CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW (CIEL)

Separate Comments of TEPAC Members on the Investment Chapter of the U.S.-Australia Free Trade Agreement

William Butler, Board Member, Audubon Naturalist Society
Rhoda H. Karpatkin, President Emeritus, Consumers Union of United States
Daniel Magraw, President, Center for International Environmental Law
Durwood Zaelke, President, Institute for Governance and Sustainable Development

March 9, 2004

We agree with some portions of the TEPAC Report and disagree with other portions. We also have additional views on some issues that are either not touched upon or referenced only briefly in the Report, but which we believe the Congress should consider. We are thus submitting these additional comments based on our review of the U.S.-Australia FTA text.

I. General Comments

We note with approval that the U.S.-Australia FTA investment chapter does not contain an investor-state dispute mechanism. This is positive for several reasons. Experience with cases being brought under existing agreements (chiefly NAFTA and numerous bilateral investment treaties or BITs) demonstrates that individual investors are pushing for expansive readings of the substantive obligations in those agreements. Further tilting international investment rules in favor of investors at the expense of the ability of governments to regulate in the public interest is a threat to good governance and public welfare. The reliance on domestic courts in the first instance, and on state-to-state dispute settlement only if needed, provides more appropriate fora for the balancing the rights of investors against the public interest. In addition, requiring investors to rely in the first instance on domestic legal remedies helps build the rule of law by allowing national legal regimes to resolve any legitimate claims by investors. Allowing investors to remove disputes from national legal systems, as is the case in most recent U.S. investment treaties, stunts the development of those systems.

Notwithstanding, the lack of the investor state dispute mechanism, the underlying provisions of the investment provisions of the U.S.-Australia FTA are largely unchanged from those negotiated in recent U.S. FTAs, and thus remain highly problematic. We do not believe that the provisions we have reviewed comply with the direction from Congress that new international investment rules not provide foreign investors with

"greater substantive rights" than domestic investors enjoy under U.S. law[1]. Nor does the approach address the fundamental problems environmental groups and others have identified with the NAFTA/BIT approach.

The explicit limitation of the minimum standard of treatment provision to "customary international law" corrects one serious flaw with the NAFTA approach, which referenced only "international law." Of course, the content of customary international law with respect to the treatment of aliens is not crystal clear and it remains to be seen how arbitral panels will apply this standard. In addition, the removal of "tantamount to" language in the expropriation text and the inclusion of a "shared understanding" in an annex to the text provide greater guidance to future arbitral panels that could limit the more expansive readings of NAFTA's expropriation provision.

However, the agreement references international law concepts as the guideposts for interpreting the substantive obligations – leaving substantial interpretive room for arbitrators to exploit. The inclusion of terms like "fair and equitable" provide arbitral panels with standards that do not exist in U.S. law. The lack of an appellate process and the lack of any oversight role for U.S. courts inhibit the development of a clear jurisprudence consistent with U.S. investor protections. There can thus be no assurance that either expropriation or minimum standard of treatment will be applied in a manner consistent with the U.S. legal norms as required by the Trade Act of 2002. Part III below details a number of specific ways in which the expropriation and minimum standard of treatment provisions fail to meet the "no greater substantive rights" standard.

Need not demonstrated. More broadly, there has been no evidence provided to TEPAC that investment rules are necessary in bilateral relations with Australia. To our knowledge, there is no publicly available information that would suggest that Australia has mistreated U.S. investors in recent years. Equally, there has been no showing that Australia's judicial system is not capable of resolving complaints of U.S. investors. One must thus question the need for investment rules in the first place.

Regulatory effects not adequately understood. The bulk of the concerns expressed by environmental groups and others involve the regulatory effects of the investment rules. In other words, the rules and the investor-state process have been used to challenge domestic regulations designed to protect the environment and public health or advance other important social objectives. We understand that the U.S. has taken reservations for a considerable number of existing domestic regulatory programs at various levels of government (the text of the reservations was not available for review via the secure web-site). Analysis of the proposed reservations would indicate the types of regulatory programs that would (presumably) fail to comply with the proposed rules in the investment chapter. Despite having this information at their disposal, USTR has thus far failed to undertake an adequate attempt to analyze the regulatory impact of investment rules through the environmental assessment process elaborated under Executive Order 14131. The failure to fully understand the impact of the proposed rules on domestic

[1] Part III below addresses in more detail the failure of the agreements to meet the "no greater substantive rights" standard.

regulation (either domestically or abroad) undermines assertions that these agreements will support sustainable development.

Failure to correct imbalance. Finally, we see the continuation of an imbalanced approach to the treatment of investors (most of which are corporate actors) as opposed to citizens generally in international economic law. Investors are given explicit rights and enforcement mechanisms to hold governments accountable. On the other hand, there is no citizen enforcement mechanism included in the agreement – not even a process analogous to the NAFTA Commission for Environmental Cooperation citizen submission process. Moreover, the investment rules do not even mention, much less require, minimum standards of corporate conduct on investors acting abroad.

In a separate minority statement on investment issues, one of our colleagues refers to the Alien Tort Claims Act and the efforts in U.S. courts to use this statute to hold U.S. corporations accountable for their actions abroad as an example of actionable mistreatment of investors. We could not disagree more strongly. Home country efforts to hold their corporations responsible for their actions abroad are a critical element in building better international governance and the Alien Tort Claims Act is an important tool in that respect.

II. Specific Concerns

Definitions. The definition of investment differs markedly from that in NAFTA and appears to be even broader in scope. The effect of this definition is not clear, but at a minimum it raises questions as to the types of property interests the agreement seeks to protect and whether those notions are consistent with the limited notion of protected property interests under the U.S. Constitution and case law. The reference in the expropriation annex to "a tangible or intangible property right or property interest" does little to elucidate the precise scope of property interests protected by the agreement for purposes of ensuring consistency with the "no greater substantive rights standard."

Distinguishing investors based on environmental criteria. In the non-discrimination provisions (national treatment and most favored nation treatment) there is no clarity regarding the extent to which environmental criteria can be used as the basis to fairly distinguish between investors. In particular, there is no explanatory note that would ensure that future panels are guided by a notion of "like circumstances" that would accept environmental criteria as an important part of the like circumstances analysis. The classic example is in regulating point source pollution of a river. The absorptive capacity of the river system could, for example, allow five sources of pollution without significant harm, but a sixth could create too heavy a load and result in significant environmental harm. Would national treatment require the sixth facility (identical in everyway to the first five, but for foreign ownership) to be compensated if it is not allowed to operate? The negotiators have demonstrated at numerous points in the text a willingness to try to provide panels with guidance, and the failure to do so here is puzzling – particularly, as

noted below, when there is no general environmental exception for the investment chapter.

Lack of environmental exception. The failure to include a general environmental exception to the investment chapter is a further indication that international investment rules remain a significant threat to environmental and other policies enacted by governments to further the public interest. If, as the supporters of strong investment protections argue, such rules pose no threat to legitimate environmental regulations or actions of government, then why not ensure that result by clearly carving out such regulations from the ambit of the rules? The approach in Article XX of the GATT, if applied to investment, would ensure that governments are not required to compensate investors for the consequences of entirely legitimate and reasonable environmental regulation. As noted above, the failure to explicitly include environmental factors in the like circumstances analysis heightens the need for an effective environmental exception.

Performance requirements. The performance requirements section includes a puzzling environmental exception for some but not all of its provisions. The exception singles out some paragraphs and not others and directs that they not be construed in a way to prevent a Party from adopting or maintaining legitimate environmental measures. Does this mean that the paragraphs not mentioned may be construed to prevent a Party from adopting or maintaining legitimate environmental measures? If not, then why not apply the exception more broadly?

Investor-State Consultations: sneaking in the back door? Article 11.16 appears to offer the possibility that investor will be able to bring direct arbitration claims against one or the other Party. The provision refers to a "change of circumstances" as providing a potential basis for such a claim going forward. This ambiguous reference creates unnecessary confusion over whether or not investor-state disputes are indeed off the table in this agreement. While we read the provision as allowing either Party to effectively prevent such claims moving forward, we see no benefit to including this provision.

III. The Investment Provisions of the U.S.-Chile and U.S.-Singapore FTAs Fail to Meet the "No Greater Substantive Rights" requirement of the Trade Act of 2002

The Trade Act of 2002 requires that investment provisions "ensur[e] that foreign investors are not accorded greater substantive rights with respect to investment protections than United States investors in the United States…." Section 2102(b)(3).

Like the Chile and Singapore FTAs, the U.S.-Australia FTA clearly reflects a departure from the investment provisions in previous agreements to which the U.S. is a party, including NAFTA Chapter 11, however, those changes fail to meet the standard articulated by Congress. While there are potentially helpful elements in the proposals, they fail to adequately reflect U.S. law, or even international law, in many respects – including the particular Supreme Court decision, *Penn Central*, on which USTR intended to base much of the standard for expropriation.

The U.S.-Australia FTA 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, and on the basis of those, imposing financial liability on the U.S. for legitimate regulatory and other actions is extremely troubling.

The agreements are also flawed, however, in failing to do what they purport to do – that is, reflect U.S law. A number of particular concerns regarding the standards for expropriation and minimum treatment are addressed below.

Expropriation

The removal of the "tantamount to" language and the inclusion of the annex setting out a shared understanding of the expropriation provision provide incremental improvements. However, in attempting to define a standard, the agreement first references customary international law on expropriation and then focuses on a limited, and imbalanced, set of the critical factors used by the Supreme Court in determining takings cases. The agreements fail to include critical standards established in U.S. jurisprudence that preclude findings of compensable expropriations, and leaves unclear in a problematic manner some of those that it has chosen to reference. For example, they do not include the critical Supreme Court principle that a governmental action must permanently interfere with a property in its entirety in order to meet a threshold requirement to constitute a taking.[2] Simply listing some of the factors the Supreme Court discussed in *Penn Central*, but without the essential explanations and limitations that were set forth in that case and in subsequent rulings, provides no assurance that foreign investors will not in fact be granted greater rights than U.S. investors. This failure to provide explanations and limitations for critical standards includes the use of the "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.[3] In addition, the

[2] The Supreme Court has clearly stated that takings analysis must be based on the effect of the government action on the parcel as a whole, not its segments. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 130-31 (1978). 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)

[3] The Supreme Court's reference to that factor in *Penn Central* reflects a clear limitation on takings claims under U.S. law that is not evident in an unexplained reference to the "character of government action." In *Penn Central*, the Court explained that a "'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government, . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the public good." The Supreme Court thus referred to the character of government action to distinguish between a permanent invasion of land, which is more likely to give rise to a right to compensation, and normal regulatory action,

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.[4] Property rights are not defined in the agreement, nor is there any reference to the fact that under Supreme Court cases takings claims must be based upon compensable property interests, which are defined by background principles of property and nuisance law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992). Furthermore, the agreement fails to include the fundamental distinction between land and "personal property."[5]

While the "rare circumstances" language in the agreements provides some direction for arbitral panels, it 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. It would be more accurate to state that regulatory actions designed to protect health, environment, or the public welfare do not constitute an expropriation, except in instances equivalent to a permanent, compelled, physical occupation.[6]

Minimum Standard of Treatment

In regard to minimum, or general, treatment, we are deeply concerned that the term "fair and equitable treatment" has been included as an essential element of the standard. "Fair and equitable treatment" opens the door to outcomes in investment cases that go far beyond U.S. law. While we welcome the clarification that "fair and equitable" includes procedural due process, inclusion of one principle in a standard does not eliminate the significant potential of a broader, unbounded interpretation of the standard. The terms "fair" and "equitable", after all, are inherently subjective and incapable of precise definition.

---

for which compensation is only required in extreme circumstances that are equivalent to a permanent, compelled, physical occupation. Without a clear explanation of how the character of government action affects the analysis of a takings claim, a tribunal applying this factor would be free to interpret it so as to afford foreign investors far greater rights than the U.S. Constitution provides.

[4] The expropriation annex 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. For example, it fails to include the *Concrete Pipe* Court's reiteration of the principle that those who do business in an already regulated field "cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end." *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 508 U.S. 602, 645 (1993).

[5] "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).

[6] 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).

- There is no right corresponding to "fair and equitable treatment" under U.S. law. The closest thing in U.S. law is the Administrative Procedure Act (APA), which allows a court to review federal regulations to determine whether they are "arbitrary or capricious." First and foremost, 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. The two proposed agreements thus constitute a massive enlargement of foreign investors' rights. Secondly, the APA does not provide for monetary damages (as these investment provisions would allow); only injunctive relief is allowed.

  Foreign investors have the same rights as U.S. investors under the APA to seek injunctive relief. Enshrining this equal access in a trade agreement is one thing, but granting foreign investors the right to be paid the costs of complying with a requirement that may violate the APA but does not constitute a compensable taking under the Constitution as interpreted by the Supreme Court would clearly violate the Congress' "no greater substantive rights" mandate. In other words, giving foreign investors the right to monetary damages under investment rules, where an identically situated U.S. investor would be limited to injunctive relief, would violate the "no greater substantive rights" mandate. Finally, U.S. courts are bound by deference doctrines in applying the APA; there is no equivalent doctrine in the Chile and Singapore agreements or other international law, to our knowledge.

- In addition, the "fair and equitable" language, if viewed as an independent standard, is extremely dangerous to good governance. It would invite an arbitral 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 free trade agreements. 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.