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Briefing note July 2015

The China Australia Free Trade Agreement – Investment Chapter

The China Australia free trade agreement (ChAFTA) was officially signed on 17 June 2015 by Australia's Trade Minister Andrew Robb and China's Commerce Minister Gao Hucheng. The investment chapter of the new treaty provides some basic protection for investors but with significant limitations. Furthermore, a number of key provisions have simply been given placeholders for future negotiations. This raises questions as to what coverage will be available for investors in the event that the Australia-China bilateral investment treaty (the Australia-China BIT) is terminated.

For commentary on other chapters and ChAFTA more generally, please click here.

Overview

While ChAFTA is predominantly focused on the promotion of trading activity, Chapter 9 covers bilateral investment. The only substantive protection for Australian and Chinese investors making covered investments is the right to non-discriminatory treatment – the host state is obliged to treat investors from the other state no less favourably than it treats its own national investors.

This kind of protection is designed to prevent a range of potentially unfair measures, for example, discriminatory taxation treatment or unequal regulatory requirements. However, without granting other protections such as the obligation to accord investors fair and equitable treatment, national legislation could still be used by the state to impair or expropriate investments.

These further protections are currently available under the Australia-China BIT (which has its own limitations – see insert). However in the investment chapter of ChAFTA they are expressly highlighted as areas for future negotiation. This suggests that the Australia-China BIT may be terminated or revised. If it is terminated, and no new investment treaty is put in place, ChAFTA alone will leave investors with very little in terms of enforceable rights against the host state.

Who and what is protected?

Individual nationals and corporations incorporated in either Australia or China are afforded protection as investors under ChAFTA. However, there is a limitation on investor identity in the form of a "Denial of Benefits" clause. This means that investments made through an Australian or Chinese company that (a) does not have substantial business operations in its home country, and (b) is not ultimately owned by investors from that country, would not be protected by ChAFTA.

The definition of "*investment*" in the treaty is broad however, covering direct and indirect investments. This is good news for investors who use complex ownership structures as well as allowing for investments to be flexibly structured for subsequent sale. For example, it would be possible for an Australian investor to make an investment in China through a holding company located in Singapore or the Netherlands and still obtain the benefit of ChAFTA protection.

The types of investments covered include:

- subsidiary companies and branches;
- most forms of debt and equity securities;

- contractual rights;
- intellectual property;
- concessions, licences, authorisations and permits; and
- tangible and intangible property, property rights and security.

In terms of its temporal scope, ChAFTA covers pre-FTA investments but only in relation to *post*-FTA measures.

The protections

National Treatment

ChAFTA provides that investors and investments covered by the treaty will be afforded treatment that is no less favourable than that which each state confers upon its own nationals "*in like circumstances*". This means that where an investor wishes to challenge a measure on the basis that it is discriminatory, its position will have to be compared against a national company working in the same sector.[i] However, the definition of "*in like circumstances*" is open-textured and it may be possible for a state to raise other factors such as the size of an enterprise or market share in order to defeat claims.

Additionally, international law jurisprudence allows for states to defend claims against discriminatory measures, on the basis that the relevant measure is in the public interest or achieves legitimate public policy objectives. For example, state subsidies for national companies in particular sectors may be excused. Some international tribunals have also taken the view that for breach to be established, it is necessary to establish intention to discriminate.[ii]

Most Favoured Nation

ChAFTA also purports to offer investors and investments "most favoured nation" treatment – meaning that Australia and China are obliged to treat each others investors and investments with no less favourable treatment than they grant to other foreign investors. However, protections given to investors under existing bilateral or multilateral agreements are excluded. Protections relating to aviation, fisheries and maritime matters given to investors in *future* treaties are also excluded. The net result is that, at present, most favoured nation treatment does not materially enhance the position of investors under ChAFTA.

In sum, ChAFTA offers fewer protections than those available to investors under the Australia-China BIT.

Carve-outs

All provisions of the investment chapter are subject to a number of significant carve-outs including measures to protect public health[iii] and the natural environment (so long as such measures are not arbitrary, unjustifiably discriminatory or disguised restrictions on international investments and trade). It is probable that the impetus for these carves-outs came from Australian negotiators who would have been mindful of the Philip Morris arbitration (where treaty provisions are being used to challenge Australia's tobacco plain packaging legislation).

Additionally, there is a carve-out for measures relating to "*the conservation of living or non-living exhaustible natural resources*". This carve-out gives the host state a relatively wide discretion to implement measures that may affect investors and investments in the energy and resources sector.

Exclusion for investments relating to government procurement

Government procurement is expressly excluded from the scope of "investments" that are covered by ChAFTA. From an Australian investor's perspective, it is unclear whether this exclusion extends to investments relating to procurement by SOEs.[iv] Given the proliferation of SOEs across the Chinese economy, if this exclusion does apply to dealings with SOEs, a significant number of Australian investors in China would not be afforded protection under ChAFTA.

From the Australian government's perspective, it may have sought to reserve its freedoms in relation to government procurement contracts given the public scrutiny that followed its engagement with Japanese companies for the possible award of submarine contracts in South Australia in 2014.

More clarity around this issue will come in the future - Chapter 16 of ChAFTA provides that the parties will commence negotiations regarding government procurement as soon as possible after China has completed negotiations on its accession to the WTO Agreement on Government Procurement (GPA).[v] Australia has also recently announced its intentions to accede to the GPA.

Arbitration

The investment chapter of ChAFTA provides for Investor-State Dispute Settlement (ISDS). At first instance, any dispute must be the subject of consultations between the disputing parties. If a settlement cannot be reached by consultation within 120 days, the claimant may submit the

claim to arbitration in accordance with the Chapter. However, only an alleged breach of Article 9.3 (national treatment) may be submitted to arbitration. Most favoured nation treatment is not subject to ISDS.

ChAFTA arbitration may take place under the ICSID Convention and Rules of Procedure, the ICSID Additional Facility Rules, the UNCITRAL Arbitration Rules or any other arbitration rules or at any other arbitration institution agreed by the disputing parties. While ChAFTA contains China and Australia's consent to the submission of a claim to arbitration there are temporal limits on the ability to make claims. Claims must be submitted:

- within three years from when the claimant had (or should have had) knowledge of the breach and resulting loss or damage; and
- not later than four years since the occurrence of the measures and/or events giving rise to the alleged breach.

Interestingly, China and Australia have undertaken to commence negotiations for an appellate and review mechanism for the hearing of questions of law arising out of arbitral awards issued under the ChAFTA investment chapter. Such an appellate mechanism would be unusual and it will be interesting to learn the particulars of any agreement on this aspect.

Future Work Program

While there are significant limitations on the effectiveness of the investment chapter (as described above), we note that it includes a formal placeholder for negotiations to take place between Australia and China for further investment protections. These negotiations will include discussion on protection from expropriation, imposing minimum standards of treatment for investments and the application of investment protection and ISDS to services supplied through commercial presence.

In the meantime, it remains to be seen whether either Australia or China will make a move to terminate the Australia-China BIT.

The Australia-China BIT

The Australia-China BIT entered into force on 11 July 1988. It covers investments made by Australian and Chinese investors in each other's territory.

The protections afforded to covered investments include:

- an obligation on the host state to ensure fair and equitable treatment towards investment;
- an obligation on the host state to treat investments with no less favourable treatment than that afforded to investments made by any other foreign investor;
- rights of access to the host state for the management of the investment;
- access to justice;
- protection from unlawful expropriation; and
- free movement of investment capital, proceeds and returns.

These protections are relatively comprehensive, however, the dispute resolution clause is a source of debate – it is doubtful that arbitration at the International Centre for the Settlement of Investments Disputes (ICSID) is available for any claims, except expropriation claims, without China's express agreement. To date there have been no registered ICSID arbitrations under the Australia-China BIT.

The Australia-China BIT can be terminated by either party giving one year's notice to the other. Upon termination, investments made or acquired prior to the date of termination will be protected for a "sunset" period of 10 years.

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i This was the measure used by tribunals in the NAFTA cases, notably *S D Myers v Canada*, First Partial Award, 13 November 2000, 40 ILM (2001) 1408.

ii For example, *Genin v Estonia*, Award, 25 June 2001, 17 *ICSID Review* (2002) 395.

iii The issue of public health is also addressed in Chapter 5: Sanitary and Phytosanitary (SPS) Measures, which aims to promote food safety and plant and animal health through cooperation and technical assistance between the parties. In this connection, ChAFTA builds upon existing commitments under the WTO SPS Agreement, the purpose of which is to address the risks that arise from the import and export of SPS products whilst simultaneously ensuring that governments do not use the "health and safety" banner as a guise to discriminate against foreign producers.

iv China's existing government procurement framework is fragmented.

v The GPA aims to break down legal barriers for foreign firms competing for public contracts. This is of special significance to China where public procurement represents such a substantial part of the economy and market access for foreign investors competing for public contracts is notoriously difficult.

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