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Peru- and Colombia-U.S. FTAs' Investor-State System Expands on CAFTA's Definition of Government Activities Subject to "Regulatory Takings" Claims

- **The Peru and Colombia FTAs' Investment chapter texts are nearly identical to CAFTA's Investment text, except that the definition of investments subject to investor-state enforcement extends beyond CAFTA.**

  Electronic comparisons of the CAFTA and Peru- and Colombia-U.S. "free trade" agreements' (PUFTA and CUFTA) Investment Chapters show that regarding sensitive issues, such as Expropriation and Compensation, Minimum Standard of Treatment, and the Definition of investment, no changes have been made to address concerns raised by many in Congress regarding the extensive nature of CAFTA's foreign investor rights. One aspect of the texts that has remained unchanged is the investor-state enforcement mechanism that allows foreign investors to demand compensation in UN and World Bank tribunals for U.S. laws that foreign investors believe are an "indirect" expropriation of their investment. Consider the Dear Colleague from New Democrat Coalition member Jane Harman and other California representatives: "We wanted to draw your attention to the attached *Los Angeles Times* article, describing the threat that the investor rights rules in the Central America-Dominican Republic Free Trade Agreement (CAFTA) pose to important state and local laws and regulations that protect the environment and public health. Like Chapter 11 of NAFTA, the investor rights provisions of CAFTA give foreign corporations the power to demand payment from the U.S. when public interest protections affect a company's commercial interests. Our state has witnessed the impact of these rules: foreign companies have brought NAFTA suits totaling more than $1 billion challenging a California law phasing out the toxic gasoline additive MTBE and one regulating mining operations to protect the environment and Native American sacred sites. The State of California has now joined state and local government groups in saying that U.S. trade negotiators failed to heed the lessons of NAFTA in their negotiation of the investor rights rules in CAFTA. We hope you will join us in opposing CAFTA." Many of the members of Congress who raised these concerns about the investor-state system's threat to basic environmental and health policies and opposed CAFTA on this basis are free traders eager to support trade agreements but for such extraneous investment provisions. Instead of addressing these concerns, USTR replicated them and indeed, as regard to the definition of investment in PUFTA and CUFTA, even extended the scope to include certain government procurement contracts.

- **PUFTA and CUFTA allow a foreign-owned company incorporated and operating in a signatory nation to use the Investor Rights rules, meaning the United States could face investor-state challenges from major multinational corporations or U.S. subsidiaries based in Peru or Colombia.**

  When members of Congress raised concerns in the context of CAFTA about U.S. regulatory policies facing investor-state claims, one counter-argument raised was that in reality U.S. firms would be the main users of such mechanisms given few Central American firms have sufficient capacity to seek investments in the U.S. market. Yet, the PUFTA/CUFTA definition of "enterprise of a Party," which is a term used in

defining who has investor rights, covers not only firms owned by Peruvian/Colombian nationals, but also foreign-owned firms that are "constituted or organized under the law of a Party."(PUFTA/CUFTA Article 1-3) Thus, PUFTA and CUFTA allow any firm incorporated and operating in Peru or Colombia, or even Peruvian- or Colombian-incorporated subsidiaries of U.S. firms, to challenge U.S. policy in investor-state tribunals.

- **PUFTA/CUFTA expand beyond CAFTA in its definition of what foreign investment activities are subject to investor-state enforcement by adding "written agreements" with the federal government to "supply services to the public," and "to undertake construction projects," which might expose Davis-Bacon to challenge.**

PUFTA/CUFTA (Article 10.28) go beyond even CAFTA to extend investor-state enforcement rights to any breach of an "investment agreement," (Article 10.16) which is defined to be: "a written agreement between a national authority...that grants rights to the covered investment or investor: …"

- "to supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or (and) telecommunications; or
- to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines(,) that are not for the exclusive or predominant use and benefit of the government." (Page 10-26)[1]

It is not in the U.S. national interest to allow foreign investors with federal contracts related to construction procurement or operation of domestic services to take disagreements about such contracts to investor-state tribunals under the FTAs' extensive grant of investor rights while U.S. firms with the same contracts would have their rights decided under narrower U.S. property rights law and in U.S. courts. Legal scholars have objected to subjecting such issues to adjudication outside U.S. courts. U.S. federal construction projects are subject to Davis-Bacon rules regarding prevailing wages and this broader-than-CAFTA definition now would extend investor-state enforcement to federal construction projects with any firms incorporated in Peru or Colombia. Yet, PUFTA/CUFTA fail to add new provisions to forestall an attack on the Davis-Bacon rules, which surely would have more of an effect on a foreign investment than many of the actions over which past NAFTA tribunals have ordered awards.

- **Dubai Ports-related issues; FTA creates foreign ownership rights for sensitive infrastructure.**

Given the recent debate about foreign companies' role in national security-sensitive facilities within the United States, it is worth noting that PUFTA/CUFTA give new rights to foreign investors to acquire control of various sensitive aspects of U.S. infrastructure. The PUFTA/CUFTA definition of "enterprises of a Party" allows firms that are "constituted or organized under the law of a Party" (PUFTA/CUFTA Article 1-3) to gain the FTAs' foreign investor privileges, including under the FTAs' service sector and investment agreements the "right to establish" within the United States. Take the following example: If Dubai Ports World's Peruvian subsidiary (which it in fact has) were to seek to invest in U.S. port operations, it would be in violation of their PUFTA "right to establish" to refuse them. The PUFTA has the standard Essential Security exception at Article 22.2. However, the hypothetical situation above – regarding a sector in which the United States allows other foreign companies to invest – would be hard to defend using the PUFTA's security exemption given that the United States already violates the basic most favored nation (MFN) treatment principle and only denies *certain* investors but doesn't find security issues with *other* foreign companies in U.S. ports. In any case, a PUFTA tribunal would decide if U.S. policy were "necessary" for "the protection of [our] own essential security interests" even if we applied the policy to all foreign investors. USTR did not take any exception in PUFTA's Annex I or II for investment and service sector measures related to ports. In fact, the U.S. maritime transportation

[1] Parenthetical notes in direct FTA quotes denotes a slight difference between PUFTA and CUFTA texts.

exception explicitly notes that port activities are covered by the FTA's terms, which is a change from U.S. WTO, Singapore FTA and other agreement obligations from which "landside" maritime activities are excluded. Only nuclear power and, relating to ports, dredging services are exempted among sensitive infrastructure matters. The exact same problems would apply under CUFTA for firms incorporated and operating in Colombia.

- **CAFTA's failure to meet Congress' "no greater rights" for foreign investors standard replicated.**

  A key demand from Congress in the 2002 Fast Track legislation was that future U.S. trade agreements not provide greater rights to foreign investors or businesses than provided to U.S. citizens and businesses by the U.S. Constitution as interpreted by the U.S. Supreme Court. This issue was raised because under NAFTA, which has narrower Investor Rights than the CAFTA, PUFTA or CUFTA, foreign investors have used NAFTA's Investor Rights and the investor-state enforcement system to challenge domestic court rulings, local and state environmental policies, municipal contracts, tax policy, federal controlled substances regulations, federal and state anti-gambling policies, emergency efforts to prevent the spread of mad cow disease, a federal government's alleged failure to provide water rights, and even the provision of public postal services. In most instances, challengers have sought millions in cash damages claiming that regulatory measures and government actions negatively affected their profitability. $35.4 million has already been awarded in the five NAFTA investor challenges in which investors prevailed. At least one NAFTA corporation, California's Metalclad firm, has succeeded in winning $16 million in a "regulatory takings" case against Mexico that would not have been possible under the U.S. Constitution. Claims for compensation for regulatory takings are almost never allowed under U.S. law, and can only be claimed for real property and are subject to complex Supreme Court-established limits, which among things, do not allow compensation for "mere diminution of the value" of property but require the total value of the complete property to be destroyed by government action before a taking can be established and compensation ordered. However, in practice, regulatory takings are almost never found to occur in U.S. courts, making the doctrine more or less moot in contemporary takings jurisprudence. The situation has been quite different under NAFTA investment terms, which were replicated in CAFTA and now again in the PUFTA and CUFTA. Aspects of these investment chapters facilitate, rather than discourage, regulatory takings claims. The key requirement in the 2002 Fast Track law was that foreign investors should have no **"***greater substantive rights with respect to investment protections than U.S. investors in the United States.*"[2] Further, that law required USTR to establish "standards for expropriation and compensation for expropriation, consistent with United States legal principles and practice." There is no new language in the PUFTA/CUFTA texts that addresses these concerns. Rather, the language is identical to CAFTA, except in that the Definition of Investment has been further expanded to include such claims on yet- new subject matter not allowed regarding such claims in U.S. courts.

- **Definition of Investment in PUFTA/CUFTA extends even beyond CAFTA, which itself extended well beyond NAFTA, and NAFTA exposed forms of U.S. property not subject to regulatory takings claims under U.S. law to investor-state regulatory takings claims.**

  Under U.S. law, generally only real property (land, homes, etc.) can be considered for takings claims. Personal property (everything other than land), generalized economic interests and concepts such as "market access" or "market share" or anticipated future profits are not eligible for such claims. The USTR failed to conform the categories of property eligible for takings claims in CAFTA – and now again in PUFTA/CUFTA – to U.S. law. PUFTA/CUFTA include as subject to takings claims all sorts of personal property including stocks, derivatives, licenses, authorizations, permits, bonds, loans, intellectual property rights and more that go beyond real property. PUFTA/CUFTA also include generalized economic interests such as "the commitment of capital or other resources, the expectations of gain or profit, or the

[2] 19 U.S.C. § 3801(3).

assumption of risk" which would be insufficient to establish the existence of a protected property right under the U.S. Constitution's Takings Clause. (Peru FTA Article 10.28) Further, PUFTA/CUFTA repeat and expand on the outrageous new language in CAFTA's definitions provisions, thus extending the investor-state dispute resolution system to corporations that have a "written agreement between a national authority of a Party" with regard to "natural resources (or other assets) that a national authority controls, such as for their exploration, extraction, refining, transportation, (distribution) or sale" (pages 10-26). These provisions mean that PUFTA/CUFTA explicitly allow foreign investors to bring disputes on their concessions and contracts with regard to an incalculably broad array of assets controlled by the federal government into investor-state enforcement. For instance, investors could bring arbitral challenges over oil and gas, mining, and water contracts without first having to resort to domestic legal remedies. In the United States, firms with concession contracts or other contracts with the federal government regarding the management of public lands or other public assets would otherwise not be allowed to avoid U.S. courts if involved in a contract dispute. None of these sorts of property would be subject to regulatory takings cases in the United States. This element of the PUFTA/CUFTA investment texts alone is a clear violation of Congress' "no greater rights" requirements in Fast Track.

- **Definition of Expropriation in PUFTA/CUFTA broader than U.S. law.**

More detailed analysis of the PUFTA/CUFTA investment chapters will raise numerous technical ways in which the PUFTA/CUFTA investment chapters extend beyond U.S. law regarding takings – physical and temporal severability, extent of damage to find a taking, etc. However, as a simple matter, the definition of what generally is considered an expropriation in PUFTA/CUFTA remains as expansive as the CAFTA and NAFTA provisions – NAFTA provisions which have resulted in compensation for foreign investors for "regulatory takings" that would not constitute a taking under U.S. law. PUFTA/CUFTA, like CAFTA, still require compensation for "indirect" expropriations (PUFTA/CUFTA article 10.7.1). U.S. law does not allow compensation for nearly any indirect taking. PUFTA/CUFTA contain the same language inserted in CAFTA, giving further guidance regarding what constitutes an expropriation. This language includes a list of factors pulled from the 1978 U.S. Supreme Court case *Penn Central Transportation Co. v. New York City*[3] regarding when a taking has occurred. The problem with this approach, which was rejected during the CAFTA debate as not remedying the problem, is that the list of *Penn Central* factors are only relevant when considered in the context of over 25 years of U.S. judicial interpretation – interpretation that has made it extremely difficult to find a regulatory taking. Outside of the U.S. jurisprudence defining them, terms such as the "character of the government action" are meaningless because the investor-state tribunals are free to interpret the words also used in the *Penn Central* case in any number of ways, without being bound by decades of U.S. court precedents. Including "indirect takings" in PUFTA/CUFTA violates Congress' 2002 Fast Track instruction that USTR negotiate terms setting standards for expropriation that are consistent with "U.S. legal principles and practice." USTR failed to add specific language in PUFTA/CUFTA that explicitly requires that a total taking be found before a tribunal can rule that expropriation has occurred.

- **Language in PUFTA/CUFTA Investment Annex fails to protect against regulatory takings.**

PUFTA/CUFTA repeat the clause from CAFTA: "Except in rare circumstances, non(-)discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations." (PUFTA/ CUFTA Annex 10-B) USTR states that it included this language to address concerns that legitimate public health and safety regulations could be subject to expropriation claims. But, this language seems to have precisely the opposite effect. Under U.S. law, public interest regulations governing personal property

[3] *See, Penn Cent. Transp. Co. et al. v. New York City et al.*, 438 U.S. 104 (1978). For example, the Penn Central factors are include in U.S.-Chile FTA, Annex 10-D; CAFTA, Annex 10-C; Model BIT, Annex B.

(everything other than land) are considered a legitimate exercise of police powers and are simply exempt from regulatory takings claims altogether.[4] In contrast, the language in this Annex enshrines the right of foreign investors to bring cases involving just such public health and safety regulations. Worse, USTR has no ability to ensure that foreign investors will only bring such cases under "rare" circumstances – this is a decision solely in the authority of the foreign investor. Even if an investor-state tribunal rules against such a claim, the United States will be obligated to spend millions on each defense. (Legal costs for the defense of the NAFTA Methanex Chapter 11 case have cost more than $3 million alone.) Despite this, USTR failed to state in the PUFTA/CUFTA text the U.S. law standard that such cases are simply prohibited.

- **PUFTA/CUFTA transparency "requirements" would violate ICSID and UNCITRAL rules.**

Another congressional demand regarding future trade agreements' investment rules was that investor-state tribunal proceedings operate with greater transparency. PUFTA/CUFTA repeat the transparency language in CAFTA (PUFTA/CUFTA Article 10.21) requiring the countries involved to make documents public, however the rules of the International Centre for Settlement of Investment Disputes (ICSID) and United Nations Commission on International Trade Law (UNCITRAL) – two bodies to which PUFTA/CUFTA investor cases may be brought – do not provide for even the publication of the final award unless the release of the final award is agreed to by both parties – i.e. including the foreign investor. Yet, PUFTA/CUFTA fail to include language requiring foreign investors to agree to make the documents available as a condition of using investor-state enforcement, despite this problem being raised in the CAFTA context. Absent such a requirement on the foreign investors, the U.S. government is forbidden under the tribunal rules to release such information.

- **U.S. investors' advantage undermined by PUFTA/CUFTA's grant of investor rights to foreign-owned firms merely incorporated in the United States.**

When members of Congress have raised past concerns about some aspects of the Foreign Investor provisions of FTAs, such as CAFTA, U.S. trade officials have stated that the goal of these provisions is to provide new protections and stability for U.S. firms seeking a secure investment environment within the countries with which the United States has signed FTAs. Yet, the definition of an "enterprise of a Party" – which is the operative term to which such investor rights apply – covers not only U.S.-owned companies, but also foreign-owned companies that are "constituted or organized under the law of a Party." (PUFTA/CUFTAArticle 1-3) Thus, U.S. FTAs provide preferential investor rights for foreign-owned companies' U.S. subsidiaries within U.S. FTA partners' territories. PUFTA/CUFTA's inclusive definition (providing the same privileges in Peru/Colombia for foreign investors from countries who have not made the same concessions that the United States made in this FTA) undercuts the competitive advantage the FTA investor rights are said to provide U.S. companies and investors.

- **In a roll-back from CAFTA, PUFTA/CUFTA doesn't require establishment of an Appellate Body.**

The 2002 Fast Track statute required that USTR provide for "an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements."[5] The CAFTA text required that some body be established three years after the pact is implemented. In contrast, PUFTA/CUFTA Annex 10-D merely requires that the "Parties shall *consider whether to establish* an appellate body or similar mechanism…" (emphasis added) The language in PUFTA/CUFTA fails to meet the Fast Track negotiating objective to obtain an Appellate mechanism.

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[4] Personal property, the Supreme Court has indicated, is unlikely to be held to have been taken by a regulatory action, since "by reason of the State's traditionally high degree of control over commercial dealings, [an owner of personal property] ought to be aware of the possibility that new regulation might even render his property economically worthless." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, at 1027-28 (1992).

[5] 19 U.S.C. § 3801(3).