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Joan Claybrook, President

May 10 Trade “Deal” Does Nothing to Fix Bush Trade Agreements’ Extreme NAFTA Chapter 11-style Foreign Investor Privileges

Peru/Panama FTAs Would Replicate Investor-State System Leading New Democrats Called a “Threat” To Public Interest During CAFTA Debate

- **The May 10 “deal” leaves in place the extreme NAFTA-CAFTA foreign investor rules that promote job offshoring and expose U.S. environmental, health laws to challenge – even though these very provisions led many Democrats to oppose past Bush FTAs:** The May 10 “deal” announced by the Bush administration and senior Democrats does not require changes to the binding provisions of the Bush-negotiated Peru and Panama “free trade” agreements’ (FTAs) foreign investor provisions. Rather, the “deal” calls for adding a sentence in the *non-binding* preamble of the FTAs’ investment chapters that simply repeats the 2002 Fast Track *non-binding* negotiating objective about not giving foreign investors in the United States greater rights than U.S. firms. Yet, the Bush administration ignored this objective when it negotiated these agreements and instead packed the investment chapters with outrageous special privileges for U.S. firms that offshore and foreign firms that invest in the United States. None of these binding terms of the Peru and Panama FTAs’ investment chapters would be altered under the “deal,” meaning the many provisions that violate the “no greater rights” rule would remain in the text. Remarkably, the Office of the U.S. Trade Representative (USTR) takes a swipe at Democrats on this issue in its fact sheet about the deal, explaining that no changes to the investment rules are needed in Bush’s Peru and Panama FTAs because these pacts – as well as CAFTA and past Bush deals – meet the “no greater rights” test.¹ **Yet, the Peru and Panama FTAs repeat the very same CAFTA terms providing extreme foreign investor rights that Democrats, including the prominent New Democrats, strongly opposed:**

Dear Colleague letter from New Democrat Coalition member Jane Harman and other Californians:
“We wanted to draw your attention to 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... **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.**”²

The same NAFTA-CAFTA foreign investor rights would be extended in the Peru and Panama FTAs because the May 10 “deal” does not address this problem.

- **The Peru and Panama FTAs’ investment chapter texts are nearly word-for-word identical to CAFTA’s investment Chapter. *The May 10 “deal” does nothing to remedy this situation:*** Electronic comparisons of the CAFTA and Peru/Panama FTAs’ investment Chapters show that the texts are nearly word-for-word identical. Regarding sensitive issues such as expropriation and compensation, minimum standard of treatment, and the definition of investment, no changes have been made relative to CAFTA to address concerns (raised by many in Congress) regarding the dangerous scope of CAFTA’s foreign investor rights. These CAFTA-style provisions provide greater rights to foreign investors operating here than our own Constitution provides U.S. residents and firms. They could thus subject U.S. laws to challenge. Many of the members of Congress who raised concerns about the investor-state system’s threat to basic environmental and health policies and opposed CAFTA on this basis are eager to support trade agreements but for such extraneous investment provisions. **Instead of addressing these concerns, USTR replicated them in the Peru and Panama FTAs. Indeed, the Peru FTA even extends the definition of investment to include certain government procurement contracts not covered in CAFTA’s investor rights regime.**
- **The Peru FTA expands 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. *The May 10 “deal” does nothing to address these serious problems:*** The Peru FTA (Art. 10.28) goes beyond even CAFTA to extend investor-state enforcement rights to disputes over an “investment agreement,” (Art. 10.16) defined as: “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 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.”

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 contract disputes with the U.S. government to World Bank or UN investor-state tribunals under expansive FTA rules, 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. For example, U.S. federal construction projects are subject to Davis-Bacon rules regarding prevailing wages, and this broader-than-CAFTA definition would extend investor-state enforcement to federal construction projects with any firms incorporated in Peru. Yet the deal fails to remove the CAFTA-plus foreign investor rights regarding contracts with the U.S. government or to remedy the threat of challenge on prevailing wage laws.

- **Both the Peru and Panama FTAs contain the CAFTA language (which extends beyond NAFTA) that allows foreign investor contracts and permits for U.S. “natural resources or other assets that a national authority controls” to be brought to UN and World Bank tribunals instead of U.S. courts. *The May 10 “deal” does nothing to address this overreach, meaning its timber trade provisions are even less likely to have any real life effect:*** These provisions mean that foreign investors involved in U.S. government mining, timber and other concessions would be empowered to dispute the terms of their contracts with the federal government outside of U.S. court and, instead, bring cases regarding their contracts with the U.S. federal government to UN and World Bank tribunals.

In addition to the obvious perils of such a provision, this provision would significantly decrease the already meager chances that the new proposed Peru FTA provisions aimed at limiting trade in mahogany

would result in any real improvements in practice. Because the May 10 “deal” failed to fix the foreign investor rules, even if President Bush unexpectedly sought to take action against lax environmental protection in Peru or decided to ban imports of Peruvian mahogany – if such improvements affected foreign investors in forestry, mining and other extractive industries – said foreign investors could challenge the new environmental policies or enforcement and demand compensation using the FTA’s investor-state system.

- **In a rollback from CAFTA, the Peru and Panama FTAs don’t require establishment of an appellate Body. The May 10 “deal” does nothing to address this:** 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.”³ The CAFTA text required that some body be established three years after the pact is implemented. In contrast, the Peru and Panama FTAs’ Annex 10-D merely requires that the “Parties shall *consider whether to establish*” an appellate body or similar mechanism (emphasis added). Thus, the language in the FTAs fails to meet the Fast Track negotiating objective to obtain an appellate mechanism.
- **The Peru and Panama FTAs allow a foreign-owned company incorporated and operating in a signatory nation to use Investor Rights rules, meaning the United States could face investor-state challenges from major multinational corporations or U.S. subsidiaries based in Peru or Panama. The May 10 “deal” does nothing to address this:** 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 Peru and Panama FTAs’ definition of “enterprise of a Party” (which is a term used in defining who has investor rights) covers not only firms owned by Peruvian or Panamanian nationals, but also foreign-owned firms that are “constituted or organized under the law of a Party” (Peru FTA Arts. 1.3 and 10.28; Panama FTA Arts. 2.1 and 10.29). Thus, the Peru and Panama FTAs allow *any* firm incorporated and operating in Peru or Panama, or even Peruvian- or Panamanian-incorporated subsidiaries of U.S. firms, to challenge U.S. policy in investor-state tribunals. For instance, both Halliburton and Newmont Mining Company, among dozens of other natural resource-related firms, have operations in Peru.⁴ Under the FTA, these companies could use their Peruvian subsidiaries to challenge U.S. environmental or other public interest laws that affect their U.S. operations.
- **CAFTA’s failure to meet Congress’ standard of “no greater rights” for foreign investors is replicated in the Peru and Panama FTAs. The May 10 “deal” does nothing to remedy this:** A key demand from Congress in the 2002 Fast Track bill was that future U.S. trade pacts not provide greater rights to foreign investors or businesses than those provided to U.S. citizens and firms by the U.S. Constitution as interpreted by the U.S. Supreme Court. This issue became prominent in the 2002 Fast Track debate because under NAFTA (which has narrower foreign investor rights than CAFTA or the Peru and Panama FTAs), foreign investors have used the foreign 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. U.S. legal costs to defend just one case against a California ban of a toxic gasoline additive cost \$3 million.⁵

Claims for compensation for regulatory takings are almost never allowed under U.S. law, can only be claimed for real property, and are subject to complex Supreme Court-established limits. Among other things, U.S. law does not allow compensation for “mere diminution of the value” of property, but requires the total value of the complete property to be destroyed by government action before compensation is ordered. In practice, regulatory takings are almost never found to occur in U.S. courts, making the doctrine more or less moot in contemporary jurisprudence. The situation has been quite different under NAFTA investment terms, which were replicated and even extended in CAFTA and now again in the Peru and Panama FTAs. 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.*”⁶ 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 texts or in the May 10 “deal” that addresses these concerns. Rather, the Peru and Panama FTAs’ language is identical to CAFTA, except that the Peru FTA’s definition of investment has been even expanded even further beyond U.S. standards.

- **Definition of investment in the Peru and Panama FTAs extends well beyond NAFTA, which exposed forms of U.S. property not subject to regulatory takings claims under U.S. law to investor-state regulatory takings claims. The May 10 “deal” does nothing to remedy this situation:** 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,” “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 the Peru and Panama FTAs – to U.S. law. The Peru and Panama FTAs include as subject to takings claims of all sorts of personal property, including stocks, derivatives, licenses, authorizations, permits, bonds, loans, intellectual property rights and more that go beyond real property. The Peru and Panama FTAs also include generalized economic interests such as “the commitment of capital or other resources, the expectation of gain or profit, or the 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 Art. 10.28; Panama FTA Art. 10.29). Further, the Peru and Panama FTAs repeat the outrageous new language in CAFTA’s definitions provisions, thus extending the investor-state dispute resolution system to corporations that have a “written agreement” with “a national authority of a Party” with regard to “natural resources or other assets that a national authority controls.”

The Peru FTA goes even farther in specifying that this includes “for [natural resource] exploration, extraction, refining, transportation, distribution or sale” (Peru FTA Art. 10.28; similar language in Panama FTA Art. 10.29). These provisions mean that the Peru and Panama FTAs 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 FTA investor-state enforcement. For instance, under the Peru FTA, investors could bring arbitral challenges over oil and gas, mining, and water contracts without first having to go to U.S. courts. U.S. firms with concession 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 Peru and Panama FTAs’ investment texts alone is a clear violation of Congress’ “no greater rights” requirements in Fast Track.

- **Definition of expropriation in the Peru and Panama FTAs broader than U.S. law. The May 10 “deal” does nothing to remedy this situation:** More detailed analysis of the Peru and Panama FTA investment chapters will raise numerous technical ways in which the chapters extend beyond U.S. law

regarding takings – physical and temporal severability, extent of damage to find a taking, etc. But, as a simple matter, the basic definition of what generally is considered an expropriation in the Peru and Panama FTAs remains as expansive as the CAFTA and NAFTA provisions – NAFTA provisions that have resulted in compensation for foreign investors for “regulatory takings” that would not constitute a taking under U.S. law. The Peru and Panama FTAs, like CAFTA, require compensation for “indirect” expropriations (Art. 10.7.1). U.S. law does not allow compensation for nearly any indirect taking. The Peru and Panama FTAs 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*⁷ regarding when a taking has occurred. The problem with this approach, which was already rejected by Democrats 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 the Peru and Panama FTAs 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 the Peru and Panama FTAs that explicitly requires that a total taking be found before a tribunal can rule that expropriation has occurred.

- **Language in the Peru and Panama FTA investment annexes fails to protect against regulatory takings. *The May 10 “deal” does nothing to remedy this situation:*** The Peru and Panama FTAs repeat the clause from CAFTA: “Except in rare circumstances, nondiscriminatory 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” (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 (everything other than land) are considered a legitimate exercise of police powers and are simply exempt from regulatory takings claims altogether.⁸ 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. (U.S. legal costs for the defense of the NAFTA Methanex Chapter 11 case alone amounted to over \$3 million.) Despite this, USTR failed to state in the Peru and Panama FTAs’ text the U.S. law standard that such cases are simply prohibited.
- **Peru and Panama FTA transparency “requirements” would violate ICSID and UNCITRAL rules. *The May 10 “deal” does nothing to remedy this situation:*** Another congressional demand regarding future trade agreements’ investment rules was that investor-state tribunal proceedings operate with greater transparency. The Peru and Panama FTAs repeat the transparency language in CAFTA (Art. 10.21) requiring the involved countries 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 Peru and Panama FTA 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 the FTAs 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 the Peru and Panama FTAs’ grant of investor rights to foreign-owned firms merely incorporated in the United States. The May 10 “deal” does nothing to remedy this situation:** 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.” (Peru FTA Art. 1.3; Panama FTA Art. 2.1) Thus, the Peru and Panama FTAs provide preferential investor rights for foreign-owned companies’ subsidiaries within U.S. FTA partners’ territories. The FTAs’ inclusive definition (providing the same privileges in Peru/Panama for foreign investors from countries who have not made the same concessions that the United States made in these FTAs) undercuts the competitive advantage the FTA investor rights are said to provide U.S. companies and investors.

ENDNOTES

¹ “We believe that the four pending FTAs (as well as the other FTAs we have concluded in the past five years) fully achieve this [no greater rights] objective of the Trade Act.” See http://ustr.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file146_11282.pdf

² Dear Colleague letter from Reps. Jane Harman (D-Calif.), Mike Honda (D-Calif.), Hilda Solis (D-Calif.), Henry Waxman (D-Calif.), July 20, 2005.

³ 19 U.S.C. § 3801(3).

⁴ *Directory of American Firms Operating in Foreign Countries, 16th Edition, Volume 3*, (New York: Uniworld Business Publications, 2001).

⁵ Mary Bottari and Lori Wallach, “NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement,” Public Citizen Report, February 2005.

⁶ 19 U.S.C. § 3801(3).

⁷ 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 included in U.S.-Chile FTA, Annex 10-D; CAFTA, Annex 10-C; Model BIT, Annex B.

⁸ 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).