

June 10, 2015

The Investor-State Dispute Settlement Provisions in the Trans-Pacific Partnership Agreement Violate Article III of the United States Constitution

Dear Representative:

I am writing to call to your attention a serious, but previously undiscussed constitutional problem with the investor-state dispute settlement (“ISDS”) provisions of the proposed Trans-Pacific Partnership Agreement (“TPP”). They would allow foreign investors to challenge laws, regulations, and court decisions of our federal, state, and local governments, not in our court systems, but before three privately appointed arbitrators. Such arbitration tribunals would be empowered to order the United States Government to pay unlimited sums in damages to the foreign investor if the investor could convince two of the arbitrators that the challenge to a governmental action violated any of its substantive rights provided by the TPP.

I am writing this letter because I believe that the creation of private arbitral tribunals to decide whether otherwise valid federal, state, and local laws are inconsistent with the investor protection provisions of the TPP improperly removes a core judicial function from the federal courts and therefore violates Article III of the Constitution. Whatever problems there may be with other aspects of the TPP, my sole focus is on the unconstitutionality of the ISDS arbitral tribunals.

I am now and have been for almost six years the Lerner Family Associate Dean for Public Interest and Public Service Law at the George Washington University Law School, where I teach constitutional law, with a special focus on separation of powers. I have also taught at Harvard, NYU, Stanford, Hawaii and American University law schools. During my more than 45 years of legal practice, I have argued 20 cases before the Supreme Court and have been co-counsel for a party or an amicus in more than another 100. Included in those Supreme Court cases are eleven major separation of powers rulings. Because I was not part of any of the three branches of the federal government, I was free to support or oppose a law depending on my view of its constitutionality.

In recent years, the United States has entered a number of trade agreements and bilateral investment treaties that include provisions that allow foreign investors – both U.S. and non-U.S. – to directly challenge certain governmental actions that adversely affect them. Those challenges can be based on a variety of provisions, but the most frequently used ground is that a government action violated the guaranteed “minimum standard of treatment” for investors and the related “fair and equitable treatment” obligation.

Instead of making the challenge in a court in the country where the investment was made, or before judges of a recognized international tribunal, the TPP would allow an investor to bring the case before an ad hoc tribunal of three arbitrators, one appointed by the investor, one by the nation in which the investment was made, and the third by the agreement of the other two

arbitrators. The arbitrators are generally private citizens, often lawyers who specialize in international trade and investment, for whom serving as arbitrators is only one source of their income. Indeed, many of those who serve as arbitrators in one ISDS case represent investors challenging governments in another. Their decisions on the merits of the case are final and not subject to judicial review in any court. ISDS investor protection provisions in trade agreements must be approved by both Houses of Congress and signed by the President, just like any other law that Congress enacts.

Under the proposed TPP, in a foreign investor case challenging one of our laws or decisions, the sole defendant would be the federal government, even if the investor's claim is that a state or city enacted the law or took the action being challenged. The sole remedy is money damages. Others, such as the state that enacted the challenged law, may only participate at the invitation of the federal government which controls the proceeding for the defense. If a law is found to be inconsistent with an investor protection provision, it may remain in effect, but other investors could also bring claims seeking U.S. taxpayer compensation. Thus, an adverse arbitral decision under TPP may well result in repeal or amendment of the offending law. In the case of the United States, if the challenge is to a state or local decision, Congress would probably pass a law preempting the offending provision. Indeed, the mere instigation of an ISDS proceeding has resulted in other governments, including Germany and Canada, reversing specific regulatory decisions as part of compensation packages for investors.

It is perfectly understandable why an investor who claims, in effect, that the local government had wrongly destroyed or at least seriously damaged its business, would prefer to have that question decided by an entity other than the court system of the government whose actions are being challenged. That is particularly true for U.S. investors in a developing country that may not have a mature and independent court system with appropriate rule-of-law standards. But that same preference for non-judicial remedies also applies when a foreign investor has a dispute here, even though our judicial system is a model for the rest of the world.

I assume for purposes of this opinion that the procedural rules applicable to ISDS arbitrations are fair, and that the substantive standards relating to investor protection are neither too broad nor unduly favor investors. I also do not suggest that Congress may never permit arbitrators to replace courts in deciding disputes under laws that it enacts. **Rather, my objection is that our Constitution does not permit disputes that, in practical effect, challenge the legality under the TPP of federal, state, or local laws of the United States, to be assigned to private parties for their exclusive resolution.**

To understand how TPP might operate to benefit investors in the United States, it may be helpful to see how it might impact four public policy issues that are now being debated here:

- Concerned about the loss of customers who no longer smoke conventional cigarettes, the tobacco companies have created e-cigarettes, which are currently unregulated. If Congress decided to regulate them after enactment of the TPP, a non-U.S. investor from a TPP country that makes e-cigarettes here could ask an ISDS panel to rule that its investment-based expectations were improperly violated and thus that it is entitled to damages under the minimum standard of treatment provisions.

- A similar challenge could be made by a TPP investor who owned farm land in California and objected to an intensification of mandatory water rationing for farms enacted after the TPP goes into effect, even if such rules also applied to U.S. owners of land that would be adversely affected by them.
- Or the non-U.S. TPP-owner of restaurants in Los Angeles could demand arbitration over a post TPP-enactment of an increase in the minimum wage to \$15 an hour, which, he claims, violates his investment-based expectations when he decided to purchase the restaurants.
- Or suppose a non-U.S. investor from a TPP nation decided to open a chain of abortion clinics in Texas and received permits for all of them. If, shortly after the TPP went into effect, Texas passed a law imposing additional health and safety requirements that significantly increased the investor's cost of doing business, the law would be subject to challenge under the TPP.

Instead of suing in federal or state court, raising U.S. or state constitutional law claims, the investor in each of those cases could circumvent domestic courts and demand ISDS arbitration.

In each of these cases, the main question would be, did the action of the federal, state or local government violate the investor protection rules in the TPP? That question is essentially one of law, and in that sense it is like a constitutional challenge in which a state or federal law is claimed to be inconsistent with a provision of the U.S. (or a state) Constitution. It is also like a challenge based on a claim of preemption, or inconsistency with a federal statute (including those relating to investor protections). The relevant facts in this kind of case, including my four hypotheticals, are rarely in dispute, and the question of legality is typically resolved by a state or federal judge and then ultimately by the U.S. Supreme Court. But not under the TPP. The foreign investor can avoid the U.S. court system entirely by choosing arbitration, not just in the first instance, but at all, since the TPP excludes judicial review of the merits of decisions by these private arbitrators.

Although no decision of any federal court has decided whether it is constitutional to assign disputes of this kind to arbitration, there are four recent cases that bear on the issue. One of these, *Thomas v. Union Carbide*, 473 U.S. 568 (1985), upheld a law that assigned to arbitrators the job of evaluating the amount of money that the holder of a trade secret used to manufacture pesticides was entitled to receive from those that used its product as a result of a decision of the Environmental Protection Agency that the secrets should be shared with other makers of pesticides, as required by federal law. Unlike cases arising under the TPP, the issues there are primarily factual, not legal, and there is some, albeit limited, judicial review of the arbitral decision.

The second case is *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 82 (1982), a bankruptcy action in which the issue was whether a particular kind of dispute – there a traditional state law claim for money damages – could be decided by a bankruptcy judge who was not a judge appointed under Article III – by the President with the advice and consent of the Senate – and entitled to serve for life and with no diminution of salary. The Court ruled

that only Article III judges could hear such cases, even though Congress had expressly authorized them to be heard by bankruptcy judges who were duly appointed, full time federal officials. The Court recognized that some kinds of claims for money damages could be assigned to non-Article III judges, but none of those mentioned is close to the TPP arbitral provisions that apply to a case that involves largely issues of law, not fact.

Third, the Court rejected an Article III claim that the Commodities Future Trading Commission, a federal agency comprised of full time, duly appointed federal officers, could not resolve a counterclaim raised in administrative proceedings in response to a claim properly filed before the agency. *CFTC v. Schor*, 478 U.S. 883 (1986). That ruling (over the dissent of two Justices) was dependent on three facts that do not apply to TPP arbitrations: (1) the objector had voluntarily filed the counterclaim with the CFTC, (2) the CFTC, a federal agency, with expertise in the subject area, would be ruling on the claim and counterclaim, and (3) there was full judicial review of the agency's ruling. Justice O'Connor, writing for the majority, emphasized that her decision was not a blanket authority to remove all cases from Article III courts, but was limited to the facts of that case.

Finally, in *Wellness International Network Ltd., v. Sharif*, No. 13-935 (decided May 26, 2015), the Supreme Court answered the question left open in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), holding that bankruptcy judges can decide claims otherwise barred by *Northern Pipeline* if the parties all consent, in that case to decide who is the lawful owner of a certain trust. In its constitutional ruling, the Court largely relied on *Schor*, as well as the facts that Article III judges appointed the bankruptcy judges, that Article III judges had to refer the matter to a bankruptcy judge, that the referral could be withdrawn at any time on motion of a party or the district court's own motion, and that any ruling by the bankruptcy judge was subject to review by Article III judges. In his concurring opinion, Justice Alito relied on *Schor* and the analogy of the consent in that case to those in an "ordinary run-of-the-mill arbitration." Chief Justice Roberts, joined by Justices Scalia and Thomas, would have decided the case on statutory grounds, but they also disagreed, in separate opinions by the Chief Justice and Justice Thomas, with the majority's view that consent can cure the Article III problems as applied to the common law claims at issue in the case.

None of these decisions resolves the constitutionality of the TPP ISDS arbitration procedures, but their collective reasoning falls heavily on the side of unconstitutionality, based on four factors that apply to the TPP tribunals: (1) they deal with questions of law, that judges normally decide, not questions of fact, that could go to juries or arbitrators; (2) the arbitrators are not federal officers, construing and applying federal law, but are private parties, none of whom has to be an American citizen; (3) the consent of the United States is general and not case specific and, where the challenge is to a state or local law, the state or locality never consents at all, but had the decision to arbitrate mandated by Congress, thereby raising federalism concerns; and (4) there is no judicial review of the merits of what the arbitrators decide, especially whether the TPP had been violated at all.

The Office of Legal Counsel in the Department of Justice has an extensive legal opinion, written in 1995, on when arbitration of matters arising under federal law is permissible. <http://www.justice.gov/olp/constitutional-issues-federal-arbitration>. The bottom line is sometimes, but not always, although nothing in that opinion bears directly on provisions like

those found in the ISDS provisions of the TPP and other trade agreements and treaties, even though some such provisions were in existence when the opinion was issued. In the intervening 20 years, the Department has not updated its arbitration opinion, although in its amicus brief filed in *Wellness International*, it agreed that consent of the parties satisfied Article III, on grounds similar to those relied on by the majority.

Given the importance of the ISDS provisions to the TPP, the Administration owes it to Congress and the American people to explain how the Constitution allows the United States to agree to submit the validity of its federal, state, and local laws to three private arbitrators, with no possibility of review by any U.S. court. That is simply not the way that our Constitution provides for the resolution of the legality of federal, state, or local government laws, rules, or other actions. If someone from the Department of Justice has a different view, I would be more than happy to debate that person before a committee of Congress or in any other appropriate forum.

I am available to discuss this matter further with you and or your staff.

Sincerely,

A handwritten signature in blue ink that reads "Alan B Morrison". The signature is written in a cursive, flowing style.

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