



5 DECEMBER 2014

LITIGATION UPDATE:

A SNAPSHOT OF THE INVESTOR-STATE DISPUTE SETTLEMENT FRAMEWORK IN AUSTRALIA'S ASIAN FREE TRADE AGREEMENT TRIFECTA

On 17 November 2014, Australia and China concluded negotiations over the China-Australia Free Trade Agreement (FTA) with the text of the agreement to be finalised in 2015. Our [previous article](#) flagged that the change of government in Australia meant a shift toward the inclusion of investor-state dispute settlement (ISDS) provisions in bilateral investment treaties and free trade agreements. That shift is manifest in the text of the agreements that Australia has entered into with China, Japan and Korea. This article considers the trifecta of agreements, their ISDS clauses, and the impact on business in the Asia-Pacific region.

As the Australian economy attempts to adapt following the end of the mining boom, the Australian government has proactively taken steps to enter into free trade agreements with its key trading partners in the Asia-Pacific region. This effort to break down trade barriers and promote foreign direct investment has culminated in a "trifecta" of free trade agreements, namely:

- On 8 April 2014, Australia and the Republic of Korea entered into the Korea-Australia Free Trade Agreement (KAFTA);
- On 8 July 2014, Australia and Japan signed the Japan-Australia Economic Partnership Agreement (JAEPA); and
- On 17 November 2014, Australia and People's Republic of China concluded negotiations over the China-Australia Free Trade Agreement (ChAFTA).

These agreements will promote trade between the States and should increase the investment flows between the States that are a party to each agreement through the safeguard of ISDS provisions (although the JAEPA does not include ISDS provisions, Australia and Japan have committed to review the inclusion of ISDS provisions).

Of course, Australia is also negotiating the Trans-Pacific Partnership Agreement (TPP) with 11 other States (including Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam) in an effort to establish a free trade area in the Asia-Pacific region. Early indications indicate that the TPP will include an ISDS provision. Australia's free trade agreements with Chile, Singapore, Thailand and ASEAN (including New Zealand) include ISDS provisions.

THE PURPOSE

The purpose of including an ISDS provision in any free trade agreement is as a safeguard for investors, offering investors from a party State the ability to arbitrate any disputes with the other party State in the agreement (Host State). Investors need not commence proceedings against the Host State in the Host State's court system (where independence, impartiality, etc. come into question).

The ISDS provisions insulate investors from types of sovereign risk that could materialise, such as the expropriation of an investors' assets or changes in policy that unfairly affect the rights of investors.

As a starting point, investors should always consider its place of incorporation and whether that place is a State which has an agreement with the State in which the investor is investing. If an agreement exists, the investor should consider whether its investment falls within the scope of the ISDS clause in the relevant treaty or agreement.

Usually, an "investment" is simply an asset that the investor owns or controls in the foreign State, such as an enterprise, intellectual property rights or shares. The definitions vary between agreements and it is important to consider each investment on a case-by-case basis.

THE KAFTA

The Department of Foreign Affairs and Trade (DFAT) has [indicated](#) that the KAFTA should enter into force towards the end of 2014. Chapter 11 of the KAFTA addresses investor-state disputes:

- Section A sets out the investment conditions that Australia and Korea must afford foreign investors, including prohibiting either State from expropriating foreign investors' assets.
- Section B of Chapter 11 contains the ISDS provisions that Australian or Korean investors might utilise if those conditions are not met.

In order to determine the threshold issue as to whether an investment qualifies under the provisions, Article 11.28 of the KAFTA provides:

- "investment" means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

- "investor" means a Party, a state owned enterprise of a Party, a national of a Party, or an enterprise of a Party, that attempts to make, is making or has made an investment in the territory of the Host State.

Article 11.15 of the KAFTA provides that before a claimant engages the ISDS provisions, they ought to attempt to resolve the dispute through consultation or negotiation.

Interestingly, the KAFTA expressly provides that, except in rare circumstances, non-discriminatory regulatory action by Australia or Korea that legitimately protects matters of public welfare (e.g. health) does not amount to an indirect expropriation that can be pursued under the ISDS provisions (this is detailed in Annex 11-B to the KAFTA). This protects Australia and Korea from being involved in an investor-state dispute [similar to the one commenced by Phillip Morris Asia Limited against Australia](#) in relation to the Tobacco Plain Packaging Act 2011 (Cth) which was alleged to constitute an expropriation of Australian investments.

THE JAEPA

DFAT has also stated that the JAEPA should enter into force in early 2015 and sets out the investment conditions that Japan and Australia must afford investors (e.g. Articles 14.3 to 14.6 of the JAEPA), including a prohibition under Article 14.11 on either State from expropriating foreign investors' assets.

The JAEPA does *not* include ISDS provisions. To the extent that these standards are not met or there is some form of non-conformity with the JAEPA (e.g. a State expropriating an investor's assets) this will simply be a matter considered by a joint subcommittee of government representatives as provided by Article 14.18 of the JAEPA.

Under Article 14.19(1) of the JAEPA, Australia and Japan have committed to conduct a review to improve the investment environment under the JAEPA in the fifth year after it enters into force, including whether to not to establish an investor-state dispute resolution framework (presumably by way of ISDS provisions). Based upon JAEPA entering into force in 2015, this review would occur in around 2019.

However, the JAEPA is likely to be reviewed sooner because Australia and Japan agreed under Article 14.19(2) that, if Australia enters into any international agreement with ISDS clauses, a review will be conducted to consider the inclusion of an equivalent mechanism in the JAEPA. Presuming the JAEPA enters into force, we expect that this provision will be triggered by the entry into force of the ChAFTA and the review must be commenced within three months of that date.

THE ChAFTA

The ChAFTA will realign China's economic relationship with Australia, and allow Australia to benefit from the enormous growth and positive commercial change in Chinese markets. The text to the ChAFTA will not be released until 2015 however the Australian Government has announced that it will contain ISDS provisions.

The ChAFTA is an exciting development for Australian investors who are interested in the Chinese market but have reservations about the Chinese legal system and regulatory action. Similarly, the ChAFTA will protect Chinese individuals have invested in the housing market and Chinese state-owned enterprises have made significant investments into Australia.

For example, a Chinese Government policy to ban or censor a website that facilitates the purchase of certain goods or services could potentially damage Australian investors offering those goods or services. The Australian investor will want a mechanism at its disposal to allow for some claim for the loss of online sales.

The ChAFTA ISDS provisions may be similar to the provisions in the KAFTA. For example, we expect the ISDS provisions will include safeguards to protect the ability of both governments to regulate according to public welfare and interest. Investors must carefully consider the final text of the ChAFTA on release, to consider their scope and whether their investments qualify.

CONCLUSION

We expect that the FTAs that Australia has negotiated with Korea, Japan and China over the past 12 months should result in increased outbound and inbound investment over the next decade. The inclusion of ISDS provisions (or the commitment to review their non-inclusion, in the case of the JAEPA) should minimise the risk associated with these investments.

MORE INFORMATION

For any enquiries relating to the enforcement of a foreign judgment or the setting aside of a registered foreign judgment, please speak to one of the following contacts:



Gitanjali Bajaj
Partner
T +61 2 9286 8440
gitanjali.bajaj@dlapiper.com



Kirk Simmons
Senior Associate
T +61 2 9286 8111
kirk.simmons@dlapiper.com

OR CONTACT YOUR NEAREST DLA PIPER OFFICE

BRISBANE

Level 28, Waterfront Place
1 Eagle Street
Brisbane QLD 4000
T +61 7 3246 4000
F +61 7 3229 4077
brisbane@dlapiper.com

CANBERRA

Level 3, 55 Wentworth Avenue
Kingston ACT 2604
T +61 2 6201 8787
F +61 2 6230 7848
canberra@dlapiper.com

MELBOURNE

Level 21, 140 William Street
Melbourne VIC 3000
T +61 3 9274 5000
F +61 3 9274 5111
melbourne@dlapiper.com

PERTH

Level 31, Central Park
152-158 St Georges Terrace
Perth WA 6000
T +61 8 6467 6000
F +61 8 6467 6001
perth@dlapiper.com

SYDNEY

Level 22, No.1 Martin Place
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 8007
sydney@dlapiper.com

www.dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities.

For further information, please refer to www.dlapiper.com

Copyright © 2014 DLA Piper. All rights reserved.

1202259707 ASL 12|14