UK-Australia FTA—what's in store for investor protection?

Arbitration analysis: On 17 June 2021, the UK Department for International Trade (DIT) published the agreement in principle (AIP) reached between the UK and Australian governments in their negotiations on a proposed free trade agreement (AUKFTA). The two governments will now move towards conclusion of a detailed FTA. Gordon Nardell QC, barrister and arbitrator at Twenty Essex provides an analysis on the investment protection and dispute settlement aspects found in the AIP.

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Original news

Beyond Brexit—DIT publishes UK-Australia Free Trade Agreement in principle, LNB News 17/06/2021 69

What is the background?

The UK's post-Brexit approach to international trade agreements is being watched closely by business, political and legal observers. To date the UK's most significant concluded agreement, in both economic and political terms, is the UK-EU Trade and Cooperation Agreement (TCA) itself. The UK is the second largest source of foreign investment in Australia after the US, with 2020 total investment stock estimated at AU$738bn (£390bn) including AU$123bn (£65bn) in foreign direct investment (FDI). Australian foreign investment in the UK was valued in 2020 at £326bn (AU$615bn) including £71.5bn (AU$135bn) FDI.

Yet the overall impact of the AUKFTA on existing flows of goods, services and investment is predicted to be modest: the DIT estimates an long-term gain of £500m in UK GDP, equivalent to just 0.001% of UK GDP. However, an important subtext to the UK-Australia negotiations is the UK's desire to accede to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), whose 11 members (which include Australia as a potentially influential supporter of UK membership) together represent some 13% of global GDP. Thus the terms of the TCA and CPTPP, and to some extent the UK-Japan Economic Partnership Agreement (EPA) concluded in October 2020, form a useful starting point for understanding the shape of the investor protection provisions likely to appear in the AUKFTA.

What does the AIP provide with respect to protection of investments?

The AIP covers four general areas: trade in goods, trade in services, mobility, and state-owned enterprises and designated monopolies (SOEs). Investor protection appears under the mobility heading. The AIP foreshadows the following commitments:

- market access for investments, ie prohibition of quantitative restrictions on investment, with any reservations on a 'whole territory' and negative listing basis. Wording to confirm that 'whole economy' market access will be equivalent to UK-Canada
- prohibition of nationality and residence requirements for senior management, and 'all Prohibition of Performance Requirements [PRRs] included in the CPTPP'

- commitment to consult on additional PRRs 'to minimise market distortions, potential barriers and bureaucracy faced by investors'. The listed PRRs are HQ localisation requirements, mandatory R&D levels, export restrictions and local hiring requirements
- the usual collection of international investment guarantees 'on the CPTPP model': Most Favoured Nation (MFN), protection from unfair or discriminatory treatment, prohibition of expropriation. The AIP text reflects the sensitivity of sovereign right to regulate, promising that while granting these protections 'the right of states to regulate in the public interest will be preserved'
- special provisions on investment in air services
- free transfer of funds not to prevent implementation of economic sanctions
- investment screening threshold raised to at least the US/CPTPP levels

Given that both sides publicly trailed their negotiating positions during 2020, there are few surprises in these high-level descriptions of prospective AUKFTA provisions. On some points, the express read-across to the corresponding CPTPP content removes much guesswork from the likely terms of the substantive FTA. On other points, the AIP text appears to leave the parties greater wriggle-room as they move towards a final text.

There will, for example, be considerable interest in the precise language the parties eventually agree to define the balance between the standard of treatment and the state's 'right to regulate'. The CPTPP calibrates that relationship through a variety of textual techniques. These range from footnoted references to generic 'legitimate public welfare objectives' (see eg footnote 14 to Articles 9.4 and 9.5), through more specific provisions integral to the operative text such as paragraphs (4) and (5) of Article 9.6, which qualify the extent to which the Minimum Standard of Treatment guaranteed by that article protects legitimate expectations and continuity of subsidies, to the overarching tie-breaker in Article 9.3(1) which gives precedence to conflicting provisions in other Chapters. The latter could include, for example, the labour and environmental commitments in Chapters 19 and 20 respectively, which the AIP also foreshadows for inclusion in the AUKFTA. Neither the UK-Japan EPA (see Articles 8.6–8.13) nor the TCA (Articles 127–133) offers comparable sophistication. However, given the 'gateway' objective of the FTA towards CPTPP accession, we can expect the AUKFTA text to incorporate at least some elements of the corresponding CPTPP provisions.

Some provisions of value to investors appear under other AIP headings. For example, guarantees on freedom for service providers to operate through establishment (presence of a national, aka GATS Mode 3) on the other party's territory, reinforced by generous sectoral guarantees, including those for legal services. The efficacy of those provisions, though, will depend crucially on the precise commitments the parties for mobility of persons. Here, the AIP appears to contemplate an entry and stay regime distinctly more liberal than the TCA, with commitments to remove economic needs tests for sponsored visas. The TCA in the case of GATS Mode 4 (temporary presence/'fly-in-fly-out') retains extensive scope for such tests through national reservations, and contains no express mobility commitments at all for GATS Mode 3 travel. The contrast reflects UK domestic Brexit politics: whereas the UK government was at pains to avoid any suggestion that the TCA replicated the EU free movement regime, that is less of constraint in negotiating reciprocal agreements elsewhere.

How are investment disputes proposed to be resolved?

The headline, expressed in blunt terms in the AIP, is that the AUKFTA 'will not include an Investor-State Dispute Settlement [ISDS] mechanism'. That is a departure from the CPTPP model, which provides investors with traditional arbitral ISDS recourse, but it is consistent with the TCA which envisages a World Trade Organization (WTO)-style state-to-state system, including arbitration, for resolving complaints of breach of its economic provisions. In the absence of any reference to an alternative from of recourse accessible directly by investors (such as the investment court model favoured by the EU), the assumption must be that the 'effective and timely dispute settlement mechanism' trailed in very general terms in the AIP AUKFTA will resemble the TCA scheme, as indeed does the mechanism under Chapter 22 of the UK-Japan EPA. The UK has announced the establishment of panels of potential

arbitrators for its post-Brexit FTAs on the basis that their role will resemble that of their TCA counterparts.

Within the UK government there is some support for inclusion of ISDS in the AUKFTA, evidenced by ministerial pronouncements in Parliament as recently as May 2021. But even if that view were to prevail on the UK side, it seems unlikely the Australian side would wish to reopen this aspect of the AIP. UK investors are frequent users of ISDS mechanisms while claims against the UK by inbound investors are rare, and none is known to have succeeded. Meanwhile ISDS provisions are a topic of greater political sensitivity in Australia in the wake of (ultimately unsuccessful) *Philip Morris Asia Ltd v The Commonwealth of Australia*, a case which challenged public health legislation on tobacco packaging. Thus the more pertinent debate is perhaps whether the absence of ISDS might impair investor confidence and thus constrain growth of investment flows. As ever, context is everything. The UK and Australia are long-standing constitutional democracies with similar common law judicial systems. Both can point to well-developed domestic administrative law regimes, accessible to nationals of the other party and readily capable of reining in official misbehaviour that impacts on economic interests. So absence of ISDS is likely to be at most a marginal factor in investor behaviour, in contrast, perhaps, to agreements between states economically and constitutionally more asymmetric.

Interviewed by Elodie Fortin

Gordon Nardell QC specialises in international litigation and arbitration. He has a particular focus on claims by and against state bodies, especially in the areas of energy, infrastructure and utilities. Gordon is also known for his work in other sectors including regulated markets such as transport, public/private partnerships and financial services.