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Protecting public welfare regulation through joint treaty party control: a ChAFTA innovation

by
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If countries wish to protect legitimate and non-discriminatory public welfare regulation from investor-state claims, what options do they have? This *Perspective* highlights an innovative feature in the recent China-Australia Free Trade Agreement (ChAFTA) that goes well beyond existing safeguards for protecting the regulatory autonomy of states by providing a mechanism for joint treaty party control. In doing so, ChAFTA evidences a new and controversial step in efforts to recalibrate interpretive authority between arbitral tribunals and the treaty parties acting collectively.

Newer-style investment treaties often seek to protect countries' regulatory autonomy by reaffirming the importance of public welfare regulation in the preamble, refining and clarifying core investment protections, and sometimes including general exceptions clauses. These approaches are useful but have limits. Preambular provisions are non-binding. Substantive clauses are binding, but states may not wish to allow arbitral tribunals to second-guess the permissibility of sensitive public welfare measures. Even if respondent states ultimately prevail, they are likely to expend considerable resources in time and money in defending claims.

Faced with these concerns, China and Australia broke new ground in ChAFTA by including a mechanism that protects public welfare measures through joint treaty party control. ChAFTA provides that "Measures of a Party that are non-discriminatory and for the legitimate public welfare objectives of public health, safety, the environment, public morals or public order shall not be the subject of a claim" by an investor.[1] If an investor challenges a regulatory measure, the respondent state is permitted to issue a "public welfare notice" specifying why it believes that the measure falls within this exception. The arbitration proceedings are then suspended and a 90-day consultation period with the other treaty party is triggered.[2]

If the treaty parties agree that the challenged measure fits within the scope of the carve-out, the decision is binding on any investor-state tribunal, and any decision or award issued by such a tribunal must be consistent with that decision.[3] Because the mechanism is triggered at an early stage of the process—the respondent state has 30 days to issue a notice after receiving a request for consultations from an investor—it may prevent an investor-state tribunal from being established at all. If the treaty parties are not able to agree on whether or not the measure falls within the carve-out during the 90-day consultation period, the matter falls to the investor-state tribunal to determine. The tribunal is not permitted to draw any adverse inference from the non-issuance of a public welfare notice by the respondent or from the absence of any decision between the treaty parties as to whether the measure falls within the scope of the exception.[4]

This ChAFTA mechanism represents a new step in a broader trend of states seeking to recalibrate the balance between investor protection and state sovereignty, and between the interpretive power of arbitral tribunals and treaty parties. Recent treaties evidence a rise in provisions that permit the treaty parties to provide an *interpretation* of the treaty that is binding on arbitral tribunals. The ChAFTA mechanism takes that a step further by allowing the treaty parties to reach an agreement on the *application* of their treaty that is binding on arbitral tribunals. This is consistent with the approach taken in some recent treaties with respect to joint treaty party control over matters relating to taxation and financial services, but the ChAFTA provision is considerably broader in scope.[5]

By requiring a joint decision of the treaty parties, ChAFTA limits the ability of respondent states to abuse the mechanism, which would be a more significant risk if the clause were self-judging. However, some will object to the measure as repoliticizing investor-state disputes by leaving investors at the mercy of joint decisions of the treaty parties. The clause does not include references to the public welfare measures being necessary or proportionate. Time constraints mean that a joint agreement is only likely to be reached in relatively clear-cut cases. There is also a question of how the mechanism would work between unequal treaty parties: there is a risk that a stronger party might lean on a weaker party to reach an agreement that was not warranted; or a stronger party might ignore attempts by a weaker party to reach an agreement that was justified.

Ultimately, whether the ChAFTA mechanism works well in practice will depend on how home states internalize their dual interests as capital exporters (who are interested in protecting their investors' rights) and capital importers (who are interested in protecting legitimate regulatory autonomy). If they get this balance right, the mechanism could provide an innovative modality for states wishing to protect legitimate and non-discriminatory public welfare measures through joint treaty control. If they get the balance wrong, however, the clause will engender controversy due to over-use or remain in obscurity due to under-use.

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[1] ChAFTA, Article 9.11.4.
[2] Article 9.11.5-9.11.6.
[3] Article 9.18.3.
[4] Article 9.11.8.
[5] *E.g.*, U.S. Model BIT, Articles 20, 21; Canada-China FIPA, Articles 20(2), 33(3).

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