Briefing
The case for banning
Investor State Dispute Settlement in Australia
Briefing
The case for banning Investor State Dispute Settlement in Australia

Contents

3 Introduction: ISDS in Australia
   5 Australia’s domestic gas security mechanism: A possible ISDS case?
   5 ISDS attacks in Australia
   6 Threaten ISDS cases: A powerful corporate weapon

6 Key problems with ISDS
   6 Outdated
   8 Impedes on the right to regulate — regulatory chill
   8 Creating an unfair system
   8 Costs
   9 Arbitrator independence
   9 Lack of transparency

10 Case study: Canada
   12 What Canada’s experience has demonstrated
   13 Lessons learned

14 The case for banning ISDS
   15 Alternatives for Australian investors
   16 Momentum for banning and reforming ISDS
   16 Recommendations

Author Ruby Grounds
Editing and input: Samatha Castro, Kat Moore and Sam Cossar-Gilbert

Published by Friends of the Earth Australia
PO Box 222
Fitzroy
VIC 3065

www.foe.org.au
Email foe@foe.org.au
Phone 03 9419 8700
Introduction

ISDS in Australia

Globalisation has led to monumental changes in the world’s economy. A key facet of this era of interconnectedness has been the increasing integration of the world’s economies, with resources, money and jobs crossing international borders more than ever before. The rapid expansion and liberalisation of the international trade network has been spurred along by the creation of preferential treaties to lower barriers to trade and encourage foreign investment between signatory countries.

After the rapid rise of Bilateral Investment Treaties in the 1990s, in which over 1600 came into force (Australia signed 17 between 1990-1999), the latest global trend has been towards mega regional trade agreements, often referred to as ‘new generation’ free trade agreements. Examples of these agreements include the EU-Canada Comprehensive Economic and Trade Agreement (CETA), the Comprehensive and Progressive Trans Pacific Partnership (CPTPP) between 11 countries in the Pacific and the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU.

Australia’s regional trade agreements

Regional Comprehensive Economic Partnership (RCEP)
Negotiations are currently underway for this trade deal which includes 16 countries in the Asian region.

Comprehensive and Progressive Trans Pacific Partnership (CPTPP)
A deal between Australia and 10 other Pacific Rim countries, which has be revived since the exit of the United States and is to be signed on 8 March 2018 and then require national ratification processes.

Pacific Alliance Free Trade Agreement
Negotiations have begun between Australia, Mexico, Chile and Colombia.

These agreements go beyond the reduction of tariffs on goods, also covering issues such as ‘services, investment, competition policy, government procurement, e-commerce and intellectual property’, as well as labour and environment provisions.

Investor-State Dispute Settlement (ISDS) is a dispute resolution method included in hundreds of trade and investment agreements designed to give exclusive legal protection to foreign companies investing abroad, giving them the right to sue host governments in a private tribunal over any perceived breach of the rules around the treatment of investors. Foreign investors can bypass domestic courts and have their case heard by three arbitrators who decide whether the host state is liable to pay huge sums in compensation. The origins of the provisions came from the need to protect companies against the seizure of their assets by host states, for example a mine being nationalised without just compensation. They have since evolved to include the values of non-discrimination, prohibition of performance requirements, fair and equitable treatment and free movement of capital, and most controversially, indirect expropriation, in which any government measure perceived to affect the actual or expected profits can be challenged. ISDS is a potent inclusion in investment treaties and trade agreements, giving powerful rights to multinational corporations which allow them to bypass domestic courts and seek compensation through secretive, business-friendly tribunals.

Analysis of the current ISDS system demonstrates how the system has dangerously strayed from its original intention; arbitration tribunals lack basic standards of a fair judicial system and corporations have attacked legitimate government measures intended to protect the public and the environment. Any reasonable political measure that impacts a company’s projected profits can be equated to expropriation, with cases already launched against the banning of toxic chemicals, restrictions on tobacco advertising, requirements to stem pollution from mining.

References:
1 Australia Productivity Commission, 2010, Bilateral and Regional Trade Agreements, p 52
and even for the introduction of a minimum wage. The ISDS system impedes on national sovereignty to the benefit of corporations, yet places no obligations on investors to behave responsibly, creating an asymmetric system that gives multinationals the same rights as sovereign states.

The significant increase in ISDS cases worldwide has resulted in more public attention on the once obscure element of international trade agreements, particularly as more cases are brought around issues of land, water security and pollution. Public backlash around the inclusion of ISDS has accompanied the negotiation of many new trade deals; an EU call for submissions on the TTIP received a record number of responses, the vast majority of which were concerned about the inclusion of ISDS.

Many countries have begun to reconsider their current trade agreement regime, and reassess the usefulness of ISDS provisions. Indonesia, South Africa, India, the EU and Poland are among those taking steps to reform their current trade regime.

ISDS has been a component of Australian FTA’s and treaties for some time, with 27 currently in force that contain varying degrees of investor protections. Proponents of ISDS often tout this as proof that the ISDS system is harmless, however, the unpredictable nature of ISDS has seen influxes of cases launched against states after having no cases filed previously,8 chewing up millions of taxpayer dollars to defend and putting the regulatory capacity of the government at risk.

As Australia strives to lock in more and more regional trade agreements, such as RCEP and the reemerging TPP, it is vital to reassess the inclusion of ISDS in future agreements, and push for a fairer trade and investment system.

---

8 See Spain and Argentina
Australia’s domestic gas security mechanism

A possible ISDS case?

In April 2017 the Australian Government announced the ‘Australian Domestic Gas Security Mechanism’ to introduce export restrictions on liquefied natural gas. The new law gives the Minister of Resources the power to vary or revoke an Export Permission LNG Exporter and is expected to reduce gas exports by a small percentage. It is described by government as needed to secure energy supply.

Australia has seen a rapid increase in gas price linked to its increasing exports and the measure is designed to put downward pressure on prices for national businesses and consumers reliant on gas. Australia is home to some of the largest gas deposits in the world but a $200 billion investment in liquefaction and shipping facilities has transformed it into the world’s biggest gas export and created shortages in country.

Ashurst international law firm emailed their clients, alerting them to potential opportunities of using ISDS to challenge the government’s Australian Domestic Gas Security Mechanism stating:

“Many organisations invested heavily in LNG plants and liquefaction facilities with government on an assumption that the regulatory environment would be stable, predictable, and supportive of the LNG sector. There is also concern in the industry that east coast exporters are being unfairly targeted, and so the possibility of investment treaty claims on the basis of this mechanism might properly be front of mind for both government and industry.”

“Recent changes to Australian gas export and taxation policy serve as reminders that the protections afforded to investors under investment treaties are not only relevant to investors in emerging markets. Investment treaties are also relevant to investors in modern and developed jurisdictions with widely recognised adherence to the rule of law. Three developing investor-state arbitrations in Australia, each also concerning alleged expropriation and breaches of other common investment treaty protections, demonstrate the relevance of investment treaty protections in jurisdictions of that kind.”

ISDS attacks in Australia

Philip Morris v Australia 2011

Australia to date has had one ISDS case brought against it: an attack on the implementation of the Tobacco Plain Packaging Act 2011 by tobacco giant Philip Morris. The US-based company first mounted a constitutional challenge against the legislation in the Australian High Court, where their case failed. Dissatisfied with the verdict, the company decided to initiate an ISDS case. With no ISDS provisions applicable between Australia and the US, the company restructured assets to a Hong Kong subsidiary and launched arbitration through the Australia-Hong Kong FTA, which contained ISDS.

The legislation was non-discriminatory, in line with Australia’s constitution, supported by health experts and the WHO, and based on extensive research with the clear aim of improving the health of the Australian public. Despite this, Philip Morris was able to initiate international arbitration, claiming the restrictions on tobacco trademarks were equivalent to acquisition of their assets, and demanding an undisclosed amount for the loss of current and future profits.

The case took four years to resolve, after which the tribunal ruled that it had no jurisdiction to hear the case due Philip Morris’ sneaky restructuring in order to gain access to the ISDS provisions, often referred to as ‘nationality planning’ or ‘treaty shopping’.

Entrenching ISDS in future trade agreements would make Australia susceptible to further ISDS attacks.

---

The case for banning Investor State Dispute Settlement in Australia

Key problems with ISDS

1. Outdated

ISDS mechanisms are outdated, dangerous and inappropriate for today’s global economy.

ISDS provisions were created 70 years ago in regards to direct expropriation of assets of foreign operations in the post colonial era. ISDS provisions aimed to contribute to ‘predictability, stability and transparency in investment relations’, and remove possible diplomatic tension that could occur if state-state arbitration was used.

While the first investment agreement with ISDS provisions was signed in 1959, it wasn’t until the 1990s the provisions were locked into hundreds of treaties. In a time when the implications of ISDS were relatively untested, more and more agreements were signed with vague treaty wording and insufficient protections on the regulatory space of governments.

Analysis of the current stock of publicly available ISDS cases demonstrates how the system has strayed:

- A 2014 study found that from the mid-1990s onwards, investment arbitrations have been filed against countries with, ‘on average, a relatively high level of democratic development and rule of law’, debunking the argument that ISDS is needed to substitute weak judicial systems.

- Multiple cases have been filed against developing countries. These usually are less concerned with matters of direct expropriation, and more based on the vague protections of ‘fair and equitable treatment’.

- ISDS is not solely being used in cases of extreme sovereign abuse, but has increasingly been used against legitimate government legislation in areas such as mining, environmental protection, health, the delivery of public services and regulations on the disposal of hazardous waste.

---

16 https://www.italaw.com/cases/5687
UNCTAD notes that virtually all of the ISDS cases filed by the end of 2016 were derived from agreements concluded before 2010. Corporations are accessing old, vaguely worded treaties that were crafted at a time when the dire potential of ISDS was not yet known, and using them to attack legitimate public legislation.

The ISDS system in its current form is no longer in line with the original intention. ISDS in its current form has gone dangerously beyond protecting investors from discrimination or expropriation, and has become a tool for multinational corporations to attack regulation intended to protect the community and the environment.

As UNCTAD advises, investment treaties are ‘legally binding instruments and not ‘harmless’ political declarations.’

“ISDS can no longer be rationalised as simply a mechanism to protect foreign investors in developing countries with spotty investment protection records or unreliable court systems. In truth, it is a coercive tool with which multinational corporations can assail and frustrate government regulation in both developing and developed countries.”

“What is abnormal is for an investor to demand a guarantee of profit, to create a parallel system of extrajudicial dispute resolution, which is often not independent, transparent, accountable, or even appealable, and to seek to usurp the function of the state and encroach on government regulation of fiscal and budgetary matters in the public interest.”

“This is tantamount to privatisation of profits and the socialisation of losses.”

21 Sinclair, S 2005, NAFTA Chapter 11 Investor-State Disputes
2. Impedes on the right to regulate — regulatory chill

‘Regulatory chill’ occurs when a government refrains from enacting particular public policy measures or regulation due to fear of, or as a result of, arbitration under ISDS.\(^{24}\) While arbitration tribunals cannot legally require a government to change a law, they can require the government to compensate a company for the effects of that law. When the mere threat of a costly arbitration is enough to deter a government from enacting a new measure, ISDS becomes a powerful lobbying tool for corporations aiming to influence the environmental, labour, health and safety regulations of a country. Examples of regulatory chill have been numerous:

- Following on from the plain packaging case brought against Australia, New Zealand announced that its own plain packaging laws would be postponed until the outcome of the ISDS case against Australia was decided.\(^{25}\)
- Following the banning of MMT, a gasoline additive, on the basis that it had the potential to cause harm to public health, fuel additive company Ethyl Corporation launched a case against the Canadian government, claiming expropriation under NAFTA. The Canadian government settled out of court, compensating Ethyl for USD$13 million, but also reversed the ban on the chemical and issued a statement asserting that Ethyl’s product was safe as long as proper safety instructions were followed.\(^{26}\)
- After environmental restrictions were placed on a coal fired power plant in Hamburg in order to limit the effects on the adjacent Elbe River, energy giant Vattenfall sued the government of Germany for USD$1.4 billion, claiming the standards made their project unviable. The case was eventually settled after the City of Hamburg agreed to weaken the environmental protection standards previously set.\(^{27}\)

These are potent examples of corporations asserting power over a government’s policy space and creating a disincentive for governments to enact necessary environmental and social policy. No benefit of international trade is great enough to justify ceding power to multinationals and away from communities and the politicians that are elected to represent them.

By signing onto more agreements with ISDS, politicians are allowing themselves to be held to ransom by multinational companies.

> “Investor-state dispute settlement has mutated from a corporate shield against allegedly unfair behaviour by states into a tactical weapon to delay, weaken and kill regulation.”\(^{28}\)

3. Creating an unfair system

By only allowing investors to initiate arbitration, ISDS creates a one-way system in which corporations are empowered to sue states, but under no obligation to behave reasonably in return. Moreover, foreign investors are endowed with more rights than are granted to domestic investors, who do not have access to a parallel legal system should they feel that their investment has been impeded.

4. Costs

Investor-state dispute tribunals are expensive, with one OECD report estimating expenses for arbitration fees for a single ISDS case averaging US$8 million.\(^{29}\) As investors are the only party allowed to initiate arbitration, an asymmetric, unfair system is created, in which states cannot arbitrate against the wrongdoing of investors, and the best outcome for the state is that the claim is dismissed. States are forced to spend millions defending themselves against claims; frivolous cases that never reach a full hearing may still incur costs to defend, and even when a tribunal decides in favour of the state, in most cases states still have to contribute for legal fees. The Australian government reportedly spent over AUD$50 million defending itself against tobacco giant Philip Morris in the case against plain packaging laws.\(^{30}\) Although the tribunal in June 2017 awarded costs against Philip Morris, the proportion and amount of costs were blacked out in the publication of the decision, and the Australian government has refused to release this information.

---

27 Bernasconi, N 2009, Background Paper on Vattenfall v. Germany Arbitration, International Institute for Sustainable Development
Arbitration tribunals have unrestricted freedom when it comes to determining the amount of compensation to be paid, with hugely inflated amounts often awarded on the basis on lost ‘future profits’. The largest recorded award was $50 billion to the OAO Yukos Oil Company in a case with the Russian Federation.31

5. Arbitrator independence

Arbitration tribunals are touted as reliable, depoliticised systems to resolve investment disputes. Many aspects of these ad hoc tribunals, however, would be considered unacceptable in a domestic court system.

Arbitrators face serious concern surrounding their independence and impartiality. Unlike domestic court systems in which judges are appointed to cases at random, arbitration panels are made up of three members chosen by the investor and the state. Conflict of interest rules are weak, with arbitration lawyers free to bounce between roles, serving as counsel on one case, then an arbitrator in the next.

Arbitrators are not obliged to refer to precedent, meaning interpretations are inconsistent and unpredictable. Decisions are not open to appeal, giving arbitrators tremendous power when it comes to making decisions that affect government regulation and cost the taxpayer tens of millions of dollars, without democratic checks and balances on the arbitration process. The arbitration industry is dominated by a small group of influential arbitrators, with just 15 arbitrators decided 55% of all publicly available ISDS disputes.32

Unlike judges, arbitrators have no cap on financial remuneration, making international arbitration a lucrative business. At the International Centre for Settlement of Investment Disputes, arbitrators reportedly make $3,000 a day,33 with no fixed fee per arbitration providing a strong financial incentive to prolong proceedings.

UNCTAD has questioned ‘whether three individuals, appointed on an ad hoc basis, can be entrusted with assessing the validity of States’ acts, particularly when they involve public policy issues’.34

“Investment arbitrators are hardly neutral guardians who stand above the law. In fact, they are crucial actors in the arbitration industry, with a financial interest in the existence of investment arbitration.”35

“Turning international investment arbitration into a lucrative business has provided a great incentive for smart lawyers to sustain and expand the system in order to maximise profit.”36

6. Lack of transparency

While the public has a stake in the outcomes of investor-state disputes, particularly where it concerns environmental and public policy, hearing documents and award amounts are often kept confidential. Ad hoc tribunals set up under the UN bodies for dispute resolution are registered publicly, but most other forum contain no obligations of transparency. In many ISDS cases limited information exists in the public domain regarding cases that could cost the public coffers million of dollars. Citizens who are affected by the outcome of these tribunals are left with no means by which to monitor the arbitration,37 and the system is allowed to continue in an undemocratic manner.

“Arbitral tribunals set up under ISDS provisions are not courts. Nor are they required to act like courts. Yet their decisions may include awards which significantly impact on national economies and on regulatory systems within nation states.”38

Former Australian Chief Justice Robert French

“The establishment of a parallel system of dispute settlement, which is not transparent, accountable or even independent, cannot be tolerated.”39

---

33 Eberhardt, P & Olivet, C 2012, Profiting From Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom
34 United Nations Conference on Trade and Investment, World Investment Report 2013, p 112
35 Eberhardt, P & Olivet, C 2012
36 Eberhardt, P & Olivet, C 2012, Profiting From Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom, p 246
37 Australia Productivity Commission, 2010, Bilateral and Regional Trade Agreements
Case Study
Canada

Canada offers a potent example of the relentless burden of ISDS. Like Australia, Canada has a federal system of governance, with states and provinces given jurisdiction over particular laws in their region. Both countries are dependent on vast supplies of natural resources, and are renowned for their natural beauty. Looking at Canada’s experience with ISDS over the last 25 years offers an unnerving warning to Australia, especially when it comes to the right to regulate in order to protect the public and the environment.

Canada was confident that a trade agreement with both the US and Mexico would protect its interests in the region. Canada signed the North American Free Trade Agreement (NAFTA) in 1992 with the US and Mexico, with the aim of eliminating barriers to trade between the three nations and increasing investment opportunities. While the previous FTA between the US and Canada did not contain ISDS provisions, they were included in NAFTA under the rationale that Mexican courts were inadequate to deal with investor disputes due to corruption and political interference. This made it the first comprehensive regional trade agreement to include ISDS provisions.

The investment chapter, commonly referred to as Chapter 11, contains investor protections of national treatment, most-favoured nation treatment, a minimum standard of treatment, direct and indirect expropriation, along with the procedure for bringing an investment claim against the host country. The agreement came into force in 1994, and since then has had 85 ISDS cases filed under it of which 41 were filed against Canada, 23 against Mexico and 21 against the US, making it the source over 10% of all known ISDS cases worldwide.

Concerning for Australia is not just the fact that Canada is being sued heavily by another developed country, but also the nature of the cases; the majority of the disputes have been over regulatory issues, with only one case filed for direct expropriation.

40 Sinclair, S 2015, NAFTA Chapter 11 Investor-State Disputes, Canadian Centre for Policy Alternatives
42 UNCTAD
47 Van Harten, S 2009, Reforming the NAFTA Investment Regime
48 Cooper, K et al 2013, Seeking a Regulatory Chill in Canada: The Dow Agrosciences NAFTA Chapter II Challenge to the Quebec Pesticides Management Code’, Golden Gate U. Envtl. LJ 7
50 Lone Pine Resources Inc v Canada, p 16
Key cases

**Ethyl v Canada**  SETTLED
Following the banning of MMT, a gasoline additive, on the basis that it had the potential to cause harm to public health, fuel additive company Ethyl Corporation launched an attack against the Canadian government, claiming expropriation under NAFTA. The Canadian government settled out of court, compensating Ethyl for USD$13 million, but also reversed the ban on the chemical and issued a statement asserting that Ethyl’s product was safe as long as proper safety instructions were followed.43

**St Mary’s v Canada**  SETTLED
A proposed quarry was prevented by the local minister following mass community rejection the project. The quarry was found to have had the potential to harm groundwater that fed wetlands and streams, vital for surrounding agricultural land, as well as long term effects on local drinking water supply. Following a democratic consultation process with the local community that received hundreds of formal objections to the proposal, the provincial government of Ontario prohibited the use of land for the quarry. St Mary’s then filed a claim for $250 million in lost future profits, effectively forcing the government to pay up in order to protect a valued community area.

**Bilcon v Canada**  WON BY COMPANY
Upon proposing the development of a quarry in Nova Scotia, Bilcon were required to submit an environmental impact statement in order to obtain provincial and federal approval. When the government took the advice of the expert environmental review panel and denied the licence due to the potential of devastating environmental effects, Bilcon used NAFTA to sue for $300 million, despite the option for domestic mediation.44 Dissenting arbitrator, Donald McRae, described the case as ‘an intrusion into the environmental public policy of the state’.45

**Dow Agrosciences v Canada**  SETTLED
The American company filed a case against the province of Quebec’s ban of pesticide 2,4-D. The cosmetic use of the pesticide was banned due to potential risks to public health. The case was eventually settled before proceeding to tribunal, with Dow Agroscience withdrawing its request without any monetary compensation. One of the terms of settlement was the Government of Quebec issuing a statement that products containing 2,4-D do not pose an unacceptable risk to human health or the environment provided that the instructions on their label are followed.

One legal commentator suggested that Dow’s claim appeared to be aimed ‘as much at deterring other governments from taking similar steps to reduce pesticide use for health and environmental reasons, as much as it [was] meant to win compensation of $2 million, as claimed, for the incidental impacts on Dow’s sales in Quebec’.46 Indeed, the relatively small amount of compensation claimed suggests that the US company launched the case in an attempt to influence how other provinces and districts legitimately use their municipal powers to protect the health of their population and the environment.46

**Lone Pine v Canada**  PENDING
In June 2011, after extensive consultation and debate, the provincial Government of Quebec placed a fracking moratorium on drilling beneath the St. Lawrence River in order to properly study the environmental risks associated with the controversial technique. Soon after, Lone Pine Resources, an oil and gas developer, filed for arbitration against Canada under Chapter 11 of NAFTA. While being a Canadian-based company, Lone Pine was able to sue the Government of Canada through its US affiliate, accessing NAFTA’s chapter 11 and suing its own government under the provision that they had not been given ‘fair and equitable treatment’ as a foreign investor, demanding over USD$100 million in compensation.

In the ongoing claim, Lone Pine claims that the temporary ban on fracking impeded on their ‘right to mine’, claiming actions taken by the government of Quebec were tantamount to expropriation, and that ‘no valid public purpose’ exists for the moratorium, despite the clearly rational grounds presented by the government of the need for further research into the extractive method.
What Canada’s experience has demonstrated

**ISDS allows foreign investors to circumvent strong national courts**

Canada, like Australia, has a suitable court system for dealing with treaty disputes in a fair and timely manner. Despite this, dozens of corporations have chosen to bypass this and instead opt for the ad hoc arbitration tribunals allowed under NAFTA.

**Measures undertaken by any level of government are open to arbitration**

More than half of the cases filed against Canada have come from measures taken by state of provincial governments, with municipal decisions also vulnerable to attack. Eg. St Marys v. Canada, Bilcon v. Canada, Dow Agrosciences v. Canada and Lone Pine v. Canada.

**Legitimate, democratically made measures can be challenged**

As seen in the case of Bilcon v. Canada, a foreign investor was allowed to initiate an arbitration case due to their dissatisfaction with the decision of an environmental review panel.

**ISDS can be used to pressure government into changing regulation**

There are many cases in which corporations have used ISDS in an apparent attempt to influence future policy. Arbitrator Donald McRae warned that Bilcon’s win would ‘create a chill on the operation of environmental review panels’.51

**Environmental protections included in treaties are not effective**

NAFTA contains articles that attempt to protect the environmental, health and regulatory capacity of the states. Similar chapters have been included in recent FTAs, including the TPP.

In *Ethyl Corporation v Canada*, the investor argued that the banning of the harmful gasoline additive was in fact a disguised on trade that unfairly impeded on them.

The last two decades of attacks on Canada’s attempts to regulate to protect the environment demonstrate the complete ineffectiveness of environmental carve-outs, and the capacity of corporations to get around environmental exclusions.

**The mining and extractive industry loves ISDS**

Of particular concern for Australia are cases brought forward by companies in response to regulation around resource extraction.

In March 2017, the state government of Victoria passed a permanent moratorium on fracking, with Premier Daniel Andrews claiming the ban would protect the state’s farming sector, which employs more than 190,000 people. The ban, largely in response to years of community pressure from those living in agricultural areas, protects Victoria’s long-term water security, and the ability of Victoria’s farming sector to continue functioning without being impeded on by mining companies. The ban, pushed for by those living in agricultural areas and supported by a majority of Australians in every state52 could be challenged by a single foreign investor, as illustrated in Canada.

---

51 McRae, D 2015, p 18
Lessons learned

Looking at the quantity and nature of cases brought against Canada demonstrates that ISDS is not being used as a last resort for when a foreign company is treated badly, but a powerful tool for companies to attack legitimate government regulation.

While the federal government may continue to push ISDS provisions as low risk for Australia, it is often measures from other branches of government, such as the legislature, state or local governments, that end up being challenged using international arbitration. While the Canadian government signed onto NAFTA at a time before investor-state arbitration had proliferated, the Australian government is negotiating agreements with full knowledge of the dangers of ISDS.

“Two decades ago, when NAFTA’s chapter 11 was put in place, neither governments nor the public grasped that it would be used to successfully attack the regulation of harmful chemical or toxic waste exports, to second guess routine bureaucratic and administrative decisions, to expand private property rights to encompass publicly-owned water and timber, to compensate investors when governments refuse to approve contentious proposals, or to restrict the ability of local governments to enforce local economic development requirements in return for an investor’s access to resources. Buoyed by their past successes, foreign investors and their legal advisors are now turning to NAFTA chapter 11 with increasing frequency and assertiveness.”

Scott Sinclair, Canadian Centre for Policy Alternatives

“As more and more countries with sound credible domestic legal systems and stable investment climates continue to conclude IIAs granting high levels of investor protection, they risk being confronted themselves with ISDS rules intended to shield their investors abroad.”

Australian agriculture and ISDS

Trade deals have the potential to offer great benefit to farmers through increasing access to international markets. The inclusion of ISDS in these deals, however, poses several risks to the Australian agricultural sector.

- Huge agribusiness has already used ISDS to protect its interests overseas.
- Around 40% of ISDS cases are in relation to oil, mining, quarrying or gas. The extractive industry is not afraid to use ISDS in order to assert their control over resources, even when it puts agricultural land at risk. Australian farmers have already shown their resistance to the mining industry through their efforts to ban fracking on agricultural land.
- The Australian Farmer Climate Survey found that the majority of farmers surveyed are worried about direct pollution from mining fossil fuels.
- ISDS impedes governments’ ability to fight climate change. Agricultural industries are predicted to be some of the hardest hit by climate change.
The case for banning ISDS

Australia has both a strong domestic legal system suitable for protecting foreign investors and many options for Australian companies when it comes to insuring their investments overseas without the need for ISDS provisions.

“In recognition of the Parties’ open economic environments and shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems, the Investment Chapter does not establish an investor-state dispute settlement mechanism.”

Australian Government of Foreign Affairs and Trade

The Productivity Commission found that ‘Australia should seek to avoid accepting ISDS provisions in trade agreements’ stating:

“An examination of foreign investment trends with Australia’s main foreign investment partners suggests that ISDS provisions are unlikely to have been relevant considerations in the investment decisions of Australian firms investing abroad or foreign firms investing in Australia.”

Advocates of ISDS argue that it is necessary to attract foreign investment; that it signals an economy is ‘open for business’ and welcoming of foreign investors. Looking at the strength of Australia’s legal system and the sources of our current inflows of FDI, however, suggest that ISDS is not imperative to securing FDI.

The strength of Australia’s governance system creates an attractive environment for foreign investors, with a World Bank report praising Australia as an excellent location for doing business. According to the report, Australia is ranked number one in the world for strength of judicial processes, and as one of the quickest when it comes to enforcing contracts. Australia is ranked as 15th in the world in terms of ease of doing business, with the strength of our governance and legal system providing multinationals with a ‘safe, secure business environment,’ in which the threat of maltreatment of investors is low.

Judicial independence is guaranteed in Chapter 3 of the Constitution, with the nation of origin of a party irrelevant to how they are treated in the judicial process. Australia’s stable and predictable legal system means including ISDS for the sake of protecting investors in Australia is completely unnecessary. Mapping Australia’s main sources of FDI suggests that ISDS is not imperative to attract investors.

Main sources of FDI stock in Australia — 2015

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
<th>Amount (AU$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>23.6%</td>
<td>173.5b</td>
</tr>
<tr>
<td>Japan</td>
<td>11.7%</td>
<td>85b</td>
</tr>
<tr>
<td>UK</td>
<td>10.3%</td>
<td>76b</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6%</td>
<td>73.5b</td>
</tr>
<tr>
<td>China</td>
<td>4.8%</td>
<td>35.2b</td>
</tr>
<tr>
<td>Total without ISDS</td>
<td>51.6%</td>
<td></td>
</tr>
</tbody>
</table>

57 Department of Foreign Affairs and Trade, Australia-United States Free Trade Agreement—Guide to the Agreement, p 59
58 Trade and Assistance Review 2013-2014, p 80
59 Bilateral and Regional Trade Agreements, p 276
60 Australian Productivity Commission, 2010, Bilateral and Regional Trade Agreements
The top four sources of foreign direct investment in Australia (the US, Japan, the UK and the Netherlands), which make up over 50% of our FDI flows, are countries that we do not currently have agreements that involve ISDS provisions with. Despite this, FDI from these countries has steadily increased over the last 10 years.\(^\text{62}\)

The US was both our biggest source of FDI inflow (27%) and the leading destination for Australian investors (28%) in 2016, despite the two countries not having an IIA with ISDS provisions. Undeterred by strong lobbying from American corporations, Prime Minister John Howard was determined to not include them in the Australia–US FTA (AUSFTA) in 2005 on the basis that the two countries has sufficient court systems to resolve treaty disputes. AUSFTA still contains an investment chapter which outlines the rules of non-discrimination, minimum standard of treatment, direct and indirect expropriation, but does not open Australia up to international arbitration from American investors.

Despite warnings from ISDS proponents there is no strong evidence that investment protections attract FDI and gain economic benefits, that treaties are not a deciding factor when investing abroad. The Productivity Commission found:

> “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.”\(^\text{63}\)

**Alternatives for Australian investors**

Proponents of ISDS often assert that due to the reciprocal nature of the protections, the trade off of allowing foreign corporations to sue us is necessary in order to protect Australian investors abroad, especially in countries with weak judicial systems. While most of Australia’s outward FDI flows are to countries with reliable systems of governance, the range of market based solutions available to Australian investors, however, means ISDS is not the best means of protecting Australians investors against the risks of doing business abroad. Options available to Australian investors abroad include:

- Insurance from the World Bank Multilateral Investment Guarantee Agency (MIGA);
- Political risk insurance offered by the Australian government’s export credit agency, Efic;
- Private political risk insurance.

Should these options not satisfy an investor, individual contracts can be negotiated between investors and host governments, with the option of ISDS. This gives the host government more control over which guarantees are appropriate for specific investments, instead of the overreaching protections that give all investors from a certain country (huge) rights.

The exclusion of ISDS from trade agreements will not diminish Australia’s ability to attract FDI, nor the ability of Australian investors to protect themselves from maltreatment abroad. Moreover, ISDS is not a fixed and indispensable part of free trade deals; Australia has negotiated many deals without the inclusion of ISDS, including the previously mentioned AUSFTA and the Australia-Japan FTA. Furthermore ANZ Closer Economic Relations Agreement and Malaysia Australia FTA also do not have ISDS.

Australia must protect its right to regulate in the interest of its citizens and its environment.

> “What I would say to Australians is that while the system is in the state it’s in right now, signing any new treaty [with ISDS] is a very serious mistake.”\(^\text{64}\)
> George Kahale, arbitration lawyer

---

\(^{62}\) Australian Trade and Investment Commission 2017, Why Australia — Benchmark Report 2017

\(^{63}\) Australian Productivity Commission, p xxxvi

Momentum for banning and reforming ISDS

South Africa began to withdraw from its bilateral investment treaties after finding that many of the old BITs were incompatible with domestic policy goals, and unnecessarily exposed the country to international arbitration. Treaties with Switzerland, the Netherlands, Spain, Luxembourg and Germany were terminated.

The Protection of Investment Act was passed in 2015, with the aim of protecting investment through domestic legislation rather than investment treaties. The act ensured domestic mediation was accessible, with state-state arbitration a last resort option.

Research conducted one year after the termination of the Germany-South Africa BIT in 2013 found that German investment in South Africa was unaffected by the ending of the investment agreement, with over 600 German companies maintaining business activities in country.65

Brazil is the only country in Latin America that has never ratified a Bilateral Investment Treaty or a trade agreement that includes ISDS. Yet it receives the largest amount of FDI in the region.

Ecuador’s has audited Bilateral Investment Treaties, which revealed that most of the FDI comes from countries with which Ecuador has no BITs. In fact, most foreign investments in Ecuador originate from two countries that are not covered by ISDS and it has decided to terminate this harmful agreements.

Indonesia and India have both implemented major Bilateral Investment Treaty reviews and reforms and in the process of canceling numerous treaties with ISDS and proposing much a system with much more limited scope.

After strong community opposition to ISDS, the European Union has declared that “ISDS is dead”66 and is proposing various alternatives to the current system, including a Multilateral Investment Court. Furthermore in March 2018 the European Court of Justice ruled that ISDS clauses in the Netherlands-Slovakia bilateral investment treaty are not compatible with EU law, raising fundamental questions about the legality of other EU trade deals which include the measure. While the ruling applies to intra-EU trade deals, it could have a significant impact on the future of the EU-Canada trade deal, CETA, which includes a similar measure – the Investment Court System. After a request from the Belgian government, the ECJ will rule on whether the Investment Court System is compatible with EU laws.

The United States Trump administration has turned its back on ISDS, proposing that governments should be able to opt out from ISDS in the current renegotiation of the North American Free Trade Agreement (NAFTA).

New Zealand Prime Minister Jacinta Arden has called ISDS a ‘dog’ and is seeking drastic reforms to minimise its impact on the NZ Government’s right to regulate.67

**Recommendations**

- Australia should conduct a full review of trade and investment agreements including ISDS and cancel or renegotiation deals to remove ISDS.
- Australia should not sign any new trade and investment treaties with ISDS.
- Australia should legislate to ban ISDS from all future trade agreement.
- Australia should actively participate in the Intergovernmental Working Group on creating a binding instrument on multinational enterprise and other businesses with regards to human rights.

---