Report of the Subcommittee on Investment

Regarding the Draft Model Bilateral Investment Treaty

Presented To:

The Advisory Committee on International Economic Policy

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The following is a report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy ("ACIEP") regarding the draft model bilateral investment treaty ("BIT") circulated for comment on December 10, 2003.

Background

The United States is a party to more than 40 BITs and three free trade agreements ("FTAs") that include investment chapters similar to BITs. In general terms, these agreements impose on the respective governments a number of obligations regarding the treatment of foreign investors and their investments. These obligations are enforceable through binding arbitration, which investors may initiate to recover monetary damages. In order to harmonize the rights and obligations contained in these various agreements, the U.S. government typically has designated a "model BIT" on which future agreements are based. The current model BIT was drafted in 1994.

Over the last year, the State Department, USTR, and other relevant agencies have been engaged in an effort to update the 1994 model BIT. According to Administration officials, there are at least two reasons to update the current model. First, the Administration has endeavored to incorporate in a draft model BIT the congressional directives on investment contained in the Trade Promotion Authority ("TPA") legislation, 19 U.S.C. § 3802(b)(3) (Supp. 2002). Second, the Administration identified a need to adapt the model BIT to the investment chapters of the recently negotiated FTAs. Administration officials have indicated that once the draft model BIT is finalized, they will identify potential BIT candidates and negotiate new agreements.

The State Department and other federal agencies first briefed the Investment Subcommittee on the contents of the draft model BIT on October 24, 2003. The State Department circulated the present draft model BIT to the ACIEP members and the members of the Investment Subcommittee on December 10, 2003. The State Department then requested that ACIEP, as a committee, provide comment to the State Department. ACIEP Chairman Michael Gadbaw tasked the Subcommittee to draft this report.

General Comments

The Members of the Subcommittee ("Members") include representatives of businesses, labor unions, environmental groups, and development organizations as well as practicing attorneys and academics. The Members hold a wide range of views on the rules that should govern international investment in general and on the draft model BIT in particular. The objective of this report, therefore, is to identify issues where there is consensus among Members, and, where such consensus does not exist, to reflect the different perspectives of the Members. These different perspectives can be divided roughly into two groups: (1) those of Members who represent companies or associations of companies, and (2) those of Members who represent labor, environmental and development organizations.

Generally speaking, Members who represent companies with investments abroad principally want to ensure that the model BIT provides effective protection for U.S. investors and their investments from arbitrary, discriminatory, or unreasonable government measures that undermine the value of their companies' investments. Members who represent labor and environmental organizations are principally concerned that the model BIT not limit the authority of governments to adopt and maintain measures that they deem appropriate to protect the environment, worker rights and other vital public interests. In spite of these differences among Members, they nonetheless agree on a few general principles regarding international investment and on the merits of a few specific provisions of the draft model BIT.

The Members agree that the State Department, in conjunction with other agencies, should designate and work from a model BIT. For U.S. investors, a model BIT helps to harmonize the basic rights and obligations in future agreements, thus providing similar levels of protection in the various countries in which U.S. multinationals operate. For labor and environmental groups, the designation of a model BIT increases transparency by providing a clear and detailed picture of the U.S. government's investment policy and negotiating objectives.

However, the Members who represent investors do not believe that the 1994 model BIT needs to be or should be changed. The 1994 model BIT offers strong protections against the substantial risks that face U.S. investors abroad, as demonstrated by ten years of case law, and it continues to reflect modern international law and investment practice. These Members believe that the draft model BIT circulated in December, by contrast, represents a substantial weakening of investor protections that in large part are not compelled by the TPA legislation nor justified by any reasonable assessment of risk to the United States as a defendant against potential claims. These Members believe that foreign investors already enjoy under U.S. law protections comparable to those found in the 1994 model BIT. By contrast, U.S. investors abroad often confront undeveloped legal systems without independent judiciaries. These Members therefore believe that adapting the model BIT to the investment chapters of recent FTAs serves only to perpetuate a downward trend in protection for U.S. investors, while their European competitors continue to benefit from BITs that now set the standard for investor protection.

On the other hand, the Members who represent environmental and labor organizations are concerned that even with the new provisions, the draft model BIT fails to protect adequately the authority of governments to adopt and maintain measures that protect important public interests. According to these Members, there has not been much case law under the 1994 model BIT, but, in their view, the 1994 model BIT abrogates long-standing rules of customary international law and provides inadequate transparency and opportunity for public participation. These Members believe that these flaws should be remedied but that the draft model BIT does not do so. These Members remain concerned that foreign investors would enjoy greater rights under the draft model BIT than they would enjoy under U.S. law. In addition, these Members believe that the model BIT should include obligations to change domestic laws to raise standards, when

necessary, for environmental protection and the protection of workers' rights. Further, these Members believe that the draft model BIT should obligate investors to meet those standards. Members who represent labor groups object to any treaty that would facilitate outbound investment that would cause jobs or production to be transferred out of the United States.

Before discussing the specific provisions of the draft model BIT, the Members note their agreement on the following principles.

International Investment Is Economically Significant

Members agree that international investment and the rules by which it is governed are increasingly important in a global economy no longer characterized by companies that operate exclusively in their home markets. Today, companies serve their foreign customers not only through exports but also through direct investment. According to the United Nation's World Investment Report, the value of goods and services provided through foreign direct investment in 2001 exceeded the value provided through cross-border trade by more than two-to-one ($18 trillion vs. $8 trillion). In the same year, the value added by foreign affiliates accounted for over 10 percent of global GDP, and these foreign affiliates employed over 53 million people.

The Members also agree that foreign investment, both inbound and outbound, significantly affects the health of the U.S. economy. According to the Bureau of Economic Analysis ("BEA"), the annual inflow of foreign direct investment grew from $45 billion in 1994 to $314 billion in 2000. Although inflows declined sharply in the next two years in response to slow economic growth, the overall value of foreign-owned investment has continued to rise, from $3.1 trillion in 1993 to $6.2 trillion in 2001. This foreign investment in the United States substantially affects the national economy. In 2001, U.S. subsidiaries of foreign corporations employed 6.4 million Americans, exported $164 billion worth of goods, which accounted for 22.5 percent of total U.S. exports, and imported $369 billion worth of goods, accounting for 32.3 percent of total imports.

Outbound investment also has important consequences for the U.S. economy. Between 1994 and 2000, U.S. investment abroad doubled from $73 billion to $148 billion, declining in 2001 and then rising again in 2002. Total U.S.-owned assets abroad increased from $2.8 trillion in 1993 to $6.2 trillion in 2000. Among its effects, U.S. investment abroad generates substantial trade. According to the Department of Commerce, exports by U.S. multinational corporations totaled $425 billion in 2001, an amount equal to some 58 percent of all U.S. exports. Approximately 42 percent of those exports, or 23.5 percent of the U.S. total, were sent to the majority-owned affiliates of U.S. companies. U.S. imports by the same companies totaled $433 billion, with 41 percent of those, or 15.7 percent of the U.S. total, shipped from their own foreign operations.

The Members agree that foreign investment has particularly important effects on developing countries, where the need for economic development is greatest. According to the World Investment Report, the value of foreign-owned investment in developing countries totaled nearly one-third of the GDP of these countries in 2001. Foreign investment can be the catalyst for growing the economies and raising the living standards in these countries. Members who represent labor, environmental and development groups, however, believe that foreign investment also can distort or disrupt economic development and thus can be harmful to the public's interest unless appropriately regulated and channeled.

BITs Can Facilitate Investment

Foreign investment flows are influenced first and foremost by economic conditions in the inbound and outbound markets, as evidenced by the marked decline in such flows since the end of 2000. An important factor in facilitating foreign investment, however, is the presence of a regulatory framework that is transparent, stable, predictable and secure. At an increasing rate over the last decade, countries have sought to create such frameworks by enacting national policies that welcome foreign investment and by entering into BITs. According to the World Investment Report, 95 percent of all national policy changes affecting foreign investment between 1991-2002 made such investment more welcome, and, by the end of 2002, a total of 2,181 BITs had been signed.

Although Members disagree on many of the specific provisions of the draft model BIT, they agree that international investment rules can provide a regulatory framework for foreign investment that is transparent, stable and predictable. Members who represent investors note that the presence of such a framework for foreign investment tends to encourage countries to adopt similar standards for their own investors. In this way, BITs can facilitate not only foreign investment but domestic investment as well. More generally, Members who represent investors believe that BITs can serve as a model for governance by the rule of law. Members who represent labor and environmental groups, however, believe that the substantive and procedural provisions of the draft model BIT must be significantly changed in order to create the desired legal framework for transparency, stability and predictability, and should include, among other things, social and environmental concerns.

Members agree that the benefits of foreign investment can be facilitated by BITs, and also agree that such investment should be undertaken in a manner consistent with the broad array of public concerns in the host countries. Safeguarding the authority of governments to enact bona fide regulation while ensuring fair treatment for investors is a key goal of investment policy. The Members of the Subcommittee agree on this goal as well as some, but not all, of the means by which it can be achieved.

Specific Provisions of Draft Model BIT

Set forth below is a synopsis of the Members' views of several significant provisions of the draft model BIT that received extensive discussion during the

Subcommittee's briefings by Administration officials. The absence of comment on other provisions should not be interpreted as indicating that the Members either approve or disapprove of those provisions.

Definition of Investment (Article 1)

The Members generally support the definition of "investment" in the draft model BIT, which is substantially similar to the definition used in the 1994 model BIT and recent FTAs. In particular, Article 1 defines "investment" as "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 or risk." The definition also sets forth a number of forms that an investment may take (*e.g.*, an enterprise, stock, contract rights).

Some Members who represent labor and environmental groups would be more comfortable limiting the definition of "investment" to foreign direct investment ("FDI") because they believe that a broader definition would offer treaty protections for speculative and "hot money" transfers. Members who represent investors would oppose any narrowing of the definition and note that limiting "investment" to FDI would exclude portfolio investment from the scope of the draft model BIT, thus leaving many U.S. investors, including pension fund beneficiaries, without treaty protections against arbitrary, discriminatory or unreasonable government measures. Some Members who represent labor and environmental groups believe that the definition of "investment" is broader than the definition of "property" in U.S. takings jurisprudence, and therefore would narrow the definition of "investment" in the draft model BIT, at least with respect to expropriation claims.

Footnote two of the definition of "investment" makes clear that licenses, permits, and similar instruments do not have the characteristics of an investment if they do not create any rights protected under domestic law. Members who represent investors believe that this footnote should stipulate that licenses and permits do not have the characteristics of an investment if they do not *ab initio* create any rights under domestic law. This modification would ensure that governments could not abolish rights created by these instruments and then claim that they are not investments.

Members who represent financial service firms recommend that the State Department clarify that the forms of investment enumerated in item (d), "futures, options, and other derivatives," also include "forward contracts" and "swaps." Although forward contracts and swaps fall within the definition of "other derivatives," the listing of these important financial products would provide greater certainty that they qualify as "investments" under the draft model BIT. Members who represent labor and environmental groups do not support specifically listing forward contracts and swaps as covered investments.

Investment Agreement (Article 1)

Under the draft model BIT, investors may submit to arbitration claims that a government has breached an "investment agreement," which Article 1 defines as

> . . . a written agreement that takes effect on or after the date of entry into force of this Treaty between a national authority of a Party and a covered investment or an investor of the other Party that grants the covered investment or investor rights:
>
> (a) with respect to natural resources or other assets that a national authority controls; and
>
> (b) upon which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself.

Members hold differing views as to the coverage provided by this definition of "investment agreement." Members who represent environmental groups have concerns that the draft model BIT would allow disputes arising under these agreements to be decided by international tribunals rather than U.S. courts. These Members believe that whether a party is in breach of an investment agreement or authorization should be determined under applicable U.S. law, and through the statutorily mandated process of administrative proceedings followed by appeal, if necessary, to U.S. federal courts. The Members also believe that legitimate U.S. regulatory decisions (*e.g.*, regarding health, environmental, communications, energy, and nuclear issues) should be tested in the U.S. court system and be subject to U.S. laws. Members who represent labor groups believe that the definition of "investment agreement," in particular, the reference to agreements involving "other assets that a national authority controls," is vague and should be more precisely defined.

Members who represent companies, particularly companies involved in natural resource development, strongly oppose limiting the definition of "investment agreement" to those agreements that take effect "on or after the date of entry into force" of the BIT. In their view, this definition represents a substantial and progressive weakening of the protections afforded by earlier BITs. Prior to 1994, BITs typically obligated governments to observe *all* agreements entered into with investors, not just those related to natural resources or other assets controlled by the government. The 1994 model BIT then limited this obligation to natural resource-related "investment agreements," but provided coverage for both existing and future agreements. The draft model BIT, by limiting coverage to prospective investment agreements only, will leave exposed to injurious action without treaty recourse billions of dollars of existing U.S. investments in countries with which the United States might conclude future BITs, such as China and Russia. These Members are particularly concerned about limiting BIT coverage of investment agreements given that such agreements not only support the operations of U.S. companies and promote U.S. exports, but also advance broader economic and

security interests of the United States, including with respect to energy security, infrastructure, and natural resources.

Footnote four to the definition of "investment agreement" clarifies that such agreements do not include "a unilateral act of an administrative or judicial authority, such as a permit, license, or authorization." Members who represent investors believe that this footnote, or footnote six, should be modified to clarify that unilateral acts on which investors rely in making investments do fall within the concept of "investment authorization." Members who represent labor, environmental and development groups do not believe that the footnotes should be modified in this manner because they believe that this modification would open legitimate regulatory permitting and licensing to challenges before tribunals.

In addition, Members who represent investors do not see any justification for footnote five, which limits the definition of "investment agreement" to only those agreements entered into by central governments, given the significant level of foreign investment that is made pursuant to agreements with sub-central governments.

Scope and Coverage (Article 2)

The Members generally support the scope and coverage provision set forth in Article 2. The draft model BIT applies to "measures adopted or maintained by a Party relating to: (a) investors of the other Party; (b) covered investments; and (c) with respect to Articles 8 [Performance Requirements], 12 [Investment and Environment], and 13 [Investment and Labor], all investments in the territory of the Party." In addition, the obligations in the model BIT apply "(a) to a state enterprise or other person when exercising any regulatory, administrative, or other governmental authority delegated to it by that Party; and (b) to the political subdivisions of that Party."

Some Members, including those who represent labor groups, are concerned that the application of BIT obligations to state enterprises in the current draft is too narrow. In the view of these Members, the obligations should apply to all conduct by state enterprises and not only conduct when state enterprises are "exercising any regulatory, administrative, or other governmental authority delegated to it by that Party." At a minimum, these Members recommend that the provision be clarified so that a state enterprise or other party need not receive an official delegation of authority from the government in order to fall within the scope of the BIT. In other words, the scope of the draft model BIT should include entities acting under the informal direction or influence of the government. In addition, Members who represent labor groups believe that "state enterprise" should be defined to clarify the scope of this provision in future BITs, especially those with countries in which the government plays a substantial role in the economy.

Non-Discrimination: National Treatment, Most-Favored-Nation Treatment (Articles 3-4)

Members who represent companies agree that the draft model BIT should foreclose governments from discriminating against investors of the other Party or their investments on the basis of nationality. More specifically, these Members support Articles 3 and 4, which require each Party to accord investors of the other Party and their investments "treatment no less favorable" than it accords, "in like circumstances," to its own investors and their investments, and to the investors of any third party and their investments, with respect to the "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." These MFN and national treatment articles in the draft model BIT are substantially the same as those in the recent FTAs and the 1994 model BIT.

Members who represent labor and environmental groups have concerns about the MFN and national treatment provisions of the draft model BIT. These Members are concerned that an investor could invoke the MFN obligation to gain access to dispute settlement procedures that are not provided in the BIT between the United States and that investor's home country. These Members believe that the MFN obligation should be clarified to address this concern.

In addition, Members who represent labor and environmental groups believe that the national treatment provision has a broad scope that international tribunals could interpret in a manner that could have negative consequences for appropriate environmental, health and safety, and other public interest protection. For example, these Members believe that the national treatment principle could be interpreted by tribunals as prohibiting public interest regulatory actions that result in *de facto* discrimination, even when there is no facial or intentional discrimination involved. The Members believe that national treatment claims should be limited to facially discriminatory measures or measures that are enacted for a primarily discriminatory purpose. Members who represent labor unions also believe that the national treatment and MFN obligations should not prevent governments from discriminating against investors from so-called rogue states and other countries that they believe violate international norms.

Members who represent investors oppose modifying the MFN and national treatment provisions as recommended by the labor and environmental groups. In their view, MFN and national treatment are fundamental rules of international investment policy and the world trade system. These Members believe that requiring claimants to prove that discrimination was a primary purpose of a measure would eviscerate the national treatment obligation and would be inconsistent with international investment and trade rules. In addition, these Members note that the national treatment standard advocated by the labor and environmental groups does not match U.S. constitutional and federal law on discrimination.

According to the Administration officials who have briefed the Subcommittee, the presumption in future BIT negotiations will be to exclude investments in financial institutions from the MFN and national treatment obligations. According to these

officials, such obligations may be added on a case-by-case basis, depending on whether the BIT partner agrees to undertake adequate market access commitments in financial services. Members who represent companies, especially financial services firms, believe that this is the wrong approach. They believe that U.S. negotiators should insist on adequate market access commitments for investments in *all* sectors, including financial services, as the condition for reaching an agreement. These Members do not believe that the United States should signal that it would be content to exclude financial services from non-discrimination obligations if the BIT partner is disinclined to offer concessions in that sector.

In addition, Administration officials have informed the Subcommittee that even if MFN and national treatment for financial services are added to future BITs, claims arising from any breach of these obligations would be subject only to state-to-state dispute settlement and not to investor-state arbitration. Members who represent companies, and especially those who represent financial services firms, believe that the exclusion of MFN and national treatment claims from investor-state arbitration is not only detrimental to this sector but also unnecessary to address the concerns of financial regulators. As discussed below, Article 20 of the draft model BIT provides a carve-out for prudential measures, including measures applied to ensure the solvency of financial institutions and the protection of depositors. U.S. BIT negotiators could also utilize discrete reservations to clarify that MFN and national treatment obligations are not breached by regulatory decisions that take into account the extent and quality of home-country financial regulation. With this reservation, in addition to the prudential carve-out, Members who represent companies believe that the model BIT should allow financial institutions to pursue national treatment and MFN claims in investor-state arbitration.

Minimum Standard of Treatment (Article 5)

The Members agree that the model BIT should obligate the Parties to provide investors of the other Party and their investments with "fair and equitable treatment" and "full protection and security."

Article 5.1 of the draft model BIT states, "[e]ach Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security." According to 5.2, this obligation

> prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.

Members who represent environmental and labor organizations believe that the minimum standard of treatment, even as so defined, is unbounded and open-ended and

thus could be interpreted by a tribunal as providing greater protection than U.S. law. In particular, they are concerned that the "fair and equitable treatment" element of the minimum standard of treatment is not adequately defined. In their view, the "fair and equitable treatment" obligation is vague, subjective and gives tribunals too much discretion to find that a government measure is in breach of the treaty. The current version of Article 5, according to these Members, provides foreign investors with greater protection under the BIT than they would enjoy under U.S. law.

Members who represent investors oppose the "minimum standard of treatment" provision of the draft model BIT and recommend retaining the provision from the 1994 model BIT, which states, "[e]ach Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law." The minimum standard contemplated in the draft model BIT not only could be interpreted to lower this standard of protection, but would convert the standard from a "floor" on the treatment of investors to a "ceiling." In addition, these Members strongly oppose omitting from the draft model BIT the following provision from 1994 model BIT: "[n]either Party shall in any way impair by unreasonable and discriminatory measures the management, conduct, operation, and sale or other disposition of covered investments." Further, these Members believe that it should be clarified that "fair and equitable treatment" includes more than the obligation not to "deny justice," and that even the latter obligation includes both procedural and substantive aspects. Finally, these Members believe that, given the high level of protection for investment in the United States under domestic law, retaining fair and equitable treatment provision of the 1994 model BIT in no way provides greater rights to foreign investors than they would enjoy under U.S. law.

Expropriation (Article 6)

The Members agree that the model BIT should impose conditions on the expropriation of property. In particular, the Members agree that governments should not directly expropriate investors' property except for a public purpose, in a non-discriminatory manner, on payment of prompt, adequate, and effective compensation and in accordance with due process of law.

The primary difference among Members relates to the point at which the government's exercise of regulatory authority becomes a taking that requires compensation. Members who represent labor and environmental organizations support a narrow view of indirect expropriation under international law and under U.S. takings law, believing that governments must have broad discretion to impose regulations to protect the environment, workplace safety, and other public interests regardless of the cost imposed on a private party. They believe that the definition of indirect expropriation should under no circumstances be broader than their view of U.S. law. These Members believe that the attempt by the Administration to reflect U.S. takings law in Annex B falls seriously short in a number of key respects. For example, these Members believe that the draft model BIT should provide that (1) measures that address a public nuisance should never be considered an expropriation; (2) tribunals should evaluate the effect of a

measure on an investment in its entirety; and (3) the "character of government action" test should be defined to reflect U.S. Supreme Court jurisprudence; (4) the term "property" should be defined clearly, including the distinction in U.S. law between real property and personal property; (5) an adverse effect on economic value should not by itself be considered an expropriation, *no matter how serious the effect*; (6) an investor's expectations should be measured at the time of the investment and the investor should expect regulations to change and become more strict. Finally, Members who represent labor groups are concerned that paragraph 4(b) of Annex B, which refers to certain protected regulatory measures, does not include measures designed and applied to protect worker rights.

Members who represent investors dispute the view of Members who represent labor and environmental groups as to the scope and content of U.S. takings law. In addition, they believe that international law encompasses a broader understanding of indirect expropriation and oppose Annex B. In their view, government measures that undermine the value of an investment to such an extent as to be equivalent to a direct taking should trigger an obligation to compensate the investor for its loss. These Members believe that the text of Article 6, which is substantially identical to the 1994 model BIT, does not require elaboration. The factors set forth in Annex B, according to these Members, are tangential to the core question in an indirect expropriation claim, that is, whether the government interfered with an investor's property to such an extent as to deprive the investor of the value of its investment, motivations being irrelevant. In addition, these Members are concerned that paragraph 4(b) of Annex B could be erroneously interpreted as carving out certain regulatory measures from the obligations of the treaty, even if they completely destroy the economic value of an investment.

In addition, these Members oppose the language in Annex B that provides that a government action will not be considered expropriatory unless it "interferes with a tangible or intangible property right or property interest in an investment." In their view, the term "property" preceding "interest" should be deleted, as it could be used by a tribunal to incorporate domestic law concepts of property that are far narrower than under U.S. law. This would result in protections for U.S. investors abroad that are much lower than those available under U.S. law, according to these Members.

Transfers (Article 7)

Article 7 requires the Parties to permit the free transfer of capital relating to covered investments into and out of their territories. This provision includes a limited number of exceptions to this obligation, such as when a Party applies its laws relating to bankruptcy, securities trading, and criminal or penal offenses. Members who represent labor and environmental groups believe that countries should have greater discretion to impose controls on transfers to prevent capital flight and other destablizing transfers of capital. Members who represent investors support Article 7 and would oppose giving government greater discretion to impose capital controls, which would increase the risk investors face and thus discourage the foreign investment flows that BITs are designed to facilitate.

Performance Requirements (Article 8)

Members who represent investors generally support Article 8, which concerns performance requirements. Article 8 prohibits the Parties from imposing certain requirements as conditions for investment, including requirements to achieve a given level of exports or domestic content, to purchase or give preference to domestic goods, or to restrict domestic sales by relating sales to exports or foreign exchange earnings. This provision also prohibits the use of similar requirements as a condition for receiving an advantage with respect to an investment, though some performance requirements can be placed on the receipt or continued receipt of government subsidies. The provision applies to performance requirements that affect investment from either Party or from any other country.

Members who represent labor groups oppose weakening or reducing any current domestic-content requirements in U.S. law. In addition, these Members oppose the carve-out in Article 8(3), which allows a Party to require investors to "locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory."

Members who represent environmental and development organizations oppose the limitations on performance requirements set forth in Article 8. In their view, governments should retain the discretion to impose such requirements on foreign investors, including requirements to use inputs produced locally.

Article 8 does not preclude the enforcement of performance requirements that are part of agreements between private parties and not imposed by the government. Some Members, including representatives of labor organizations, are concerned that in some countries private parties are subject to considerable influence from the government. In such countries, governments could use private parties to implement performance requirements that otherwise would be prohibited. As with Article 2 above, Article 8 should ensure that the BIT obligations also apply when private parties act under the influence or direction of the government to carry out the government's policies.

Senior Management and Boards of Directors (Article 9)

Article 9(2) provides that "[a] Party may require that a majority of the board of directors . . . be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over the investment." Members who represent companies believe that investors should have full discretion to name their directors, free from any nationality or residency requirements imposed by the host government.

Publication of Laws and Decisions Respecting Investment (Article 10)

The Members support Article 10, which requires each Party to ensure that its "(a) laws, regulations, procedures, and administrative rulings of general application; and (b) adjudicatory decisions respecting any matter covered by this Treaty are promptly published or otherwise made available." This provision is substantially the same as the 1994 model BIT and the recent FTAs. The Members agree that this provision can encourage the development of more transparent, predictable, and secure legal regimes based on adherence to the rule of law.

Transparency (Article 11)

The Members support Article 11, which imposes transparency obligations that are substantially the same as those contained in the transparency chapters of recent FTAs. For example, each Party is required, to the extent possible, to publish in advance measures it proposes to adopt and to provide interested persons the opportunity to comment. In addition, each Party is required to ensure that when its administrative proceedings directly affect persons of the other Party, those persons are provided notice and description of such proceedings and an opportunity to support their position, in accordance with domestic law. Moreover, each Party is required to establish or maintain tribunals or procedures for the purpose of appealing final administrative actions regarding matters covered by the BIT. The Members agree that these transparency provisions, to an even greater degree than the publication requirements in Article 10, may serve as an example for the development of governance systems based on the rule of law.

Some Members who represent environmental groups, however, believe that these transparency obligations may give an undue advantage to businesses. They argue that businesses have greater technological and economic resources to access information and to prepare comments for government proceedings. They believe that the transparency obligations should ensure that domestic residents will be provided adequate access to any information provided to investors, including through dissemination in local languages and non-traditional means.

Investment and Environment (Article 12)

Members hold differing views with respect to Article 12 concerning investment and the environment. Article 12.1 requires each Party to "strive to ensure" that it does not derogate, for the purpose of encouraging investment, from domestic environmental laws "in a manner that weakens or reduces the protections afforded in those laws." A Party may request consultations if it believes that the other Party has offered such encouragement, and the two Parties must consult "with a view to avoiding any such encouragement." Article 12.2 provides that the BIT shall not be construed "to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."

Members who represent environmental organizations believe that Article 12 falls short of the mark by requiring governments merely "to strive" not to derogate from existing environmental laws, which themselves may be inadequate. Further, these Members believe that recourse to consultations rather than binding arbitration is an ineffective remedy. In their view, the model BIT should obligate Members with inadequate environmental protection laws to strengthen, as well as not to derogate from, those laws. These obligations should be enforceable through binding arbitration. In addition, such Members are concerned that allowing Parties to adopt and maintain environmental measures "otherwise consistent with this Treaty" does not provide any additional, substantive protection for such measures.

Members who represent investors support Article 12 and agree that countries should not weaken existing environmental laws for the purpose of attracting investment. On the other hand, these Members would oppose expanding the scope of this Article by, for example, obligating parties to adopt and enforce particular environmental protection measures. These Members also believe that it is necessary to stipulate that only measures "otherwise consistent with this Treaty" are protected; otherwise, countries could avoid the obligations of the BIT simply by asserting that any challenged measure serves an environmental purpose.

Investment and Labor (Article 13)

As with Article 12, Members hold differing views with respect to Article 13 concerning Investment and Labor. Article 13.1 provides that "each Party shall strive to ensure that it does not waive or otherwise derogate from" its labor laws "in a manner that weakens or reduces adherence" to "internationally recognized labor rights" as an encouragement for investment. Those rights include the following: (i) the right of association; (ii) the right to organize and bargain collectively; (iii) a prohibition on forced labor; (iv) labor protections for children, including a minimum age for employment; and (v) acceptable conditions of work with respect to minimum wage, hours of work, and occupational health and safety. If a Party considers that the other Party has derogated from its law in order to encourage investment, then the two Parties shall consult with a view to avoiding any such encouragement.

Members who represent labor organizations believe that Article 13 provides inadequate protection of workers' rights. The provision does not require countries to ensure that their laws in fact protect internationally recognized labor rights, but rather requires only that their laws not become more inconsistent with such rights. These Members believe that the protection of internationally recognized labor rights in domestic law, as well as the commitment not to derogate from those laws to attract investment, should be a fundamental obligation of future BITs. These obligations, according to such Members, should not be subject merely to consultations but should be enforceable through binding arbitration. Moreover, Article 13 fails to include a provision analogous to the limited safeguard in Article 12, *i.e.*, the protection of worker rights measures "otherwise consistent with this treaty."

For reasons similar to those set forth in the discussion of Article 12 above, Members who represent companies do not support going beyond the obligations presently included in Article 13 of the draft model BIT.

Essential Security (Article 18)

Article 18 provides in part that a Party may not be precluded from applying measures that it considers necessary for "the protection of its own essential security interests." Members who represent investors believe that it should be made clear that this provision relates to "national security" and not merely to economic measures that a Party may try to characterize as involving "essential security interests" of any kind. Because this provision is largely self-judging, *i.e.*, the Parties unilaterally decide when a measure is necessary to their essential security, it is important to delimit the circumstances in which the provision can be invoked to prevent its abuse.

Financial Services (Article 20)

Members who represent companies with foreign investments oppose certain provisions of Article 20 concerning financial services. Article 20.1 provides that Parties shall not be prevented from adopting or maintaining measures related to financial services for "prudential reasons," including the "protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system." If, in response to an investor's claim, a Party invokes this so-called "prudential carve-out," the two governments must consult for 180 days to reach a joint determination as to whether the carve-out is a valid defense to the investor's claim. The Parties' determination is binding on the investor-state tribunal. If the Parties do not make a joint determination within 180 days, then either Party may establish a state-to-state panel to resolve the same question, which must render a decision within 180 days. This decision is binding on the investor-state tribunal.

Some Members believe that the draft model BIT, like the 1994 model BIT, should not include any special carve-out for prudential measures. In their view, financial services measures should be subject to the same BIT obligations (*e.g.*, non-discrimination, minimum standard of treatment, conditions on expropriation) as all other types of government regulation. These Members believe that the prudential carve-out could shield a broad range of government measures from the BIT obligations and thus expose U.S. investors to substantial risk.

Other Members accept that a prudential measures carve-out may be appropriate, but believe that the review mechanism for such measures imposes unnecessary restrictions and excessive delays to the point of blocking effective access to investor-state arbitration for financial institutions. In their view, the 180-day consultation period—which is three times longer than the consultation period provided in recent FTAs—is excessive and unjustified. These Members also believe that if the two Parties cannot agree that a measure is prudential in nature, then the claim should return to investor-state

arbitration rather than proceed to state-to-state dispute settlement. With these changes, the review procedure for prudential measures would match the procedure for reviewing whether a challenged tax measure constitutes an expropriation.

Members who represent environmental, labor, and development groups would support government screens and exceptions not only for financial services but also for other types of vital governmental regulation, such as environmental protection, workplace safety, and food safety regulation. In their view, these and other forms of government regulation also deserve the insulation from challenges that the draft model BIT affords to financial services regulation.

In addition, all of the Members question why financial services measures should be subject to different transparency obligations than other government measures. As discussed above, Article 11 requires the Parties to publish in advance and provide a reasonable opportunity to comment on all proposed government measures "to the extent possible." With respect to financial services measures, however, governments need only publish in advance and provide opportunity for comment "to the extent practicable." The Members see no reason why financial services measures should be subject to lesser transparency obligations than other government measures.

Investor-State Dispute Settlement (Articles 23-36)

The investor-state dispute settlement procedures in the draft model BIT are substantially the same as those in the investment chapters of recent FTAs, but are far more detailed than those included in the 1994 model BIT. Although the Members generally believe that these new procedures improve upon the dispute settlement process, the procedures have not been the subject of extensive discussion among Members. The following, therefore, is simply a summary of the key provisions that does not reflect any agreement among the Members on the desirability or value of the investor-state arbitration mechanism.

Article 24 allows investors to submit claims to binding arbitration that a Party has breached a substantive obligation of the BIT, an investment agreement, or an investment authorization, causing the investor to suffer a loss. A claim may not be submitted until at least six months have elapsed since the events giving rise to the claim. Under Article 26, a claim may not be submitted more than three years after the claimant first acquired, or should have acquired, knowledge of the breach for which the claimant suffered a loss. In order to submit a claim, an investor must waive any right to initiate or continue any domestic dispute settlement procedures. The Members who represent investors believe that the waiver provision of Article 26(3) should be modified to provide that a claimant not only may continue actions for injunctive relief, but also may defend itself in administrative or judicial proceedings and may appeal from an adverse decision in any such proceeding.

With respect to the conduct of the arbitration, the draft model BIT incorporates the latest developments from the FTAs. For example, Article 28 authorizes tribunals to

accept and consider *amicus curiae* submissions. In addition, tribunals are required to address, on an expedited basis, objections by the respondent Party that the claimant has failed to state a claim for which an award in favor of the claimant may be granted. In the context of such preliminary proceedings, tribunals are directed to consider whether a claim or defense was frivolous in determining whether costs and fees should be awarded to the prevailing party.

Article 29 requires that the principal documents of the proceedings be released to the public and that hearings be open to the public, but allows certain information, including business confidential information, to be protected from disclosure. The Members who represent investors support this provision. Article 33 alleviates the burden of defending multiple claims arising from the same event by permitting such claims to be consolidated in a single proceeding. Finally, the draft model BIT provides that if a separate multilateral agreement enters into force that establishes an appellate body for the purpose of reviewing investment decisions, the Parties will "strive to agree" that such body will review the awards under the BIT agreement.

Members who represent labor and environmental groups recommend several changes to the dispute settlement procedure. First, they believe that the two governments should have the opportunity to block claims involving vital public interests, such as health and safety, the environment, and workers' rights from proceeding to investor-state arbitration in the same manner as claims involving allegedly expropriatory tax measures may be blocked. Second, they believe that investors should be required to exhaust domestic remedies before pursuing international arbitration. Third, these Members are concerned that the draft model BIT allows subsidiaries of U.S. corporations to bring claims against the United States, which, in the view of these Members, would undermine what they believe to be the "diversity of nationality" principle. Fourth, these Members believe that the draft model BIT should itself include an appellate mechanism, rather than a provision indicating the Parties' intent to consider such a mechanism.

Members who represent companies oppose each of these recommendations. In their view, creating a governmental filter on investment claims would defeat a core purpose of BITs, which is to de-politicize disputes and resolve them by the rule of law rather than by political negotiation. In addition, they believe that requiring the exhaustion of local remedies runs contrary to a second basic purpose of BITs, which is to provide a stable, transparent legal framework for investment in countries where such a framework may not yet be assured. Further, these Members believe that the Parties should be able to deny the benefits of the treaty to particular claimants only if those claimants have no substantial business operations in the other Party. Finally, these Members do not believe that the negotiation of future BITs should be delayed until an appellate mechanism, which involves many complex legal and public policy issues, is developed.

Governing Law (Article 30)

Article 30(1) directs tribunals to apply the provisions of the BIT and applicable rules of international law when deciding claims arising from an alleged breach of the treaty. For claims arising from alleged breaches of investment agreements or investment authorizations, Article 30(2) directs the tribunal to apply the rules of law specified in the agreement or authorization, or, where such rules have not been specified, the law of the respondent and such rules of international law as may be applicable. Finally, Article 30(3) provides that any joint decisions by the Parties regarding the interpretation of the BIT shall be binding on a tribunal.

Members who represent investors emphasize their support for the governing law provisions related to investment agreements and authorizations. In particular, these Members believe that for investment agreements and authorizations that do not specify the rules of law, the incorporation of applicable rules of international law in addition to the law of the respondent represents an appropriate balance between the parties to the agreement and can further strengthen the rule of law in countries with which the United States negotiates BITs. On the other hand, Members who represent investors oppose Article 30(3), which in effect invites respondent governments to convert investor-state disputes, where the rule of law governs, into diplomatic negotiations between the parties to the BIT. As such, this provision runs contrary to one of the core purposes of BITs, that is, to de-politicize disputes between investors and host governments.

Interpretation of Annexes (Article 31)

Similar to the mechanism in Article 30(3), Article 31 invites a respondent government to seek a joint interpretation from the parties to the BIT as to the meaning of any disputed provision of Annex I and II, which set forth the parties' reservations to the treaty. Members who represent investors oppose this provision because they believe that, like Article 30(3), it tends to re-politicize a dispute settlement process that should be governed instead by the rule of law.

State-to-State Dispute Settlement (Article 37)

Members who represent companies with foreign investments, particularly financial services firms, are concerned that the state-to-state dispute settlement procedure in the draft model BIT, unlike the 1994 model BIT and recent FTAs, does not include a limit on the length of the procedure. The absence of a time limit is of particular concern to financial services institutions because, as discussed above, state-to-state dispute settlement is the only recourse envisioned by the draft model BIT for the national treatment and MFN claims of such institutions. By directing such claims to state-to-state dispute settlement without any limit on the duration of those proceedings, the draft model BIT provides an ineffective remedy for the national treatment and MFN claims of U.S. financial institutions.

Conclusion

As reflected in this report, the Members of the Investment Subcommittee have differences of opinion with respect to the draft model BIT. At the same time, the Members agree on some specific provisions of the draft model BIT as well as on the following general principles:

(1) U.S. investment policy should facilitate investment that strengthens the U.S. economy, and, in particular, should ensure that international investment is treated fairly, while not imposing undue restraints on the authority of governments to implement regulatory measures to protect the public interest.

(2) Although Members disagree as to the specific content of international investment rules, they agree that such rules, if appropriately written, can play a role in facilitating foreign investment by creating a regulatory framework that is transparent, stable and predictable.

(3) The State Department should establish a model BIT, as it increases the transparency of U.S. investment policy and negotiations.

ANNEX

MEMBERS OF THE SUBCOMMITTEE ON INVESTMENT

Peter Bass ..... Goldman Sachs
Steve Beckman ..... United Auto Workers
Jake Caldwell ..... National Wildlife Federation
Stephen Canner ..... U.S. Council of International Business
Katherine Daniels ..... Oxfam America
Elizabeth Drake ..... AFL-CIO
John Echeveria ..... Georgetown University Environmental Policy Project
Jim Fatheree ..... U.S.-Japan Business Council
Jennifer Federico ..... The Center for Int'l Environmental Law
Mike Gadbaw ..... General Electric
Oscar Garibaldi ..... Covington & Burling
John Goyer ..... U.S. Coalition of Services Industries
RW Haines ..... ExxonMobil
Mary Irace ..... National Foreign Trade Council
Thea Lee ..... AFL-CIO
Chuck Levy ..... Business Roundtable
Daniel Magraw ..... The Center for Int'l Environmental Law
Linda Menghetti ..... Emergency Committee for American Trade
Joel Messing ..... CIGNA
Marcos Orellana ..... The Center for Int'l Environmental Law
Matt Porterfield ..... Georgetown University Law Center, Harrison Institute for Public Law
Bill Primosch ..... National Association of Manufacturers
Rick Rowden ..... Action Aid USA
Dan Seligman ..... Sierra Club
David Strongin ..... Securities Industry Association
Jose Unis ..... Natural Resources Defense Council
Bob Vastine ..... U.S. Coalition of Services Industry
Martin Wagner ..... Earthjustice
David Waskow ..... Friends of the Earth

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