Australia have presently ratified the *Kyoto Protocol 1997* as a mechanism for reducing greenhouse emissions. Should a party wish to ratify the protocol and it come into force, this is an issue that is likely to cut across and conflict with the tenets of AUSFTA.

Consideration needs to be given to the best and most equitable procedure for allowing for future changes in the international arena without compromising environmental and health and safety standards.

5. Forum for Compensation Claims

We understand the current construction of the agreement makes it unlikely that Australian Courts will be the forum in which AUSFTA compensation claims will be heard. Instead, it is likely that disputes will be heard by an international arbitration tribunal. International trade arbitration rules provide that judges be appointed by the parties, with no guarantee of open hearings or avenues for appeal. Such an approach would exclude the public (and, indeed, all levels of Government, apart from the Commonwealth) from presenting their views or even being informed that a claim has been brought. In the Australian context, this might mean that a State Government – entrusted with the management of Australian's natural resources – would not be involved in the arbitration process despite having the most direct, formal interest in the outcome.

Both Australia and the USA have rigorous and independent Court systems governed by the rule of law. These systems are open, transparent and have appropriate appellate procedures. Moreover, they provide opportunities for non-adversarial settlement between the parties. Provided the relevant parties are present, non-adversarial dispute resolution methods arguably provide the best way to ensure certainty of outcomes, as well as being far more successful at gaining compliance. As such, there is no need for an international arbitration system outside this process.

6 Negotiations and Consultation Process

We appreciate the opportunity to provide input into this important process, as part of the community consultation process. However, it is of concern that the negotiation process has largely taken place beyond closed doors, and without being underpinned by proper

environmental impact assessment or strategic impact assessment investigations and processes. These deficiencies seriously undercut the legitimacy and efficacy of the broader community consultation process.

Should you have any queries, please do not hesitate to contact Jeff Smith, Director, NSW Environmental Defender's Office, on 9262 6989.

Yours sincerely

Environmental Defender's Office

Jeff Smith
Director

On behalf of ANEDO

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