Fixes to Problematic Foreign Investor, Financial Deregulation Provisions in Bush’s Korea FTA Text Could Limit Prospective Damage, Start Obama’s Promised Trade Reforms

Foreign Investment

- The current Bush Korea FTA text includes extraordinary foreign investor rights and their private “investor-state” enforcement – in which a foreign corporation is empowered to directly challenge U.S. laws as trade pact violations before foreign tribunals to demand compensation. This is especially threatening, and totally unnecessary, in the context of Korea.

  ➢ The special threat is posed by the fact that there is a huge number of U.S. and Korean companies cross-established in each other's national markets. If the Korea FTA were to be passed with its current text, at least 1,030 corporations with 2,055 establishments across the United States and South Korea would obtain new FTA rights to demand taxpayer compensation through challenges of U.S. and Korean federal and subfederal laws in foreign tribunals. The scale of investment going in both directions is very unlike previous U.S. FTAs with small developing nations.¹ (For a list of these firms and maps showing their locations, see [http://www.citizen.org/Page.aspx?pid=3967](http://www.citizen.org/Page.aspx?pid=3967).)

  ➢ Investor-state enforcement is not necessary or appropriate for an agreement between two developed countries with well-established rule of law and sound domestic court systems. The ostensible purpose of the mechanism is to provide U.S. investors a stable investment environment, and the ability to adjudicate problems with foreign investments in countries that do not provide reliable domestic judicial systems. But such a provision is not even arguably necessary between two stable democracies with well-functioning court systems. The U.S.-Australia FTA did not include private enforcement of its investor provisions.

  ➢ During his campaign, President Obama explicitly committed to fixing the substantive and procedural problems with the Bush FTA model’s foreign investment terms.

- The current Bush Korea FTA Investment Chapter 11 text includes private investor-state enforcement of extraordinary new substantive FTA-granted property rights with respect to a broadly defined array of investments, including in financial services. Combining investor-state private enforcement with the Korea FTA’s expansive substantive foreign investor and financial service terms would provide Korean firms operating in the United States greater rights than provided to domestic firms and investors under U.S. law as interpreted by the U.S. Supreme Court. This would violate Congress’ requirement that FTAs provide foreign firms “no greater rights.” President Obama pledged during his campaign to fix this problem in his trade pacts.

- The current Bush Korea FTA text would allow foreign investors to demand compensation from the U.S. government in foreign tribunals for “regulatory takings” and other claims that would not be allowed under U.S. law. The FTA definition of investment to which the new rights apply extend beyond U.S. law. It includes investment agreements between a government and a foreign firm with respect to natural resources, certain procurement construction activities and more; investment authorizations; enterprises; shares, stock, and other forms of equity participation in an enterprise; bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives;

For more information, contact Public Citizen’s Global Trade Watch [www.tradewatch.org](http://www.tradewatch.org)
turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; intellectual property rights; licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

- Many Democrats have raised concern about expansive new substantive FTA property rights and their investor-state enforcement. They oppose FTAs empowering foreign investors to sue the U.S. government for compensation in foreign tribunals under FTA rules – skirting U.S. courts and laws. The current Bush Korea FTA text includes the same terms that led to past opposition. For instance, in a Dear Colleague letter, New Democrat Coalition member Jane Harman and other Californians warned: “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… 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.”

- Past U.S. FTAs with investor-state enforcement have been with developing countries. This has reduced the prospects for challenges of U.S. laws somewhat, given relatively few foreign investors from such countries operate within the United States. In contrast, the Korea FTA would be the first FTA since NAFTA with a major capital exporter that includes investor-state arbitration. This creates a considerably greater likelihood that U.S. state and federal laws would be challenged in foreign tribunals, exposing U.S. taxpayers to potential large new liabilities and threatening to undermine important public interest policies. According to Uniworld, the leading proprietary source on Foreign Direct Investment, there are roughly 80 Korean corporations with around 270 establishments now in the United States. There are also hundreds of U.S. establishments in Korea that the FTA would newly empower to challenge Korean public interest laws in foreign tribunals.

- To date, Canada under NAFTA is the only other developed, capital exporting country with which the United States has such an investment agreement. Canadian firms have used NAFTA’s investor-state system to attack an array of U.S. environmental, health and other policies in foreign tribunals. The United States has to date dodged the bullet on the six of these challenges in which final rulings have been issued, mainly thanks to an array of errors by the challengers. (For instance, in the Loewen case, the tribunal ruled in favor of Loewen on the merits, but the Canadian firm’s bankruptcy lawyers reorganized it as a U.S. corporation, thus destroying diversity of jurisdiction.) In some of these cases, substantial amounts of U.S. taxpayer dollars were wasted defending lengthy cases that would not have been allowed in U.S. courts. Many millions in outstanding cases remain to be concluded. This includes a $340 million challenges to the 1998 U.S. Tobacco Settlement and a Canadian drug firm disputing a patent issue that went all the way to the U.S. Supreme Court.

- Excluding investor-state from the Korea FTA was of special concern to the National Conference of State Legislatures, which wrote: “Since South Korea is a sophisticated and developed trading partner, NCSL does not believe that an investor-state chapter should be negotiated into the U.S.-Korea FTA for fear that similar abuses may arise. Until we have further refined the FTA investor-state language to protect state sovereignty and federalism, we fear that it may be more dangerous to include revised yet still flawed investor-state language in the U.S.-Korea FTA than to forego the provision all together.”
The current Bush Korea FTA text’s “denial of benefits” language provides a loophole that could allow Korean subsidiaries of U.S. firms to use their status as “Korean entities” to challenge U.S. laws in foreign tribunals. This provision must be rewritten in future agreements. With respect to the Korea FTA, eliminating or restricting investor-state enforcement could help alleviate this threat.

The TRADE Act (HR 6180/S 3083) describes important changes to the substantive investor rights provided in past FTAs. This is a new model for trade pact investor rules that should be included in any future U.S. FTA with investor rules, and in U.S. Bilateral Investment Treaties (BITs). However, given the Korea FTA has already been negotiated and signed, there is a minimum fix that is necessary and simple to the Bush FTA text. At this juncture, to avoid attacks against legitimate public interest laws and new exposure for U.S. taxpayers to liabilities arising from such cases, the Obama administration must eliminate the investor state enforcement provisions from the Bush Korea FTA text.

- This fix is technically simple. It requires the U.S. and Korean governments to sign an executive agreement or exchange diplomatic letters before the FTA is voted on that indicates that immediately upon implementation, the FTA will be subject to a self-executing amendment that eliminates the investor-state mechanism in Chapter 11 (strike Chapter 11 Section B (Arts. 11.16-11.27)) and remove the references to investor-state dispute settlement in Chapters 11, 12 and 13. This does not require re-opening of the FTA text, and thus avoids issues with Fast Track rules. Rather, the parties agree to use the FTA’s existing provisions setting out the process for making amendments - by consensus of both parties, as established in Korea FTA Article 22.2. Agreeing in advance to an amendment which will become effective upon entry into force of an agreement is far from unusual: in CAFTA the Bush administration used an exchange of diplomatic letters to agree to self-executing amendments that implemented three changes to CAFTA that the administration deemed necessary to gain GOP support for the pact.

- This fix would merely replicate the standard set in the U.S.-Australia FTA: FTAs between developed countries should not include investor-state enforcement. This fix would leave in place state-state enforcement of the FTA’s investment, services and financial services chapters.

There is a good likelihood that the Korean government would accept this change. Korean civil society organizations report that Korean government officials expressed concern about investor-state, which was characterized by Korean negotiators as a U.S. demand. The FTA text itself reveals Korea’s concerns: Korea insisted on and obtained a limitation on investor-state enforcement. Under this limitation, if a U.S. firm starts proceedings in a Korean court or administrative tribunal about a Korean policy that they claim breaches the various property rights established in the FTA, then they may NOT also use the investor-state system. U.S. firms have to pick domestic OR investor-state. (See Korea FTA Annex 11-E.) USTR did NOT make that exception apply to us. (So, Korean firms could be fighting over the same U.S policy in U.S. court and an investor-state World Bank or UN tribunal.) That the Korea government would be concerned is reasonable: there are hundreds of U.S. firms in Korea that would be newly empowered to use the investor-state mechanism to privately enforce the FTA’s extraordinary foreign investor rights that extend beyond Korea domestic law, which like U.S. law does not generally recognize compensation claims for “regulatory” takings.
Financial Services

- The current Bush Korea FTA Financial Services chapter reflects the pro-deregulation mentality that helped foster the worst financial crisis since the Great Depression. More than other FTAs, it has been justified for its role in pushing financial services liberalization and deregulation. According to fact sheets published by the Bush administration, “The Financial Services Chapter of the United States-South Korea Free Trade Agreement … is a groundbreaking achievement, providing more extensive provisions related to financial services than ever before included in a U.S. FTA.”
- Citigroup’s Laura Lane, co-chair of the U.S.-Korea FTA Business Coalition, stated that “it is the best financial services chapter negotiated in a free trade agreement to date.” Does anyone really want to support financial services policies celebrated by an administration and firm that wrecked the economy?

- Including the past deregulatory model in the Korea FTA is especially problematic. The U.S. Congress has just passed new financial regulations that could conflict with the FTA. Korea has also begun implementing new financial stability measures. The FTA’s Financial Services chapter reads in the investor-state enforcement mechanism established in the Investment Chapter – thus empowering private investor attacks on domestic financial regulation and capital controls. There are at least 74 financial corporations cross-established in the United States and Korea that would be newly empowered to use the private investor-state enforcement rights in the FTA to attack financial regulations of the United States and Korea.

- The current Bush Korea FTA financial services chapter conflates liberalization of the financial sector and deregulation, simply banning many forms of regulation even when rules are applied equally to domestic and foreign firms. It contains problematic deregulation lock-in terms similar to those in the other Bush FTAs. These provisions, negotiated well before the financial crisis, do not represent a change of course from the failed policies of the past that helped fuel the meltdown.

- Like the WTO, CAFTA and the Peru FTA, the Korea FTA commits its signatory countries to refrain from limiting the size of financial institutions, imposing firewalls between the sort of financial services one firm may offer, banning toxic derivatives, or controlling destabilizing capital flights and floods. While the underlying U.S. financial reregulation legislation has passed before the FTA could go into effect, the regulations implementing the new policies will be implemented thereafter. Thus, some of these policies could become subject to investor-state challenges. Also, the underlying bill would be subject to government-government challenges. At the time that the U.S. Congress has worked to reregulate the financial sector, implementing a trade agreement negotiated pre-crisis that imposes constraints on regulation with the world’s 15th largest economy (whose financial firms are operating here) is a breach of faith with the American public.

- The Korea FTA text’s Financial Services chapter “reads in” terms from the FTA’s investment chapter, including the right for foreign investors to directly enforce various provision of the FTA related to financial services through the investor-state system. As noted above, the loophole in the “denial of benefits” provisions in the agreement could allow Korean subsidiaries of U.S. (or Chinese or European) banks and securities firms to challenge U.S. laws in foreign tribunals.

- Also, because Korea is a capital exporter, Korean financial firms are established in the United States and would obtain new rights to attack U.S. regulatory policy. The Export Import Bank of Korea (EMIMBANK), Hana Bank, Div. Hana Financial Group Inc., the Korea Development Bank, Korea Exchange Bank, Pusan Bank, and Woori Financial Holdings have banking operations in the United States.
United States. CJ Corp., KTB Securities Co. Ltd., Kyobo Life Insurance Co. Ltd., and Samsung Fire and Marine Insurance Co., Ltd. have insurance or securities establishments in the United States. Woori, one of Korea’s top banks, is the top Korean financial institution operating in the United States, and its U.S. subsidiary bank holding company, Woori America Bank, has recently undertaken a Federal Reserve Board approved merger. (It is FDIC-insured, and regulated by the State of New York. It is not a member of the Federal Reserve. It has participated in one of the FDIC’s Transaction Account Guarantee Program in 2009.) If the FTA were to go into effect, Woori America Bank would be empowered to directly challenge state or federal laws that it considered equivalent to even indirect expropriation.

- The Bush Korea FTA Financial Services chapter also “reads in” the investment chapter’s rules that forbid countries to limit transfers of capital. Yet, even the IMF has revisited its past opposition to capital controls, now concluding that their prudent use can help foster financial stability. Recently, Korea implemented certain capital control measures to avoid being exposed to the devastating destabilization it suffered during the 1997 Asian financial crisis. This includes limits on foreign exchange practices that could conflict with the FTA rules. Yet, such safeguards could help avoid rapid, severe outflows of capital, which can in turn lead to regional or global crises that depress demand for U.S. exports globally.

- The current Bush Korea FTA text also includes “prudential measures” language that fails to protect financial stability measures. The Korea FTA prudential measures “defense” is much less deferential to regulators than that found in NAFTA, but is identical to other FTAs pushed by the Bush administration. It reads: “a Party shall not be prevented from adopting or maintaining measures for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party’s commitments or obligations under such provisions.” This self-cancelling language undermines the use of the defense to actually protect a financial regulation: a country would only need to use this provision if its domestic policy did not conform with the agreement. In other words, a country would only be challenged because it undermined an obligation that a foreign firm or government believed was provided in the pact. To restate, this circular defense measure does not provide a reliable safeguard.

- The current Bush text of the Korea FTA also includes new limits on governments’ abilities to protect consumers’ confidential information. In March 2006, prior to the formal U.S.-Korea negotiations, the Coalition of Service Industries (CSI) stated that one of its primary objectives in the negotiation related to data processing services: “Korean laws make it difficult for foreign companies to outsource and offshore activities. These laws often relate to privacy (private data protection law and real name law)… These regulations should be modified to permit companies to follow their global operating models for outsourcing and offshoring provided they have existing practices to protect consumer information.” A provision unique to the Korea FTA reads: “Transfer of Information: Each Party shall allow a financial institution of the other Party to transfer information in electronic or other form, into and out of its territory, for data processing where such processing is required in the institution’s ordinary course of business.”

- The TRADE Act (HR 6180/S 3083) describes important changes relative to the financial services rules of past FTAs that should be included in all future U.S. FTAs and BITS with financial services rules. However, given the Korea FTA has already been negotiated and signed, there is a minimum
fix that is necessary to the Bush FTA text to avoid damage from attacks against critical domestic policies needed to restore global economic stability. At this juncture, minimally the Obama administration must fix the Bush Korea FTA text’s language providing safeguards for countries’ prudential financial measures, so that the FTA includes a reliable, usable defense against such attacks.

- This fix is technically simple. It requires the U.S. and Korean governments to sign an executive agreement or exchange diplomatic letters before the FTA is voted on that indicates that immediately upon implementation, the FTA will be subject to a self-executing amendment that replaces the second sentence of Article 13-10(1) with the following: “For greater certainty, if a Party invokes this provision in the context of consultations or an arbitral proceeding under this Agreement, the exception shall apply unless the Party or investor initiating a dispute can demonstrate that the measure is not intended to protect consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or is not intended to ensure the integrity and stability of the financial system.” Like the fix on the investor-state system noted above, this change could be achieved via a self-executing amendment that would not require re-opening of the text.

- NAFTA’s financial service defense for prudential measures includes only the first sentence in the Korea FTA’s Article 13.10(1). In other words, NAFTA’s parallel provision has no anti-abuse clause. The instructions to a tribunal on burden of proof in the proposed anti-abuse clause above is a modified version of the change made to the Essential Security defense provisions of the Korea FTA and the three other Bush FTAs modified in May 2007.

- There is a high likelihood the Korean government would accept this fix. All it involves is ensuring that an existing FTA provision can actually deliver on its ostensible purpose. This is especially the case because of the new Korean policies noted above (banning currency-based derivatives, new margins required on foreign exchange trade) that could violate the FTA’s regulatory constraints.

MORE ON KOREAN FIRMS OPERATING HERE THAT WOULD BE EMPOWERED TO USE FOREIGN TRIBUNALS TO ENFORCE THE FTA AGAINST THE U.S. GOVERNMENT

Please visit http://www.citizen.org/documents/KoreancompaniesintheUS.pdf to see a chart of Korea firms in the United States, their industries and their location by congressional district. Some of the Korean firms now invested in the United States that have been engaged in regulatory disputes in the past would have standing to challenge state and federal regulations were the Korea FTA to pass. These include:

- Hynix is among the 20 largest chaebol in Korea, was originally a part of the Hyundai chaebol, and its U.S. subsidiary Hynix Semiconductor Manufacturing America was once the largest private employers in the Eugene, Oregon area. It also has operations in San Jose, California. In 2006, nearly three dozen U.S. states – including Oregon and California – sued Hynix and several other corporate defendants, whom the states accuse of conspiring “to rig the market for [dynamic random access memory microchips, or DRAMs], working together to keep prices artificially high. They victimized individual consumers, governmental agencies, schools and taxpayers.” The damages sought by the states could be in the hundreds of millions of dollars. Because Oregon joined the plaintiffs in the price-fixing case, environmental and consumer groups in Eugene called for
elimination of the $58 million in property tax breaks that Hynix received. “It seems that if a company is doing illegal activity that is harming people in Oregon, the state of Oregon shouldn’t be giving that company tax breaks,” said Bern Johnson of the Environmental Law Alliance. But a spokesperson for Hynix’s Eugene operation argued that it “is immune to all issues related to price fixing” because its Korean parent company “is a legally separate entity.” In fact, the Eugene plant is a wholly owned subsidiary of Hynix in Korea. And this was not the first time there have been moves to remove Hynix’s tax breaks, which it enjoyed by virtue of its location in Eugene’s “enterprise zone.” When the company was charged with employee discrimination in 1999, the county government investigated whether this was sufficient cause for revocation of the tax breaks, which require companies to comply with all local, state and federal laws. More recently, the enterprise zone laws were loosened and Hynix was able to retain the tax breaks. Hynix also came under fire for its application for a license to nearly triple its emissions of hydrogen fluoride (HF), a toxic air pollutant and acid rain contributor that the U.S. government describes as “severe pulmonary irritant.” This request enflamed local opinion following the rapid successive deaths from pulmonary fibrosis of three people that lived near the Eugene plant. In 2008, the Hynix parent company – citing “short- and long-term market conditions, which include a steep reduction in the price of memory chips worldwide and accelerated technological migration towards next-generation production standards” – closed down its Eugene facility, but it claimed that it may use the property for some other purpose. As of June 2010, the property was still vacant.

PMX Industries is a wholly owned subsidiary of Korea’s Poongsan Corporation and is based in Cedar Rapids, Iowa. The Iowa operation is a brass and copper rolling mill that employs special alloy processing methods. The company has given substantial amounts of soft money contributions to Republican congressional campaigns, and its employees have given over ten thousand dollars to political candidates and committees, mostly Republicans. PMX is intimately involved with U.S. government policies, both as a supplier to the government and as a recipient of a variety of tax subsidies.

- In 2005, PMX was one of the first companies to sign onto then-Gov. Tom Vilsack’s income tax credit scheme for Iowa companies that utilize Iowa-grown soybean oil-based metalworking fluids.
- In 2006, it followed much of the rest of the copper industry and implemented and passed a hike in input costs to its customers through a series of surcharges.
- That same year, Sen. Tom Harkin (D-Iowa) secured $2 million in funding for PMX’s research costs in the Department of Defense appropriations bill.
- In 2007, it was announced that PMX would be supplying half of the copper alloy strip for the U.S. Mint’s special $1 presidential coins.
- This continues on many years of hundreds of millions of dollars in federal contracts – much of them awarded on a non-competitive basis – that PMX receives.
- The Korean subsidiary has also been substantially involved in regulatory issues in Iowa. In 2004, PMX led a successful corporate effort to overturn the local utility board’s cross-subsidization of poorer customers by charging richer customers higher utility rates. A PMX spokesperson said of the rate plan that “Being competitive is not possible when we have to subsidize another area,” and even when the utility board agreed to the companies’ demands, complained about the pace of the policy change.
- An Iowan environmental organization cited PMX Industries as one of the top six emitters of cancer-causing chemicals, developmental toxicants, and reproductive toxicants into Iowa waterways, based on 2007 Environmental Protection Agency data.
• PMX has asked the Iowa congressional delegation to oppose the cap-and-trade climate change bill.  

• **USS-Posco** is a joint venture of U.S. Steel and the Pohang Iron and Steel Company (Posco), a Korean government-created steel producer (now privatized), that is one of the world’s largest. USS-Posco has had substantial run-ins with local government in regards to its Pittsburg, California facility. In the summer of 2006, the Pittsburg City Council considered a bill to transfer leases held by the steel and other companies from a California State Lands Commission to the city. But Posco was implicated in a related bill that would have condemned part of the company’s property as a blighted area. Posco was in the middle of negotiations to sell the area, which had experienced problems with soil toxicity, to a firm that wanted to develop an industrial park on the site. The company was opposed to the legislation, as it would have made the company liable for any clean-up of the site irrespective of the sale to the developer, according to local experts. The company is also trying to recycle and treat the water it uses in its manufacturing processes and thus avoid the cross-hairs of local officials and environmentalists as it relates to California’s water shortage problem, which developers blame on “political roadblocks.”  

---

1 For a full list, see http://www.citizen.org/documents/KoreancompaniesintheUS.pdf  
3 For a full list, see http://www.citizen.org/documents/KoreancompaniesintheUS.pdf  
17 PMX, “What We Do,” Available at: http://www.ipmxC.com/about/what.html  
18 http://opensecrets.org/indivs/search.asp?key=4xb8k&txtName=PMX&txtState=(all%20states)&txtAll=Y&Order=N  
19 http://opensecrets.org/indivs/search.asp?key=qypgb&txtState=(all%20states)&txtEmploy=PMX&txtAll=Y&Order=N  