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Submission to the Senate Foreign Affairs, Defence and Trade References Committee on the Proposed Trans-Pacific Partnership Agreement

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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INTRODUCTION

CHOICE thanks the Foreign Affairs, Defence and Trade References Committee for the opportunity to provide feedback on the proposed Trans-Pacific Partnership (TPP) Agreement, with particular reference to the impact of the TPP on the effect of Investor-State Dispute Settlement (ISDS) and consumer rights.

The TPP's ISDS provision places future reform to benefit Australian consumers at risk. Specifically, CHOICE is concerned about ISDS action against Australia should the Federal Parliament pass legislation or if the Government implements regulations to:

- Require specific-ingredient labelling on food products, like palm oil;
- Change or strengthen our country of origin labelling system;
- Require the display of 'health stars' or 'traffic lights' on the front of packaged foods;
- Ban the import of products that are dangerous or potentially dangerous; or
- Improve the Australian Consumer Law to, for example, ban unfair trading or to strengthen consumer guarantees.

The TPP has been signed, but there is still an opportunity for the Federal Government to minimise the worst of the risks that the trade agreement carries with it. CHOICE urges the Government to take steps to re-negotiate on a party-by-party basis provisions that will allow Australia to opt out of ISDS mechanisms with all participating countries. As a matter of priority, opt outs should be secured with the United States and Japan, given their stable legal systems and the lack of existing ISDS agreements between Australia and those two countries.

The Government has already opted out of ISDS with New Zealand. It should seek the same option with the rest of the TPP parties. This won't resolve all of the issues that CHOICE has raised with the TPP. For instance, excising ISDS from the agreement does not address the risks associated with locking in outdated copyright provisions that would benefit from reform. However, it will help reduce the risk of harm and safeguard our Parliament's ability to make laws that benefit Australians.

Recommendation

The Australian government should not ratify any international treaty containing an Investor-State Dispute Settlement Mechanism.

- CHOICE recommends that the Federal Government take steps to opt out of ISDS with individual parties to the TPP by negotiating side letters using the Australia- New Zealand side letter as a model. Agreements with Japan and the United States should be prioritised.

Investor State Dispute Settlement

ISDS clauses found in free trade agreements or investment treaties operate to grant foreign investors the right to access an international tribunal if they believe actions taken by a host government are in breach of commitments made in the agreement.[1] The TPP includes ISDS, although Australia and New Zealand have bilaterally agreed to not utilise this section of the agreement in respect of investors from each country operating in the other.[2]

CHOICE opposes the inclusion of ISDS clauses in trade agreements, including the TPP. ISDS clauses are not necessary in agreements between nations that have confidence in the integrity of each other's legal systems.

ISDS clauses can operate to give special preferential treatment to foreign investors in comparison with domestic investors, in part by enabling foreign companies to challenge the decisions of Australian superior courts in international tribunals, whereas domestic companies have no such avenue of appeal.

In addition, ISDS provisions can damage the sovereignty of Australia and encourage the government to avoid passing laws that are in the public interest if they also risk negatively impacting on business. These clauses have the potential to constrain or 'chill' the development of public interest policy and law, by providing foreign investors with a pathway for having laws declared to be in breach of international trade agreements. Governments wanting to avoid costs and penalties may avoid passing contentious legislation altogether, even in instances where legal reform could provide a significant public benefit.

While ISDS clauses pose significant risks, these mechanisms are simply not necessary. As the Cato Institute has noted, companies have open to them a simple and effective way to mitigate

[1] Definition as per Department of Foreign Affairs and Trade, 'Frequently Asked Questions on Investor-State Dispute Settlement (ISDS)', available at https://www.dfat.gov.au/fta/isds-faq.html

[2] Trans-Pacific Partnership Agreement, Chapter 9, section B: Investor-State Dispute Settlement, and letter dated 4 February 2016, 'Australia – New Zealand: Investor State Dispute Settlement, Trade Remedies and Transport Services', numbered paragraphs 3 and 4.

risk - by buying insurance.[3] Under ISDS, the Australian public is subsidising international companies, effectively paying for insurance on their behalf. This situation is unfair and unnecessary, and could be addressed by refusing to negotiate free trade agreements that include ISDS mechanisms. In the case of the TPP, an option would be to negotiate on a party-by-party basis to opt out of ISDS.

ISDS clauses are not appropriate in trade agreements

CHOICE is opposed to ISDS provisions in trade agreements because they prevent sensible law reform in the interests of consumers. ISDS provisions, including in the TPP, are not necessary to protect business interests and offer no benefits to the Australian public.
There has been growing concern about the appropriateness of ISDS provisions from a number of authoritative sources. Critics of ISDS include the Productivity Commission (PC) and the Chief Justice of the High Court. The PC found that there is no economic reason for including ISDS clauses in trade agreements, and that such clauses are associated with significant risks:

> *"Australia should seek to avoid accepting ISDS provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already afforded in Australian law".*[4]

More recently, in 2014 Chief Justice French expressed serious concerns about ISDS, noting the tensions that exist between ISDS arbitration and the legitimate functioning of the parliament, executive branch of government and the courts.[5] His Honour referenced a paper by the EU Parliamentary Research Service that identified no less than nine significant procedural issues with ISDS, including the very high costs borne by governments, the vagueness and inconsistency in interpretation of ISDS clauses and the absence of any effective review or appeal processes.

It is fair to say that ISDS provisions are not novel; these clauses are included in 21 bilateral investment treaties that Australia is party to. However, up until the negotiation of the Australia-US free trade agreement (AUSFTA), ISDS was included primarily in agreements with developing countries, for the purpose of protecting Australian investment from expropriation by governments in countries lacking a strong rule of law. During AUSFTA negotiations, the

[3] Ikenson D., 4 March 2014, 'A Compromise to Advance the Trade Agenda: Purge Negotiations of Investor-State Dispute Settlement', Free Trade Bulletin No. 57, The Cato Institute, available at http://www.cato.org/publications/free-trade-bulletin/compromise-advance-trade-agenda-purgenegotiations-investor-state
[4] Productivity Commission Research Report, Bilateral and Regional Trade Agreements, November 2010.
[5] French CJ, 9 July 2014, 'Investor-State Dispute Settlement: A Cut Above the Courts?', available at http://www.hcourt.gov.au/assets/publications/speeches/current-justices/frenchcj/frenchcj09jul14.pdf

Government of the day decided that ISDS clauses were not necessary due to the participating countries' "open economic environments and shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems".[6]

In 2011, the then Government committed to excluding ISDS clauses from future agreements due to their potential to "constrain the ability of Australian governments to make laws on social, environmental and economic matters".[7]

On 28 August 2014, the Senate's Foreign Affairs, Defence and Trade Legislation Committee released a report on the *Trade and Investment (Protecting the Public) Bill 2014*.[8] The bill, if passed, would have operated to prevent the inclusion of ISDS clauses in future free trade agreements. The Committee recommended the bill not be passed, in part because of a view that ISDS risks could be managed more effectively and in ways that do not require legislation, including through careful treaty drafting. Unfortunately, this view was not followed during the drafting of the TPP, and now alternate risk-management strategies need to be considered.

Protecting the right to regulate

As discussed above, the inclusion of ISDS in the TPP has the potential to restrict the development of public interest policy by opening up Australian governments to legal action in response to the introduction of new laws. One option Australian governments will likely take to manage this risk will be to avoid introducing contentious new policies even in circumstances where reform could lead to substantial public benefit.

The TPP includes 'carve-out' clauses alongside ISDS, which theoretically seek to protect the right to pass certain laws. Carve-out clauses generally aim to prevent laws on specific topics from forming the basis of ISDS actions. The TPP includes two carve-outs intended to prevent certain laws and policies from being challenged under ISDS: one specific carve-out for tobacco control measures, and one general carve-out for public health and the environment "except in rare circumstances".[9]

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[6] Statement by DFAT, in response to the recommendation by the Senate Foreign Affairs, Defence and Trade References Committee that ISDS clauses not be included in AUSFTA.

[7] Aust. Government, Department of Foreign Affairs & Trade, Gillard Government Trade Policy Statement, April 2011, 'Trading Our Way to More Jobs and Prosperity', available at http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html

[8] Available here - http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/Trade_and_Foreign_Investment_Protecting_the_Public_Interest_Bill_2014/~/media/Committees/fadt_ctte/trade_foreign_investment/report.pdf

[9] See Chapter 29, Exceptions and General Provisions, Article 29.5: Tobacco Control Measures and Chapter 9, Investment, Annex 9-B: Expropriation.

In theory, a government that has signed an agreement including a carve-out like this could enact legislation that impacts on a company's profits without risk of being sued, provided the law is for the purpose of environmental protection. In practice, however, these carve-outs have not provided the protection they were designed to. For instance, the Canadian-North American Free Trade Agreement included a carve-out for environmental policy. Despite this, a US gas company was able to use the agreement's ISDS mechanism to sue the Canadian government for $118.9 million USD in lost profits following a ban on fracking.[10]

Another challenge with carve-out clauses is that they require the drafters to foresee the range of public interest issues that may be important to future legislators, which is a dangerously unrealistic expectation. For instance, a carve-out clause like that included in the TPP will, even if it functions perfectly, only prevent actions being taken that relate to tobacco control measures, public health and the environment. Consumer rights, on the other hand, are not the subject of a carve-out and laws passed on this topic remain at risk of ISDS action.

The right of governments to regulate in the public interest must be protected. The best way to retain this right is to ensure that ISDS is not included in any trade agreement. Carve-out clauses may be effective provided careful thought is given to the construction of clauses – the tobacco carve out included in the TPP, for instance, may effectively mitigate the risk of the Australian Government losing an ISDS case brought in objection to tobacco control legislation. However, the strength of this carve out highlights the weaknesses inherent in the general carve outs. If the general public health carve out were likely to be effective, there would be no need for a specific tobacco carve out. Given the weakness of the general carve out, we recommend that steps be taken to negotiate bilateral ISDS opt outs with all parties to the TPP, in particular the US and Japan.

Indirect expropriation

Expropriation is defined as 'the action of the state in taking or modifying the property rights of an individual in the exercise of its sovereignty'.[11] In its general use, expropriation carries a connotation of 'a "taking" by a governmental-type authority of a person's "property" with a view to transferring ownership of that property to another person".[12] In relation to free trade agreements, two concepts of taking property have developed: direct expropriation, a 'legislative

[10] This case is active, see http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/lone.aspx?lang=eng
[11] See Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/expropriation
[12] S.D. Myers Inc. v Government of Canada, Partial Award (Nov. 13, 2000), International Legal Materials, para. 280

or administrative act that transfers the title and physical possession',[13] and indirect expropriation, a murky phrase which involves "the effective loss of management, use or control or a significant depreciation of the value of the assets of a foreign investor."[14]

Indirect expropriation can refer to almost any administrative or legislative act that impacts on the way in which a business is able to conduct itself. For example, indirect expropriation could potentially arise from passing a law requiring new country of origin labelling, as implementing this labelling could impact on a business's profits as consumers choose to purchase products made in Australia over other sources.[15] The concept of "indirect expropriation" is unique to international investment arbitration, and is not recognised in most national legal systems, including Australia's.[16]

The TPP will allow ISDS claims to be brought in cases of indirect expropriation.[17] As has been observed by respected academics, this will "allow foreign investors to claim government actions (such as the plain packaging laws) require technically unlimited financial compensation because of a slightly higher burden in complying with the law".[18]

The fact that the TPP enables action under ISDS for indirect expropriation of profit compounds the risk of constraining the Australian Government's ability to develop public interest policy. The Australian Government should have the power to make executive decisions and create laws in the public interest, even if these decisions could have a negative impact on the interests of individual corporations and investors.

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[13] UNCTAD, Taking of Property. UNCTAD series on issues in international investment agreements (UNCTAD/ITE/IIT/15), UN, 2000, p3, cited in El Attar et al, June 2009, 'Expropriation clauses in international investment agreements and the appropriate room for host States to enact regulations: a practical guide for States and Investors', The Graduate Institute, Geneva, available at http://graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Research%20Projects/Trade%20Law%20Clinic/Expropriation%20clauses%20in%20International%20Investment%20Agreements%20and%20the%20appropriate%20room%20for%20host%20States%20to%20enact%20regulations,%202009.pdf

[14] Ibid.

[15] For example, the WTO case against the US brought by Canada and Mexico objecting to country of origin labelling requirements for beef. See World Trade Organization, 20 October 2014, 'WTO issues compliance panel reports on US "country of origin" disputes', available at https://www.wto.org/english/news_e/news14_e/384_386rw_e.htm

[16] As discussed in the Australian Fair Trade and Investment Network Ltd's (AFTINET) submission to the Senate Foreign Affairs, Defence and Trade Legislation Committee Inquiry into the Trade and Foreign Investment (Protecting the Public Interest) Bill 2014, April 2014, available at http://aftinet.org.au/cms/sites/default/files/AFTINET%20submission%20ISDS%200404.pdf

[17] Article 9.8 of Chapter 9 – Investment, available at http://dfat.gov.au/trade/agreements/tpp/official-documents/Documents/9-investment.pdf

[18] Faunce T., 29 August 2012, 'An Affront to the Rule of Law: International Tribunals to Decide on Plain Packaging', The Conversation, available at http://theconversation.edu.au/an-affront-to-the-rule-oflaw-international-tribunals-to-decide-on-plain-packaging-8968, as cited in Rimmer, M., April 2014, 'Trojan Horse Clauses: Investor-State Dispute Settlement', available at http://works.bepress.com/matthew_rimmer/178

Procedural fairness

Given that ISDS clauses developed to protect investors operating in countries with a weak rule of law, it stands to reason that if Australia is to sign and implement an agreement including ISDS, like the TPP, the procedural elements of the ISDS system should be at least on par with our domestic legal system. That is, there must be safeguards against abuse of process, requirements for transparency and accountability in decision-making, the guaranteed independence of the decision-makers, and opportunities to have decisions reviewed through appropriate appellate mechanisms. The TPP attempts to address some, but not all, of these concerns.

Ideally, proceedings should be public and recorded in a public database. Article 9.24 of the TPP's Investment Chapter provides for increased transparency; pleadings, transcripts and other documents will need to be made available to the public. Hearings will be open to the public, and the tribunal has the discretion to accept *amicus curiae* submissions from non-disputing parties who have a significant interest in the proceedings. This is a positive move that should result in greater transparency. However, this alone will not be enough to engender public trust in the arbitration process.

One significant concern in ISDS arbitration is the lack of independence of the decision-makers. Arbitrators should be held to a similar standard of independence as judges in Australia; they should not also be permitted to act as advocates or advisors, and should not be involved in matters that could result in a real or perceived conflict of interest. Tribunals should develop precedent and give weight to the decisions and law of the host country and to previous Tribunal decisions in order to promote consistency and accountability in decision-making. TPP arbitrators will be appointed from a pool of lawyers who may be acting as advocates in other matters. Under the TPP, each disputing party can appoint one arbitrator, with the presiding arbitrator appointed by agreement. This does not address the possible conflicts of interest. The TPP arbitration process also does not provide an effective avenue for appeal.

In contrast, the European Commission has proposed a new system for dealing with ISDS, an 'Investment Court System' for use in ISDS cases arising under the Transatlantic Trade and Investment Partnership (TTIP) and future EU investment negotiations. The new system will be "composed of fully qualified judges, proceedings will be transparent, and cases will be decided on the basis of clear rules. In addition, the Court will be subject to review by a new Appeal

Tribunal."[19] While it is too early to reach a definitive conclusion on whether this new system adequately addresses concerns or not, it was announced after extensive public consultation and acknowledges that the ordinary ISDS arbitration processes are flawed.

ISDS is not a necessary element of the TPP

It is possible to enter into the TPP without including ISDS. Australia and New Zealand have opted out of ISDS processes between the two nations and their investors. The side letter on investment between Australia and New Zealand states that:

- No investor of New Zealand shall have recourse to dispute settlement against Australia under Chapter 9, Section B (Investor-State Dispute Settlement) of the TPP Agreement; and
- No investor of Australia shall have recourse to dispute settlement against New Zealand under Chapter 9, Section B (Investor-State Dispute Settlement) of the TPP Agreement.

ISDS is not necessary when dealing with countries whose legal systems we trust, and this side letter provides proof that the Department of Foreign Affairs and Trade accepts that. If ISDS were necessary, we would not have risked opting out of it with New Zealand.

When the Australia-United State Free Trade Agreement (AUSFTA) was negotiated, the government of the time was clear in its view that ISDS was not necessary due to the countries' "open economic environments and shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems".[20]

The same justifications for excluding ISDS from AUSFTA apply to the TPP. The same justifications for seeking to opt out of ISDS with New Zealand particularly apply to our dealings with the United States, Japan, and the various other parties to the TPP with reliable legal systems comparable to Australia's. For instance, Canada's government has paid US corporations more than CAD$200 million in the seven ISDS cases brought under the North American Free Trade Agreement (NAFTA) that it lost. Just defending cases that may not be successful for the US claimants has also been extremely expensive for Canada, costing over

[19] European Commission First Vice-President Frans Timmermans, 16 September 2015, Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations, http://europa.eu/rapid/press-release_IP-15-5651_en.htm

[20] Statement by DFAT, in response to the recommendation by the Senate Foreign Affairs, Defence and Trade References Committee that ISDS clauses not be included in AUSFTA.

CAD$65 million to date. Canada and Australia are both dominated by US investors.[21] Australia could see a similar rush of US-led ISDS cases if the TPP is ratified without an ISDS opt-out between the US and Australia.

The costs of ISDS

After the introduction of tobacco plain-packaging rules in Australia, cigarette companies unsuccessfully challenged the new laws twice in our High Court. Rather than accept the court's decision, Philip Morris Asia acquired Philip Morris Australia and challenged the plain packaging rules using an ISDS provision in a 1993 bilateral investment treaty between Hong Kong and Australia.

To access the benefits of ISDS, an investor has to be from one party, bringing an action against the other party's government. In this case, the investor would need to be from Hong Kong, bringing a case against the Australian Government. Philip Morris Australia was an Australian company, so could not access the arbitration provided in the investment treaty. Almost a year after the government announced the plain packaging policy, Philip Morris Asia acquired Philip Morris Australia.

On 18 December 2015, the international tribunal hearing the case rightly decided that it had no jurisdiction to hear Philip Morris Asia's claim. Philip Morris clearly tried to manipulate its corporate structure to take advantage of the ISDS system.

No decision was made on the substance of the case. Had Philip Morris Asia acquired Philip Morris Australia a year earlier, the case likely would have proceeded and it is not clear whether the Australian Government would have won on the merits or not. The Philip Morris decision on a procedural matter does not affirm the right of the Australian Government to pass laws in the public interest without being subject to ISDS action. The substance of the Philip Morris decision has yet to be published due to the confidentiality regime governing the arbitration.

Even when ISDS cases are successfully defended by governments, they cost taxpayers enormous amounts of money. Reports estimate that the recent Philip Morris ISDS action cost

[21] Nearly 50% of Canada's investors (Tienhaara K, 9 October 2015, 'Canada has an ISDS clause with the US. It has faced 35 challenges. Is this Australia's future?', The Conversation, available at https://theconversation.com/canada-has-an-isds-clause-with-the-us-it-has-faced-35-challenges-is-this-australias-future-48757) and 27% of Australia's (Australian Bureau of Statistics, 8 May 2015, 'International Investment Position: Australia: Supplementary Statistics 2014', available at http://www.abs.gov.au/ausstats/abs@.nsf/mf/5352.0) are US-based.

us approximately $50 million in fees.[22] The OECD estimates a lower, but still substantial, average cost for ISDS arbitration at roughly $8 million per case. As discussed above, Canada's government has paid US corporations more than CAD$200 million following ISDS cases brought under NAFTA, and spent CAD$65 million to date defending cases that have not yet been settled or decided.

Recommendation

The Australian Government should not ratify any international treaty containing ISDS.

- CHOICE recommends that the government take steps to opt out of ISDS with individual parties to the TPP by negotiating side letters using the Australia-New Zealand side letter as a model. Agreements with Japan and the United States should be prioritised.

[22] Martin P, 28 July 2015, 'Australia faces $50m legal bill in cigarette plain packaging fight with Philip Morris', Sydney Morning Herald, available at http://www.smh.com.au/federal-politics/political-news/australia-faces-50m-legal-bill-in-cigarette-plain-packaging-fight-with-philip-morris-20150728-gim4xo.html