CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW * EARTHJUSTICE
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Wesley S. Scholz
Director, Office of Investment Affairs
Department of State

Jonathan S. Kallmer
Deputy Assistant, U.S. Trade Representative for Investment
Office of the United States Trade Representative

Dear Mr. Scholz and Mr. Kallmer:

On behalf of a coalition of civil society organizations, we are submitting written comments concerning the Administration's review of the U.S. Model Bilateral Investment Treaty (hereinafter 2004 model BIT, 2004 model, or model BIT), as solicited in the Federal Register Public Notice 6693 (FR Doc No: E9-16639). As the Administration proceeds to review the current model bilateral investment treaty to assess whether changes should be made, we write to express our numerous concerns regarding the impact of the model on the capacity of U.S. and foreign government authorities to protect the public interest. We urge you to take our suggestions into account and revise the model BIT.

United States foreign policy as well as trade and investment policy, should have as a core objective the promotion of sustainable development. Interests in expanding exports and investment opportunities must be balanced with the broader public interest of improving livelihoods, reducing poverty and inequality, and promoting environmental sustainability. Thus, expansion of investment can and must be made compatible with the protection of the public interest in the United States and overseas. Regrettably, the 2004 model BIT perpetuates many of the flaws of earlier treaties. In this regard, the review process provides an opportunity to correct the shortcomings of the past and chart a new course for investment rules that emphasizes a balanced approach to ensuring both investor rights and responsibilities.

Specifically, the model BIT creates a set of rights for investors (including foreign investors in the U.S.), but fails to establish obligations for investors and corporations in the communities in which they operate. Further, by establishing "investor-State" dispute settlement procedures that will allow foreign investors, including foreign subsidiaries of US companies, to challenge U.S. and foreign public interest laws and regulations directly, the model BIT provides a potent tool for foreign investors to assert the imbalanced rights provided by the treaty. Moreover, claims made under these agreements will be decided by ad hoc panels that are not trained in or bound by U.S. Supreme Court precedent. In addition, the decisions of these panels are not subject to review by U.S. courts to ensure that they do not deviate from U.S. law or grant greater rights to foreign investors than are accorded to U.S. investors. Nor are the panels subject to any other appellate review to ensure quality and consistency.

In sum, we believe that this review process should result in a model BIT that does not pose threats to public interest protections for sustainable development, the environment, health and safety, and workers' rights. We outline below some of our most serious concerns with the model BIT. We

address both procedural and substantive issues, including the failure of the model BIT to ensure that the rights provided by the investment rules are limited to those accorded under U.S. law to U.S. citizens.

PROCEDURAL ISSUES

The international dispute resolution mechanism provided in the model BIT for investment disputes poses significant risks to the public interest. Because international arbitrators frequently lack expertise in and understanding of local laws and societal values that are often at the heart of investment disputes, their decisions risk undermining national laws and values. Especially where investment disputes raise constitutional questions, such as in the allocation of powers among governmental organs or permissible limitations of property rights, principles of democratic accountability require that domestic courts adjudicate such disputes whenever possible.

For this reason, there should be a strong presumption that disputes between an investor and the host State should be resolved by the domestic courts of the host State. Only if evidence reveals that domestic courts are unwilling, unable, or otherwise incapable of administering justice in a manner that secures due process of law should a dispute be addressed by an international forum.

When international dispute resolution is appropriate, the model BIT should provide for government-to-government dispute settlement, which guarantees the crucial role of governments in determining and protecting the public interest. The model BIT should not provide for investor-State dispute resolution, which gives investors inappropriate leverage to undermine legitimate measures to promote sustainable development, environmental protection, and human health and safety. However, if the model BIT does provide for investor-State dispute resolution, this mechanism should be limited to cases in which available domestic remedies have been exhausted, and should require the agreement of both States party to the BIT. If either Party does not agree, the model BIT should require the States to take up the dispute in a government-to-government dispute resolution process.

I. Exhaustion of Domestic Remedies

As noted above, allowing investors to take claims to international tribunals without first requiring domestic courts with expertise in these matters to review the claim, develop a factual record and provide interpretations of relevant domestic law invites international tribunals to misread domestic laws, unintentionally undermine public policy, and reach inconsistent and erroneous decisions. This is particularly inappropriate where the domestic legal system is well-developed, such as in the United States.

Removing cases from domestic legal systems also undermines incentives for countries to establish a sustainable rule of law. Requiring foreign investors to exhaust domestic remedies would help to build the capacity of developing country judicial systems to address disputes concerning foreign investment and would help build and sustain the rule of law in countries hosting foreign investments. Rather than allowing investors to jump immediately to international tribunals, they should at least be required to test the domestic legal system in host countries. It is a U.S. foreign policy objective to strengthen judicial systems in developing countries; this should not be undermined by U.S. trade and investment policy.

Further, the model BIT should comply with U.S. and international law, both of which require exhaustion of domestic remedies. Under U.S. law, investors must exhaust all available procedures for

obtaining compensation before bringing a regulatory takings claim under the Takings Clause of the Fifth Amendment. By not requiring such exhaustion, the 2004 model BIT provides foreign investors greater rights than those enjoyed by U.S. citizens.

International law similarly requires that foreign investors exhaust domestic administrative and judicial remedies before pursuing claims before international tribunals. In human rights cases, for example, claimants are required to exhaust domestic remedies before bringing a claim to an international tribunal. Under the UN Convention on the Law of the Sea (UNCLOS), exhaustion of domestic remedies is a condition of admissibility for claims where required under international law. By analogy, the international criminal court does not substitute for domestic courts, and cases are inadmissible if local courts are investigating or prosecuting them, unless the local courts are unwilling or unable genuinely to carry out the investigation or prosecution, having regard to the principles of due process established in international law.

Requiring foreign investors to exhaust domestic remedies does not mean that they must unnecessarily subject themselves to costly delay when domestic courts provide no chance of a meaningful remedy. Under both U.S. and international law, exhaustion is not required when local remedies are unavailable or unreliable, or the local tribunals are not independent. Any investor-State mechanism in the model BIT should follow this model by only allowing direct access to international dispute settlement without prior exhaustion of domestic remedies when the arbitrators determine that the foreign investor has established that: 1) domestic laws or judicial processes do not afford the investor due process of law for the rights that have allegedly been violated; 2) the investor has been denied access to domestic remedies or has been prevented from exhausting them; 3) there has been, or is likely to be, unwarranted delay in the domestic tribunal's rendering of a final judgment; 4) domestic remedies are otherwise unavailable; or 5) where both State Parties agree that the dispute should proceed directly to government-to-government dispute resolution.

II. State-to-State Dispute Settlement Should Replace the Investor-State Mechanism

The 2004 model BIT affords to the investor the right to bring claims directly to an arbitral tribunal, by-passing domestic courts and excluding the home State as a party to the process. This scheme is often justified on the grounds that it de-politicizes the dispute. If this justification were correct, then all State-to-State arbitrations would inevitably politicize disputes. This cannot be right. For one, it fails to account for the fact that a government-to-government legal dispute settlement mechanism is designed to resolve disputes on the basis of law, in an open process where both State Parties are able to present their legal arguments. Moreover, it fails to appreciate the distinction between political means of dispute settlement, such as mediation and good offices, and legal means like arbitration. Finally, by fully engaging both of the States that established the investment protection framework of the BIT, government-to-government dispute settlement is better suited than investor-State arbitration to address, in the manner intended by the parties, public law and policy issues that arise in the adjudication of investment disputes.

The new model BIT should provide for State-to-State rather than investor-State dispute settlement, along the lines established by Article 37 of the 2004 model BIT, when domestic remedies are unavailable or fail to provide the relief to which the foreign investor believes it is entitled.

III. Government Screen for Direct Investor-State Disputes

Direct investor-State dispute resolution can undermine the ability of governments to implement legitimate measures to address environmental, public health or other concerns. For this reason, the model BIT should provide for government-to-government dispute resolution, but not for investor-State resolution. However, if an investor-State mechanism is included, that mechanism should provide a screen that allows the party governments to prevent inappropriate claims.

The current model BIT appropriately limits the ability of foreign investors to bring claims involving taxation measures and provides a government screen for such claims to ensure that the public interest is adequately protected. Similarly, the model BIT provides a government screen for claims involving financial services measures taken for prudential reasons. Other public interest measures deserve the same level of protection that is provided to tax policy and financial services regulation.

The governments that are parties to the agreement should have the opportunity to prevent investment cases from proceeding if, for example, the claim is inappropriate, without merit, or would cause serious public harm. At a minimum, health and safety, environmental, consumer protection, and human and labor rights measures should be treated in the same manner as taxation measures. Providing such a screen for direct investor-State disputes would in no way impede the ability of a government itself to bring a claim against the other government. If both countries do not agree to bar a claim within a fixed period of time, then the direct investor-State claim would be allowed to proceed.

IV. Denial of Benefits

Significantly, the model BIT's language on Denial of Benefits would explicitly permit U.S. corporations to use the investor- to -state dispute settlement process against the United States by using a foreign subsidiary in the other Party to the BIT, so long as the U.S. corporation has "substantial business activities" in the other Party. We are concerned that U.S. corporations could use this provision inappropriately to avoid the normal "diversity of nationality" requirement for investor-State arbitration before international tribunals.

V. Appellate Mechanism

We are deeply disappointed that the model BIT does not include a meaningful, effective, independent appellate mechanism. In the Trade Act of 2002, Congress directed USTR to seek the creation of "an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements." Such coherence is just as important in BITs as in trade agreements. The new administration should correct this problematic omission and respond to the will of Congress by creating an appellate mechanism in new BITs. It is not sufficient merely to provide that the parties to the agreement shall consider in the future whether to establish such a mechanism.

VI. Appointment of Arbitrators

The model BIT's preference for investor-State arbitration is often rationalized as an independent, neutral and impartial mechanism for the resolution of disputes. These terms, however, are not interchangeable. Arbitration may be independent from domestic courts, but it is neither neutral nor impartial. In fact, given that the investor is allowed to appoint one of the arbitrators that decide a public law dispute, there is an inherent bias in the mechanism.

The commercial arbitration approach of the 2004 model BIT is unsuited for investment arbitration. It leads to conflicts of interests, profiling of arbitrators as either pro-State or pro-investor,

and a biased system of dispute settlement that favors the interests of a particular class of investors above the public interest.

There is no good reason for allowing the investor involved in a dispute to appoint an arbitrator. The better approach is for the States party to the BIT to appoint arbitrators on an ad hoc basis. This approach would preserve the integrity of the public law framework that is essential to the adjudication of the public interest issues that arise in investment arbitration.

There are other advantages to having the Contracting Parties appoint the arbitrators. First, this approach would help ensure respect for the intent of the treaty drafters in their definition of the applicable law. In this regard, some investment tribunals, such as GAMI and Corn Products International, have gone outside the bounds of the law as understood by the Contracting Parties. Second, it gives both Contracting Parties notice of the dispute, which enables the non-disputing party sufficient time to make submissions to the Tribunal if it chooses to do so. Third, this approach engages the Contracting Parties in a constructive partnership in implementing the BIT and resolving investment disputes that may arise.

This procedural change could help address the inherent bias in investment arbitration. This view, however, does not endorse investor-State as an adequate mechanism to resolve disputes between investors and host States, especially where no exhaustion of domestic remedies is required. As noted above, the better approach is to design a State-to-State dispute settlement mechanism for the resolution of investment disputes.

VII. Transparency and Public Participation

The transparency and public participation provisions in the US model BIT are critical to democracy and must be retained or strengthened. In addition, attention should be placed on their adequate implementation. Finally, the current Model's firm endorsement of transparency and participation should inspire the revision of BITs that do not contain such provisions.

SUBSTANTIVE ISSUES: FAILURE TO MEET THE "NO GREATER RIGHTS" STANDARD

The model BIT does not accomplish the congressional mandate in the Trade Act of 2002 requiring that investment rules not grant foreign investors greater substantive rights than U.S. investors are afforded under U.S. law. The May 10th, 2007 Agreement between Congressional leadership and USTR reaffirmed the importance of this requirement in trade agreements, although it fell short on implementation. We believe this principle should be fully respected and ensured in the negotiation of BITs. Unfortunately, however, the model BIT fails in many ways to adequately reflect U.S. law, or even international law, and fails to apply longstanding and fundamental principles of U.S. Supreme Court jurisprudence.

Given these concerns, it is essential to emphasize that the model BIT cannot ultimately comport with the "no greater rights" congressional mandate if foreign investors are able to bring claims that would be decided by ad hoc panels that are not trained in or bound by U.S. Supreme Court precedent and that would not be subject to review by U.S. courts to ensure that they do not in fact deviate from U.S. law and grant greater rights to foreign investors. The prospects of such panels engaging in subjective balancing tests, on the basis of which they will impose financial liability on the United States and developing country governments for their regulatory actions, is extremely troubling.

This fundamental failure to meet the "no greater rights" test occurs in at least several critical parts of the investment rules discussed below – Expropriation, Minimum Standard of Treatment, and the Definition of Investment.

I. Expropriation

The model BIT fails to define expropriation in a manner consistent with U.S. law. The model BIT uses only some of the critical factors established by the Supreme Court in determining what constitutes a takings case; the omission of other Supreme Court factors results in an imbalanced standard that inappropriately privileges the investor. In setting out some of the indispensable factors that must bind decisions on whether an "indirect expropriation" has occurred, we believe each of the problems we identify must be addressed to ensure that the current model BIT does not breach the ceiling of U.S. law.

- The model BIT fails to state that a government regulatory action taken to address a public nuisance cannot be considered a taking, or expropriation. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992).

- The model BIT does not include the critical Supreme Court principle that a governmental regulatory action must be analyzed in terms of its permanent interference with a property in its entirety in order to determine whether a taking has occurred. This standard prevents segmenting a property, whether measured in terms of area or time, as clearly articulated in the Supreme Court's *Tahoe-Sierra* case, which rejected a taking claim arising out of a temporary moratorium on development. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 122 S. Ct. 1465 (2002).

- The model BIT fails to include the Supreme Court's fundamental distinction between land and "personal property." "In the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulations might even render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale)." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1028 (1992).

- The model BIT fails to provide explanations and limitations for critical standards from Supreme Court jurisprudence, including the use of "character of government action" as a factor in expropriation analysis. "Character of government action" is extraordinarily ambiguous and could easily be misapplied by tribunals that are neither trained in nor bound by U.S. precedent.

- The 2004 model's language concerning the analysis of an investor's expectations is too vague, leaves too much to the discretion of the arbitrators, and does not indicate the deference to governmental regulatory authority that is found in U.S. jurisprudence. The proposal does not include critical limitations stating that an investor's expectations are a necessary, but not sufficient, condition for liability, that an investor's expectations must be evaluated as of the time of the investment or that an investor must expect that health, safety, and environmental regulations often change and become more strict over time.

- In considering whether a regulatory action constitutes an expropriation, the 2004 model BIT language does not clearly include the standard established in Supreme Court jurisprudence that an adverse effect on economic value does not by itself constitute an expropriation, no matter how serious the adverse effect: "[O]ur cases have long established that *mere diminution in the value of property, however serious*, is insufficient to demonstrate a taking." *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 508 U.S. 602, 645 (1993) (emphasis added).

- The language in paragraph 4(b) of Annex B of the model BIT clarifying that the exercise of regulatory powers by governments only constitutes an expropriation in "rare circumstances" needs to be strengthened to accurately reflect U.S. law. We believe that "rare circumstances" fails to adequately convey the degree to which it is unlikely that a regulatory action would be considered an expropriation under U.S. law. It would take an extreme circumstance for any of the thousands of our country's laws and regulations to be found to constitute an expropriation. As the Supreme Court unanimously stated in the *Riverside Bayview* case, land- use regulations may constitute a taking in "extreme circumstances." *United States v. Riverside Bayview Homes, Inc*., 474 U.S. 121, 126 (1985).

II. Minimum Standard of Treatment

In regard to the minimum standard of treatment, we are deeply concerned that the standard in the model BIT is completely unbounded and open-ended, with no clear definition. The standard therefore could be interpreted by tribunals in ways that go far beyond U.S. law.

For example, we are concerned that the term "fair and equitable treatment" has been included as an essential element of the standard. While we welcome the clarification that "fair and equitable" treatment "includes" procedural due process, this in no way eliminates the significant potential of a broader, open-ended interpretation of the standard. "Fair and equitable treatment" opens the door to outcomes in investment cases that are in no way limited by, or consistent with, U.S. law.

There is no right corresponding to "fair and equitable treatment" under U.S. law. The closest U.S. law analogue is the Administrative Procedure Act (APA), which allows a court to review federal regulations to determine whether they are "arbitrary or capricious." But the APA's standard is presumably more difficult for claimants to prove than "fair and equitable" (which invite a balancing of all facts and circumstances), and the APA does not apply to many governmental actions (*e.g*., legislation, court decisions, actions by state, local and tribal governments, and exercises of prosecutorial discretion) that are covered under investment agreements.

Moreover, the APA does not provide for monetary damages (as these investment provisions would allow); only injunctive relief is allowed. Finally, the APA requires U.S. courts to accord substantial deference to government decisions; there are no equivalent doctrines in treaties or other international law, to our knowledge, and certainly no doctrine of deference is articulated in the model BIT.

In addition, the "fair and equitable" language, if viewed as an independent standard, is extremely dangerous to good governance. It would invite an investment tribunal to apply its own view of what is "fair" or "equitable," unbounded by any limits in U.S. law. Those terms have no definable meaning, and they are inherently subjective. Indeed, we wonder how they can have any principled meaning when applied to countries with such different histories, cultures, and value systems as are

involved in BITs. The kind of second-guessing of governmental action – e.g., legislation, prosecutorial discretion, police action, court decisions, regulatory actions, zoning decisions, *etc*., at all levels of government – invited by this type of standard is antithetical to democracy.

III. Definition of Investment

The definition of "Investment" in the draft model BIT is much broader than the real property rights and other specific interests in property that are protected under the Takings Clause of the U.S. Constitution. The model BIT definition includes "every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk." Under the U.S. Constitution, in contrast, such broad economic interests are not considered forms of property that are protected by the Takings Clause, nor does the model BIT recognize the Supreme Court's holdings that property interests are limited by background principles of property and nuisance law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992).

Furthermore, the definition in the current model BIT was extended to explicitly include "futures, options, and derivatives," and it exceeds customary international law for state responsibility for injuries to aliens. These types of instruments have played a troublesome role in the recent financial crisis experienced by the United States. Their inclusion also introduces a concerning element of uncertainty in relation to their application to instruments designed to address climate change, such as carbon offsets or other financial instruments relating to carbon mitigation.

OTHER SUBSTANTIVE ISSUES

In addition to these three issues of particular concern regarding the "no greater rights" standard, namely expropriation, fair and equitable treatment standard, and the definition of investment, the model BIT includes provisions that unduly constrain the necessary regulatory flexibilities of the State, or allow investors to attack public interest laws and regulations. The following are some examples.

I. Performance Requirements

The 2004 Model BIT proscribes the use of performance requirements. This norm is often justified on the basis that the market is more efficient in driving decisions regarding the conduct of economic activities. Accordingly, the model BIT prohibits the host State from requiring local content, forms of technology transfer, and other requirements related to the operations of the investment.

The proscription of performance requirements, however, removes an important tool to ensure linkages between investment and the local economy. These linkages are essential for an investment to contribute to the development of the local economy, and more broadly to the sustainable development of the host State. For example, using local sources and engaging in joint ventures with local economic operators fosters local economic opportunities and effective transfer of technology and know-how.

From a development perspective, these performance requirements are essential to ensure that foreign investments do not constitute enclaves that crowd out local investors, but instead effectively link with the local economies. Enabling adequate policy tools that help promote long-term sustainable

development in our developing country partners is also important for the long-term security and prosperity of the United States.

II. Exceptions for Health, Safety and Environmental Measures

The 2004 model BIT does not contain a general exception for health, safety and environmental (HSE) measures. This omission introduces a high level of uncertainty regarding the legality of measures adopted by the State to protect its people and environment from HSE threats. This uncertainty reduces the ability of the State to effectively respond to HSE risks.

In disputes concerning HSE measures, the absence of general exceptions for HSE measures places the interpretive focus on the substantive investment disciplines, such as expropriation, the fair and equitable treatment standard as an element of the minimum standard of treatment, and the non-discrimination standards. In this regard, it has been argued that there is no need for a general exceptions clause given that the substantive rules already provide sufficient flexibility to the State for the adoption of measures necessary to address health, safety and environmental threats. While certain flexibility does exist in certain disciplines, this is a matter of interpretation that is left to each tribunal. Consequently, there is no certainty that an investment tribunal will interpret the substantive rules in a way that provides sufficient flexibility to safeguard the regulatory needs of the host State. As noted earlier, the lack of certainty reduces the ability of the State to respond to HSE risks. Moreover, it is far from clear that existing flexibilities are sufficient to fully safeguard measures designed and applied for the protection of health, safety and the environment. In this regard, a general exceptions clause makes explicit what may be implicit, thereby providing guidance to tribunals as well as certainty to the law in a critical area of public policy.

The General Agreement on Tariffs and Trade, for example, contains a general exception in Article XX for measures necessary for the protection of human, animal or plant life or health, or that relate to the conservation of exhaustible natural resources, provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. These exceptions have been critical in ensuring that the United States can adopt measures to protect the environment and natural resources. For example, in *US-Shrimp Turtle*, the general exceptions in Article XX were critical to upholding the need for measures to protect endangered marine sea turtles.

In the context of performance requirements, the U.S. model BIT already contains an exception for measures necessary to protect human, animal, or plant life or health, or related to the conservation of living or non-living exhaustible natural resources. While this exception is important in this particular context, it should nevertheless be designed to apply to the whole BIT. The fact that it only applies to performance requirements leads the treaty interpreter to question whether the drafters intended to exclude similar measures from the scope of application of other disciplines when in fact the need for such exceptions to safeguard governments' ability to protect HSE applies to all aspects of the BIT.

In the particular context of treaties for the protection of investments, countries like Canada, China, India, New Zealand and Singapore, for example, have incorporated general exceptions for the protection of health, safety or the environment, in varying formulations. Other countries, like Germany, have incorporated exceptions for particular disciplines, such as national treatment. These provisions are critical to ensuring that the State will be able to respond to HSE threats and provide protection to its people and environment, without having to risk liability under the BIT.

III. **Agreements Relating to Natural Resources and Other Assets**

The grant of arbitral jurisdiction over claims based on a breach of "an investment authorization" or "an investment agreement" involving natural resources and other government assets undermines domestic legal systems by removing an important class of disputes and by opening whole new areas of potential investor challenges to domestic regulatory programs. This expansion of investor-State arbitration is especially problematic because these disputes can involve judging not only the propriety of collecting royalties for natural resource extraction, but also the validity of measures adopted by government agencies to ensure compliance with regulations, such as permits.

The investment agreements covered by these jurisdictional grants are not commercial disputes, but involve important policy questions regarding public assets, including natural resources such as oil, gas, timber, water, *etc*. Moreover, the inclusion of "assets that a national authority controls" in the model BIT is broad enough to encompass, *inter alia*, disputes over government procurement, services, and a number of regulations and permits.

In particular, we are concerned that the new jurisdictional grants make any dispute and all issues arising out of investment agreements actionable for damages before unaccountable, ad hoc arbitral tribunals outside the host country legal system. Whether a party is in breach of investment agreements or authorizations should be determined under applicable U.S. law, and through the statutorily mandated process of administrative courts followed by appeal, if necessary, to U.S. federal courts. That comprehensive body of law defines the competence, rights and obligations of the U.S. government regarding its contracts, including those concerning natural resources. Similarly, that procedural system ensures fairness and consistency in dealing with the multitude of issues involved in U.S. government contracting. It is also critically important that legitimate U.S. regulatory decisions (*e.g.*, regarding health, environmental, communications, energy, and nuclear issues) be tested in the U.S. court system and be subject to U.S. laws, not subject to second-guessing by ad hoc arbitrators.

IV. Capital Controls

We are deeply concerned that the provisions on capital transfers in the model BIT would limit governments' ability to use legitimate measures designed to restrict the flow of capital in order to protect themselves from financial instability. The severe financial crisis experienced by the United States and the world in 2009 should lead to a serious re-thinking of these provisions. Without adequate measures to prevent and respond to severe financial instability, broad sustainable development will remain out of reach for many developing countries. The increased frequency and severity of financial crises also hurts U.S. economic interests, as crisis-stricken countries devalue their currencies and flood the U.S. market with under-priced exports in order to recover.

Full capital account liberalization has not been shown to be necessary to stimulate investment flows, deepen capital markets, or enhance economic growth. In a March 2009 report, the International Monetary Fund (IMF) noted the capital controls in several countries mitigated the effects of the financial crisis. Further, the IMF has indicated support for the availability of capital controls as a policy tool and no longer insists on full capital account liberalization as a requirement for its borrowers. In June 2009, a UN communiqué on the financial crisis also indicated support for the use of capital controls as an appropriate and useful policy tool to weather the impacts of the crisis. The United States should ensure – for the sake of developing economies, international financial stability, and its own economic interests – that countries have the policy flexibility needed to impose capital controls in appropriate circumstances.

V. Investment and Environment/Investment and Labor

The inclusion of "Article 12: Investment and Environment" and "Article 13: Investment and Labor" reflects the important recognition that investments have the potential to compromise environmental quality and workers' rights and that a country may feel incentives to weaken environmental protection and labor standards in order to attract investments. These provisions suffer from structural flaws that render them hollow, however. First, the provisions require only an intention that countries will "strive to ensure" the relevant protections, rather than establishing a mandatory and enforceable obligation to do so. The May 10th, 2007 Agreement between Congressional leadership and USTR established a higher and clearer standard in this regard. At a minimum, this standard should be applied in the model BIT.

Second, each provision has a footnote that limits its scope solely to federal laws and regulations, leaving aside all other subnational environmental laws. This limitation is particularly noteworthy given that the scope of the draft model BIT otherwise covers measures adopted or maintained by all governmental organs and other entities – national or subnational – exercising public functions.

Third, the procedural mechanisms to ensure compliance with these provisions are also exceptionally weak, as further proceedings beyond consultations are excluded. These provisions should be made mandatory ("each party shall ensure") and should be subject to the State-State dispute resolution mechanism currently established in Article 37 of the model BIT. (This latter step would require removing paragraph 5 from the current Article 37.)

Finally, the second paragraph of Article 12 attempts to safeguard a Party's ability to adopt, maintain, or enforce measures necessary for the protection of the environment. Unfortunately, even the limited safeguard for environmental protections in Article 12(2) is rendered meaningless by the qualification that only those environmental measures "otherwise consistent with this Treaty" may be protected from challenge. Thus, the use of Article 12(2) as a defense or exception to the other substantive obligations of the BIT appears to have been severely constrained or even eliminated. Article 12(2) cannot operate as a defense or exception to the other substantive obligations of the BIT, which in effect means that a Party may be ordered to pay damages to an investor even for adopting a measure necessary to protect the environment.

Given the broad range of government measures an investor could challenge under the model BIT, it is essential that this safeguard be binding and effective. This effect could be achieved by the introduction of a general exceptions provision, discussed above. Further, this safeguard should apply to environmental protection measures as well as other government measures vital to the public interest, such as laws protecting consumers, health and safety, and workers' rights and human rights. Yet there is no provision analogous to Article 12(2) under the labor article or any other place in the model BIT, although such a provision has been introduced to the U.S.-Uruguay BIT.

VI. Preambular Language

Although the preamble of a treaty does not constitute a source of obligation *per se*, it provides guidance in interpreting the meaning and scope of the agreement's obligations. The NAFTA and the WTO agreements demonstrate the importance of including references to important public policy goals such as environmental protection and sustainable development in situating the respective agreements in the broader international legal context. The model BIT, however, fails to state that the goal of the BIT is sustainable development, and its preambular references to the public interest objectives of health,

safety, the environment and workers' rights are extremely weak. These shortcomings further invite tribunals to interpret the BIT with a singular focus on the primacy of private capital flows, and with disregard for the broader public interest.

VII. Most Favored Nation

The implications of the most favored nation (MFN) treatment provisions are widespread and affect important public interest issues. We are particularly concerned that the lack of clarity in the text concerning MFN leaves open the possibility that foreign investors covered by a BIT could use the MFN principle to assert rights provided by other investment agreements or treaties that a host government has entered into. This could result in investors using the MFN to claim greater rights than are provided under the BIT that was agreed to by their home country. This is particularly problematic given the attempt in the interpretive annexes of the current model BIT to adjust some of the expropriation and minimum standard of treatment disciplines found in NAFTA Chapter 11 and to provide more transparency and public participation. Investors may be able to invoke MFN to circumvent these attempted limitations and gain the full set of rights accorded to foreign investors under NAFTA.

Conversely, foreign investors who enjoy the right to MFN through an existing trade agreement or other treaty could cite that MFN obligation in demanding the full new set of rights – both substantive and procedural – granted to foreign investors in the model BIT.

A German investor, for example, with a right to MFN under the 1956 Treaty of Friendship, Commerce, and Navigation between the U.S. and Germany, could claim the additional rights accorded to other foreign investors under the new model BIT, including possibly the right to direct investor-to-state dispute resolution.

The unfettered application of the MFN clause in investment agreements would thus push towards a harmonized and enlarged system for the protection of investments, where investors could pick the most favorable standards and dispute settlement mechanisms. Further, such expansive interpretations of the MFN clause blur the distinctions between procedural and substantive elements in international agreements, thereby threatening to expand investor-State arbitration to treaties contemplating other mechanisms for the resolution of disputes, *e.g.*, Treaties of Friendship, Commerce, and Navigation and the General Agreement on Trade in Services.

To respect the fundamental public policy considerations that the Parties envisaged when entering into international agreements, explicit limitations to the MFN clause should be established either in its construction or as exceptions to its disciplines.

VIII. National Treatment

The broad scope of the "national treatment" non-discrimination principle in the model BIT leaves the principle open to interpretations by international tribunals that could have negative consequences for appropriate environmental, health and safety, and other public interest protections. As has been the case in WTO jurisprudence, the principle can be interpreted by tribunals as prohibiting regulatory actions that result in "de facto" discrimination, even when there is no facial or intentional discrimination involved. For example, an otherwise neutral regulatory action to protect the environment that results in a greater impact on a foreign investor could run afoul of this standard. We believe that national treatment should be explicitly limited to instances in which a regulatory measure is enacted for a primarily discriminatory purpose and the discrimination bears no justification.

Given all of these concerns, we urge the Administration to revise the 2004 model BIT to reflect our recommendations. International investment rules must balance investor rights and responsibilities, and guarantee that governments have the flexibility to protect important public policy goals such as environmental protection, health and safety, and workers' rights. In addition, any investment treaty the U.S. enters into should ensure that foreign investors are granted no greater rights than U.S. citizens under domestic law. The 2004 model BIT falls short of these goals.

Sincerely,

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