CAFTA's Threat to U.S. Gambling Regulation

<u>Background on CAFTA's structure, rules</u>

Supporters say CAFTA merely creates a level playing field for U.S. businesses by granting U.S. exports the same duty-free treatment now enjoyed by CAFTA imports to the U.S. under the Caribbean Basin Initiative.

- If that were the totality of CAFTA's obligations, CAFTA would be a one sentence agreement: "Tariff treatment for U.S. and Central American goods shall be on a reciprocal basis."

- Instead, CAFTA contains 1000 pages of international law that would impose on the U.S. obligations about:
  - how foreign firms providing services *within* U.S. territory may be regulated (Chapter 11),
  - guaranteeing international law property rights not set forth in the U.S. Constitution to foreign investors operating in the U.S., subjecting the U.S. to challenge by such investors at UN and World Bank tribunals for failure to meet these international standards and agreeing that the United States will compensate such investors if the international tribunals find that their CAFTA investor rights are not being met (Chapter 10), and
  - how our federal and state tax dollars may be spent. (Chapter 9)

- <u>CAFTA explicitly requires that existing and future U.S. federal, state and local law conform to CAFTA's 1,000 pages of international law that extend beyond traditional trade matters</u> (such as cutting tariffs and removing quotas) unless an exception has been taken for specific laws. "*The parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state governments*." (CAFTA Art. 1.4) CAFTA obligations extend far beyond merely ensuring laws are nondiscriminatory (i.e. treat domestic and foreign goods alike) as claimed by CAFTA supporters. CAFTA contains numerous *absolute* requirements regarding what policies countries may or may not maintain, regardless if they treat domestic and foreign players alike. CAFTA signatories (ie. federal governments) are required to take all constitutionally available means to force state and local compliance with CAFTA's rules, for instance passing pre-empting federal legislation, using the U.S. court system or cutting off federal funds.

- Under CAFTA's Chapter 20 government-to-government enforcement mechanism allows *other CAFTA nations* to challenge U.S. laws they believe violate CAFTA. The U.S. would face trade sanctions until laws deemed "CAFTA-illegal" by this tribunal were eliminated or changed. (CAFTA Art. 20.16) The design of the new Chapter 20 international tribunal CAFTA would create ensures that challenges against the U.S. will be heard by two "judges" from other CAFTA nations, but only one U.S. "judge" (CAFTA Art. 20.9). This is a worrisome design flaw in instances when all other CAFTA nations might have a common interest in eliminated a U.S. policy.

  - <u>NAFTA's similar international tribunal ruled against U.S. restrictions on the access of Mexican-domiciled trucks to U.S. roads</u>. The Administration sought to weaken U.S. safety and environmental standards to comply with NAFTA's tribunal. Congress passed a law to stop the Administration's regulatory implementation of the NAFTA ruling. The Administration successfully overturned Congress in U.S. court and issued new regulations to allow entry to the Mexican trucks. Mexico refused to meet new regulations requiring truck inspections and is now threatening trade sanctions because the United States failed to meet the NAFTA tribunal's orders.

- Additionally, under CAFTA's Chapter 10 foreign investor protection rules, a seperate *investor-to-state* enforcement mechanism allows *foreign investors* from CAFTA nations directly to challenge U.S. federal, state and local laws that they claim violate the international property rights that CAFTA would grant them. These cases are heard by international tribunals established under the auspices of the United Nations or World Bank. (CAFTA Art. 10.16.3)

  - These UN and World Bank tribunals would be empowered to order the payment of U.S. tax dollars to foreign investors who claim the United States is not meeting the new protections CAFTA would grant to foreign investors. (CAFTA Art. 10.17) This aspect of CAFTA shifts decisions over the payment of U.S. tax dollars away from Congress and outside of the Constitutionally-established Art. III federal court system (or even U.S. state system) and into the authority of international tribunals.

- The standard of review for these UN and World Bank tribunals is not U.S. law, but rather international law set in CAFTA. (CAFTA Art. 10-22 "… *when a claim is submitted…the tribunal shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.")*

  - ✓ Although the 2002 Trade Promotion Authority required U.S. negotiators to base future trade agreement's property rights on U.S. law, CAFTA guarantees foreign investors a minimum standard of treatment for foreign investors set forth by "***customary international law"*** (CAFTA Art. 10.5.1, Annex 10-B) and established in "***principle legal systems of the world***." (CAFTA Art. 10.5.2(a))

  - ✓ CAFTA also requires compensation for regulatory takings, which CAFTA labels "indirect takings." Compensation for regulatory takings (regulations that affect a property's value, but do not terminate its full value) is almost never allowed under U.S. law. CAFTA would allow compensation of foreign investors operating in the U.S. for government actions not subject to compensation in U.S courts under U.S. law.

- Under NAFTA's similar system, the U.S. lost one case on the merits, faces 14 more cases, and has spent over $3 million defending just one still-pending case. In total under NAFTA, 41 challenges to domestic regulatory policy have been filed. With eleven completed cases, five times foreign investors have been compensated over challenges to zoning laws, construction permits, toxics bans and more. Over $35 million has been paid by governments. Among the undecided cases is the "Thunderbird" case in which a Canadian firm is challenging Mexico's ban on all forms of gambling. Only one NAFTA investor case had to do with actual expropriation of an investor's property. The others were attacks on regulations, many of which were non-discriminatory.

<u>CAFTA's Chapter 10 foreign investor protections pose a new, serious threat to Utah's gambling ban.</u>

- Buried in CAFTA is a new route for foreign gambling companies to attack Utah's ban on gambling that does not exist in the WTO. This significant new threat is posed by CAFTA's Chapter 10 foreign investor protections and their investor-to-state private enforcement.

- Unlike the investor rules in the WTO, CAFTA's investor rules apply "pre-establishment." This means that investors from CAFTA countries would have a <u>right to establish</u> an investment here. (In contrast, the WTO's Trade Related Investment Rules (TRIMs) only apply *after* an investment has been allowed by the authorities of a WTO country.)

- CAFTA's definition of investment is extremely broad. (CAFTA Art. 10.28) It includes generalized economic interests, such as obtaining "market access" or "market share" and "the commitment of capital or other resources, the expectations of gain or profit, or the assumption of risk." Under CAFTA, a foreign investor would not be required to own anything in the U.S. in order to have an actionable claim that its property were being "indirectly expropriated" by a domestic policy. A foreign investor would have a claim if the investor *sought* market access in the U.S. that was thwarted by a domestic regulation, which would be the sort of CAFTA claim likely posed against the Utah gambling ban or other state and federal laws that limit market access to the U.S. gambling market.

- Thus, CAFTA's foreign investor protection rules would empower foreign gambling companies to use the UN and World Bank international courts described in the background section of this fact sheet to demand payment of U.S. tax dollars as compensation if laws, like Utah's gambling ban, undermined their CAFTA rights to do business here.

- When asked about this problem, USTR shows people CAFTA's Annex I, which includes broad-sounding descriptive language exempting existing state laws from meetings certain CAFTA provisions, including some Chapter 10 investment provisions. However, closer inspection of the actual, listed specific CAFTA provisions to which this Annex applies show that these are not the Chapter 10 provisions that pertain to a foreign investor's right to establish new U.S. gambling investments – investments as broadly defined in CAFTA Article 10.28. (Regarding other Utah non-gambling sector laws that might be covered by CAFTA Annex I, it is worth nothing that only existing laws are grandfathered in through this clause and any changes to existing laws or new laws in these areas must conform with CAFTA.) USTR also often cites Annex II which lists areas of policy in which states may maintain existing laws that violate CAFTA and create new policies that do so. However, a careful reading of the Annex II particulars shows that the U.S. Annex II list of carve outs for state service sector policies that do not comply with CAFTA is based on the U.S. service sector commitments under Article XVI of the WTO' General Agreement on Trade in Services (GATS.) Thus, as regards gambling, the April 2005 WTO Appellate Body ruling that the U.S. gambling sector is committed without any reservations to GATS is binding on CAFTA. Thus, neither CAFTA Annex carves out state laws that regulate gambling from coverage by any of the relevant CAFTA rules.

  - In fact, because CAFTA Annex II specifies that the U.S. has service sector obligations that include gambling, a foreign investor would have a strong basis for proving a reasonable "expectation of gain or profit" in that sector.

- ***The bottomline to this technical march through numerous CAFTA provisions and a WTO ruling shows that CAFTA newly would expose U.S. federal, state and local gambling regulation to a CAFTA Chapter 10 foreign investor-to-state direct challenge at the UN or World Bank tribunals.*** Thus, if passed, CAFTA would open a new door for gambling interests to reverse the April WTO ruling that held that, with certain adjustments, the U.S. could maintain its internet gambling ban. Moreover, CAFTA would provide a new means for challenges regarding non-internet gaming – ie. the right for foreign investors to establish brick and mortar casinos in the U.S.

  - It is worth noting that CAFTA Chapter 10 does not include a 'public morals' exception. The WTO GATS Agreement contains such an exception (Article XIV). The WTO Appellate Body relied on the GATS public morals exception in its April ruling as the reason why the United States might be able to maintain its internet gambling ban if we altered some of the related laws to meet WTO rules. CAFTA Chapter 10 does include a list of exceptions similar to those in the WTO, so the absence of a public morals exception in notable. (Article 10.9.3 (c)) CAFTA also contains several "General Exceptions." The General Exceptions incorporate GATS Article XIV by reference, but does not apply this exception to CAFTA Chapter 10 provisions. That is to say, the CAFTA General Exceptions clause that incorporates GATS "public morals" exception only applies to CAFTA Chapter 11, 13 and 14 provisions, not to CAFTA's foreign investor rights.

- This threat is not hypothetical. Since CAFTA was signed in May 2004, many Internet casino firms have moved from Antigua, a Caribbean island that has been a haven for Internet gambling, to Costa Rica – one of the CAFTA nations. Recently, some of these e-casinos were acquired for huge sums by European companies. For instance, the Costa Rican internet gambling site called ParadisePoker.com was purchased for $300 million (!!) by U.K internet gambling giant Sportingbet Why would European firms spend vast sums to buy Costa Rican Internet gambling establishments, given that Internet gambling services can be offered worldwide from any single location? The only logical answer is that European companies are gambling that CAFTA will go into effect and they want to establish Costa Rican corporate citizenship so they could then use the extraordinary foreign investor rights CAFTA would grant to companies located in any CAFTA target nation to force their way over existing limitations to their access to the lucrative U.S. gambling market – from Utah and Hawaii's gambling bans to many states' limits on gambling.

The CAFTA gambling 'side letter' does not safeguard Utah's gambling ban.

- The USTR's office has also shown an "Uunderstanding" on gambling signed by the CAFTA nations to those who raise concerns about CAFTA's threat to U.S. gambling regulation. To start with, the legal status of Understandings and the bilateral Side Letters attached to CAFTA are dubious. (For instance, only some NAFTA side letters were attached to the version of NAFTA sent to the Mexican Congress. Excluded was a vital side letter defining whether only cane sugar or also high fructose corn syrup counted in a key market access formula. The U.S. has been in trade litigation for eleven years over this problem.) However, as regards the CAFTA gambling Understanding, even if the language contained in the Understanding were included in the core CAFTA text, it would be worthless. The Understanding states that nations can maintain gambling regulations that "are not otherwise inconsistent with" CAFTA's rules. Yet, if a domestic law were consistent with CAFTA's rules, it would not be subject to challenge and that if it is not consistent, this "Understanding" does nothing to protect or save it.

- Finally, when all else fails, USTR often states that: "CAFTA does not in any way pre-empt or invalidate federal, state or local laws that may be inconsistent with the agreement….[CAFTA] rules do not automatically override any domestic laws." (USTR CAFTA Fact, June 2005) Effectively, USTR has created a strawman and then answered a question no one has asked. No one has claimed that CAFTA automatically "pre-empts," "invalidates" or "override[s]" U.S. gambling laws. The problem is that if the UN, World Bank or CAFTA Chapter 20 international courts decide that our domestic gambling laws violate CAFTA's dictates, then the United States would be forced to pay millions in our tax dollars to foreign gambling companies to compensate for their not being able to offer gambling services and would face trade sanctions until such U.S. laws were removed. USTR does not refute these claims, because they cannot. This is what CAFTA would require