Investment Rules in Trade Agreements

Top 10 Changes to Build a Pro-Labor, Pro-Community and Pro-Environment Trans-Pacific Partnership

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Investment Rules in Trade Agreements: *Top 10 Changes to Build a Pro-Labor, Pro-Community and Pro-Environment Trans-Pacific Partnership*

Summary

The Trans-Pacific Partnership (TPP) offers an opportunity to develop a new model that balances the interests of private foreign investors with those of labor, environment, and the general public interest. President Obama and countless members of Congress have campaigned on just such a pledge.

The U.S. government has signed "free trade agreements" (FTAs) or bilateral investment treaties (BITs) with 52 nations that provide sweeping powers to private foreign investors and corporations, but impose no new social or environmental obligations. As a result, these rules facilitate off-shoring of U.S. jobs and undermine sustainable development strategies. They are also anti-democratic. Private foreign investors are allowed to bypass domestic courts and sue governments in international tribunals, demanding compensation for laws and regulations that reduce the value of their investments.

This document identifies the top changes to these investment rules that should be made to the TPP and that would do the most to reduce the threat to the general public and environment. The list begins with the most controversial and problematic element – investor-state dispute settlement. Changes to this mechanism are critical if we are to strike the right balance between public versus private for-profit interests. However, even if this mechanism is left intact, other reforms could go a long way towards reining in the excessive powers granted to private investors.

1. Replace the Investor-State Dispute Settlement Mechanism

The international tribunals that currently rule over investor-state claims lack public accountability, standard judicial ethics rules, and appeals processes. This system should be replaced with a state-to-state mechanism to guarantee the crucial role of governments in protecting the public interest. If this is not possible, investors should at least be required to exhaust domestic remedies before proceeding to international tribunals. A diplomatic screen should also be established to prevent frivolous claims or claims which otherwise may cause serious public harm. See page 3 for more detailed information.

2. Limit Claims over the "Minimum Standard of Treatment" to Ensure Compliance with the "No Greater Rights" Principle

Vaguely worded provisions guaranteeing foreign investors a "minimum standard of treatment" (MST), including "fair and equitable treatment," open the door to investor-state claims over a wide range of government measures that are otherwise permissible under the U.S. Constitution. In *Glamis Gold v. the United States*, the United States successfully persuaded the tribunal to accept a relatively narrow interpretation of the MST principle. Since the tribunals are not required to follow judicial precedent, State's arguments should be codified in FTA or BIT text to prevent arbitrators in future cases from making overly broad interpretations that undermine responsible policymaking. See page 4 for more detailed information.

3. Limit Claims over "Indirect Expropriation" to Comply with the "No Greater Rights" Principle

In the past, expropriation applied to the physical taking of property, for example when a government expropriates a house to make way for a highway. Under most international investment agreements today, investors are also protected against "indirect" expropriation, which can be interpreted to mean regulations and other government actions that reduce the value of a foreign investment. While international arbitration tribunals cannot force a government to repeal laws or regulations, the threat of massive damages awards can put a "chilling effect" on policymaking. FTAs and BITs should be revised to clarify that regulatory measures that do not transfer ownership of the investment do not constitute acts of indirect expropriation. See page 6 for more detailed information.

4. Narrow the Definition of Investment

Covered investments should include only the real property rights and other specific interests in property that are protected under the U.S. Constitution. See page 7 for more detailed information.

5. Allow Policies to Prevent and Mitigate Financial Crises

Although many governments have used capital controls effectively to avoid the worst effects of financial crises, U.S. FTAs and BITs still include sweeping restrictions on this policy tool. Existing rules could also thwart efforts to adopt small taxes on foreign exchange transactions and trades of other financial instruments aimed at curbing excessive speculation. Agreements should include safeguards for financial crises that are not subject to investor-state dispute settlement. They should also exclude short-term investments ("hot money") and sovereign debt from the definition of investment. Moreover, the prudential measures defense language common to many FTAs and BITs should be strengthened in the TPP. See page 10 for more detailed information.

6. Add a General Exception for Environmental and Labor Protections

Some FTAs include an "Investment and Environment" provision that appears to be intended to safeguard environmental regulations from investor-state claims. However, the language could be interpreted as meaningless, since it provides protections only for government actions that are "otherwise consistent" with the FTA or BIT. Investment rules should include a general exception for measures related to the protection of health, safety and the environment; natural resource conservation; and international human and labor rights. See page 13 for more detailed information.

7. Eliminate the Subsidiary Loophole

"Denial of Benefits" provisions contain a loophole that allows corporations to bypass their own country's domestic courts by filing investor-state claims through foreign subsidiaries located in a FTA or BIT partner nation. This is explicitly permitted in many agreements, so long as the corporation has "substantial business activities" in the other Party. Since "substantial" is not clearly defined, a U.S.-based corporation could sue the U.S. government by setting up a storefront subsidiary in another country. See page 15 for more detailed information.

8. Prevent Abuse of National Treatment Obligations[1]

Protecting foreign investors from flagrant discrimination is a basic principle of international trade and investment agreements. However, existing texts open the door to abuse. Under national treatment provisions, an environmental regulation that results in a disproportionate impact on a foreign investor could be considered a violation – even if there is no intentional discrimination.

9. Prevent Abuse of Most-Favored Nation Obligations[2]

Existing MFN provisions leave open the possibility that foreign investors could claim greater rights than are provided under the FTA or BIT agreed to by their home country. This loophole could lead to an even larger web of excessive international investor protections, where investors could pick the most advantageous standards and dispute settlement mechanisms.

10. Create a Level Playing Field Between State-owned and Private Enterprises[3]

As the U.S. government pursues investment agreements with countries that are major capital exporters and that have large state-owned enterprises, it is clear that these deals can no longer be viewed solely as packages of rights for U.S.-based foreign investors. Negotiators should ensure that state-owned enterprises which invest in productive assets in the United States do not receive financing and inputs at below market rates or access to other anti-competitive subsidization by a foreign government.

Replace the Investor-State Dispute Settlement Mechanism

The investor-state dispute settlement mechanism should be replaced with a state-to-state mechanism. If the administration continues to include an investor-state dispute settlement mechanism, investors should be required to exhaust domestic remedies before filing a claim before an international tribunal. That mechanism should also provide a screen that allows the Parties to prevent frivolous claims or claims which otherwise may cause serious public harm.

Investor-state claims often involve matters of vital importance to the public welfare, the environment, and national security. However, international arbitrators are not ordinarily well-versed in human rights, environmental law, or the social impact of legal rulings. Accordingly, BITs and the investment chapters in free trade agreements (FTAs) should provide only for state-to-state dispute settlement, which guarantees the crucial role of governments in determining and protecting the public interest.

However, if investors are still allowed to file claims against governments before international tribunals, they should at least be required to first exhaust domestic legal remedies. The exhaustion requirement is a fundamental principle of international law.[4] It is also U.S. policy with regard to most claims by U.S. citizens against foreign governments.[5] There is simply no reason for foreign investors to pursue claims against the United States outside of the U.S. judicial system, unless it is in an attempt to obtain greater rights than those provided under U.S. law.

Moreover, many of the countries that the United States is negotiating investment agreements with have strong domestic legal systems. For example, New Zealand, Australia and Singapore, which are among the countries negotiating the Trans-Pacific Partnership Agreement with the United States, are all ranked by the World Bank as performing at least as well as the United States with regard to control of corruption and adherence to rule of law.[6]

In countries with less well developed legal systems, the exhaustion requirement would promote a key U.S. foreign policy goal – the strengthening of domestic judicial systems. Requiring exhaustion would also restore some balance to a system that currently elevates the interests of foreign investors over other groups – including labor, environmental and human rights organizations – which do not enjoy comparable private rights of action to enforce international legal obligations.

Under international law, the exhaustion requirement does not apply when attempts to use domestic legal remedies would be futile. This would allow investors to proceed to international tribunals if, for example, domestic remedies caused undue delay[7] or if domestic courts lacked jurisdiction to provide relief.[8] Even if the domestic courts lacked jurisdiction to hear international law claims, the exhaustion requirement could be satisfied by raising the substance of the claim under domestic law.[9]

In addition to requiring exhaustion of domestic remedies, the dispute settlement mechanism for investment agreements should include a diplomatic screen that would allow a Party government to prevent claims that the Party believes to be inappropriate, without merit, or would cause serious public harm. The screen mechanism could be based on the provisions in some investment agreements that permit both Parties (*i.e.* both the home state of the investor and the Party whose measure is being challenged) to block certain claims against tax measures or prudential regulations regarding financial services. The screen should apply broadly and include, at a minimum, health and safety, environmental, consumer protection, and human and labor rights measures. Either Party involved in an investment dispute should be able to invoke the screen mechanism to prevent a claim from proceeding.

Limit Claims over the "Minimum Standard of Treatment" to Ensure Compliance with the "No Greater Rights" Principle

Vaguely worded provisions guaranteeing foreign investors a "minimum standard of treatment" (MST), including "fair and equitable treatment," open the door to investor-state claims over a wide range of government measures that are permissible under the U.S. Constitution. In the case of Glamis Gold v. the United States*, U.S. State Department lawyers successfully persuaded the tribunal to accept a relatively narrow interpretation of the MST principle. Since these tribunals are not required to follow judicial precedent, State's arguments should be codified in FTA or BIT text to prevent arbitrators in future cases from making overly broad interpretations that undermine responsible policymaking.*

There is broad, bipartisan support for the principle that the investor protection standards contained in U.S. investment agreements should not provide foreign investors with greater rights than those enjoyed by U.S. investors in the United States. Congress first instructed U.S. negotiators to comply with the "no greater rights" principle in the Trade Act of 2002.[10] In May 2007, the Bush Administration and the Democratic leadership in the House of Representatives agreed that this principle would be explicitly stated in the preamble of the investment chapters of free trade agreements.[11] During his election campaign, President Obama similarly pledged not to grant foreign investors any rights in the U.S. greater than those of Americans.[12] Moreover, the bipartisan Trade Reform Accountability and Democracy Act (TRADE Act), supported by a majority of House Democrats, would require trade agreement investment provisions to ensure that foreign investors operating in the United States are not afforded greater rights than those afforded to domestic investors by the Constitution and laws of the United States, and define the standard of minimum treatment to provide no greater legal rights than United States citizens possess under the due process clause of section 1 of the 14th amendment to the Constitution of the United States.

The minimum standard of treatment provisions in U.S. investment agreements is intended to reflect the relevant standard under customary international law, which is created through the "general and consistent practice of states followed by them from a sense of legal obligation."[13] Given that the U.S. Constitution provides among the highest levels of protection for property rights of any country, standards that are based on the general and consistent practice of nations regarding the protection of property rights would generally comply with the no greater rights principle.

Unfortunately, arbitral tribunals have not based their interpretations of the "minimum standard of treatment" provisions of investment agreements on the actual practice of nations, but rather have simply cited the characterization of these standards by other tribunals, using essentially a common law methodology to create "evolving" standards of investor protection.[14]

In *Glamis Gold v. United States*, the United States, represented by the State Department, noted that state practice and *opinio juris* had established minimum standards of treatment with regard to foreign investors and investment in only a few areas, including the following:

1) the obligation to provide internal security and police protection to foreign investors and investment (*i.e.* "full protection and security"),

2) the obligation not to "deny justice" by engaging in "notoriously unjust" or "egregious" conduct in judicial or administrative proceedings (*i.e.* the *Neer* standard), and

3) the obligation to provide compensation for expropriation (which is redundant with the expropriation articles of BITs and FTA investment chapters).[15]

Conversely, the United States rejected Glamis's assertion that the minimum standard of treatment prohibits either conduct that frustrates an investor's expectations concerning an investment,[16] or "arbitrary"[17] conduct. Regarding Glamis's claim that the minimum standard of treatment required compensation for measures that adversely affect an investor's expectations, the United States noted that such an interpretation was both inconsistent with the no greater rights mandate and unsupported by state practice.[18]

The asserted right to compensation for government measures that a tribunal deems "arbitrary" would similarly provide greater rights than the comparable standard under U.S. law. The Administrative Procedure

Act does provide for review of certain final agency actions under an "arbitrary and capricious" standard of review. No comparable standard of review for economic legislation has been available, however, since the 1930s, when the Supreme Court abandoned the aggressive substantive due process review of the *Lochner* era.[19] Although substantive due process review of economic legislation remains theoretically possible, the post-*Lochner* standard is a highly deferential "minimum rationality" review, pursuant to which legislation will be upheld "unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators."[20]

Not only would an international "arbitrary" standard of review for economic legislation provide greater rights than the highly deferential standard of review for substantive due process claims, it would also exceed the standard of protection afforded under the domestic law of other developed countries. The Supreme Court's *Lochner* era jurisprudence, in fact, "stands as perhaps the paradigmatic instance of an 'anti-model' of comparative constitutional experience."[21] Accordingly, future U.S. investment agreements should codify the State Department's deferential interpretation of the minimum standard of treatment.

Recent FTAs include an annex that provides guidance on identifying customary international law. If such an annex were included in the TPP, additional language (indicated in italics) could be added to both clarify the standard for relevant state practice and reflect the positions taken by the U.S. State Department concerning the establishment of customary international law:

> The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Article 11.5 and Annex 11-B results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 11.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.
>
> *The sources for determining what constitutes the relevant practice of a particular state shall include provisions contained in domestic constitutions, a consistent pattern of rulings in the country's highest courts, or long-standing statutory or common law practices. The claimant has the burden of demonstrating both the existence of a rule of customary international law and of demonstrating that the respondent State has violated that rule with regard to the investor.*[22] *The awards of arbitral tribunals that do not examine relevant state practice are insufficient to demonstrate the content of customary international law.*[23]

Limit Claims over "Indirect Expropriation" to Comply with the "No Greater Rights" Principle

U.S. investment agreements should clarify that an "indirect expropriation" occurs only when a host state seizes or appropriates an investment for its own use or the use of a third party, and that regulatory measures that adversely affect the value of an investment but do not transfer ownership of the investment do not constitute acts of indirect expropriation.

Recent U.S. investment agreements contain several important clarifications concerning the standard for "indirect expropriation." Three provisions in particular are significant: language indicating that the standard is intended to reflect customary international law concerning the obligation of States with respect to expropriation,"[24] provisions indicating that in order to constitute an expropriation a measure must affect a property right,[25] and language indicating that "[e]xcept in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations."[26]

Despite these reforms, however, there remains the potential that the indirect expropriation provisions of investment agreements could be applied in a manner that would violate the "no greater rights" principle by providing foreign investors with greater rights than the comparable protections of the Takings Clause of the Fifth Amendment of the U.S. Constitution.[27] For example, U.S. investment agreements typically permit tax measures to be challenged as violations of the prohibition on uncompensated expropriations,[28] and there is substantial precedent in international arbitral practice for finding that tax measures can constitute forms of indirect expropriation.[29] Under the Fifth Amendment's Takings Clause, in contrast, the Supreme Court has repeatedly rejected takings challenges to tax measures, even when the tax is set at a level that threatens the viability of a business.[30]

The restriction of expropriation claims to situations involving "property" as opposed to the more broadly defined "investment" is also inadequate to ensure compliance with the "no greater rights" principle, because it does not reflect that the requirement of compensation for "regulatory takings" under the Fifth Amendment of the U.S. Constitution has generally been only held to apply to regulations affecting *real* property.[31] For example, the Supreme Court has indicated that personal property is unlikely to be the basis for a successful regulatory takings claim given that "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 regulation might even render his property economically worthless."[32] Moreover, the indirect expropriation provision in investment agreements has been interpreted to require compensation based on the impact of the government measure on the value of the investment, regardless of whether there has actually been some appropriation of an asset by the government.[33] This interpretation of the standard for indirect expropriation cannot be justified as reflecting the general practice of states, given that the dominant practice of nations is to provide for compensation only when the government has actually acquired an asset, not when the value of an asset has been adversely affected by regulatory measures.[34]

Accordingly, future U.S. investment agreements should include text to clarify that an indirect expropriation occurs only when the government acts indirectly to seize or transfer ownership of an investment, and not when the government merely acts in a manner that decreases the value of profitability of an investment. This approach would be consistent with both the "no greater rights" mandate and the general practice of states that forms the basis of customary international law. It would exclude from the compensation requirement only a very narrow class of non-confiscatory regulatory measures that would be compensable under U.S. law (although not under the legal systems of most other countries). One option for codifying this approach in TPP text is would be to include a modified version of the Annex 11-B from the Korea FTA, so that paragraph Art 3 reads as follows:

> 3. The second situation addressed by Article 11.6.1 is indirect expropriation, where a Party acts indirectly, including through a series of actions, to seize, appropriate, or transfer ownership of a property right. Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, the environment, and real estate price stabilization (through, for example, measures to improve the housing conditions for low-income households), do not constitute indirect expropriations.

Narrow the Definition of Investment

To meet Congress' requirement that trade pacts not provide foreign investors with greater rights, a TPP trade agreement must not replicate the boilerplate definition of "investment" that has been used in past U.S. trade and investment agreements.[35] The old expansive definition has the effect of giving foreign investors in the United States greater rights than are provided domestic investors in the United States under domestic law and the jurisprudence of the Supreme Court.

There is wide agreement on the breadth of past FTAs' "investment" definition from all sides of the trade debate. The progressive members of the State Department Model BIT Subcommittee wrote, "the definition of 'Investment' in Article 1 of the Model BIT is much broader than the real property rights and other specific interests in property that are protected under the U.S. Constitution. The inclusion of 'futures, options, and derivatives' is also worrisome, given the troublesome role these instruments played in the financial crisis and ongoing regulatory reform efforts."[36] The Emergency Committee for American Trade (ECAT), a multinational corporate group, noted that some past U.S. pacts appeared to go beyond U.S. legal standards.[37] ECAT refused to state whether more recent agreements' definition of investment extended beyond U.S. standards or not, but noted that the purpose of broader investment provisions from the corporate perspective was to have greater rights in other markets than these countries' allegedly "much more restrictive definitions of property interests than [that of[the United States."[38] ECAT and other corporate members of the State Department subcommittee noted that other countries may not accord "a broad definition of property that covers contract rights and other types of financial instruments (e.g., debt instruments, loans, futures, options, and other derivatives)."[39]

Embedded in the problem of how investment should be defined in U.S. trade agreements is the reality that the jurisprudence defining various property rights is a living doctrine. Even if a trade pact text were to include provisions that described the state of U.S. property rights jurisprudence at any particular juncture, over time the pact could result in greater rights for foreign investors, as the domestic jurisprudence continues to be refined. However, there are clear solutions to this problem that any future TPP trade agreement text can incorporate. In fact, there are at least three approaches to the problem, aspects of which can be pursued in a complementary fashion: 1) Adopt the principles of the TRADE Act; 2) adopt a 21st century "hyperlinking" methodology; or 3) make certain listed thresholds for and exclusions from the definition of investment in current FTAs.

First Approach: TRADE Act

The TRADE Act contains a provision that would define the term investment as limited to the commitment of capital or the acquisition of real property and to make clear that vague concepts such as assumption of risk or expectation of gain or profit are not to be used as a basis of determining whether an investment exists. The TRADE Act also would define the term "investor" to mean only a person who makes a commitment or acquisition described above. The goal of this provision is to root the definition of investment in trade agreements in the context of U.S. legal standards. Given the investment rules contemplated in the TRADE Act would not include investor-state enforcement, the definition of investment above would avoid the prospect of foreign investors obtaining greater rights than domestic investors in the context of indirect expropriation claims over forms of investment not subject to such compensation in U.S. domestic law. Such a definition would deliver on the stated goal of the inclusion of investment provisions in trade agreements without creating the policy and political problems that have resulted under the past definition.

Second Approach: Hyperlinking

However, the TRADE Act approach, while clearly an improvement on the past overreaching definition, is static. Accordingly, a 21st century agreement could address this most modern of problems by adopting a modern approach: "hyperlinking" to domestic legal definitions. That is to say that the definition of investment in a TPP agreement would be based on the domestic law of the host country. Such a new definition of "investment" in the TPP could read:

> **"investment** means property, property right or property interest as defined under the law of the respondent state at the time the alleged injury occurred. For greater clarity, in instances where the respondent has substantially changed the definition of property,

property rights or property interests from the time that the investment was initially made to the time of the alleged injury, a tribunal will find that the later definition applies, unless the investor can show that the primary motivation for the substantial change was to specifically deprive the investor of rights under this Chapter."

The first sentence reflects a useful insight from the U.S. Supreme Court, which has stated: "Because the Constitution protects rather than creates property interests, the existence of a property interest is determined by reference to 'existing rules or understandings that stem from an independent source such as state law'" (*Phillips v. Wash. Legal Found., 524 U.S. 156, 164 (1998); Bd. Of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972)).* Meanwhile, the second sentence of the recommended new definition of investment is a classic anti-abuse provision, which would give investors protection if a government were altering legal definitions solely for the purpose of effectuating an "expropriation," for instance.

The first sentence also builds on innovations in the definition of investment in recent U.S. BITs and FTAs, which read:

- "Some forms of debt, such as bonds, debentures, and long-term notes, *are more likely* to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, *are less likely* to have such characteristics." However, much like the language on "rare circumstances" and indirect expropriation noted elsewhere in this packet, the contours of "likelihood" are not defined by this footnote.
- "Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends *on such factors as the nature and extent of the rights that the holder has under the law of the Party*. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those *that do not create any rights protected under domestic law*. For greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment." Unfortunately, the reference to domestic rights is not limited to "property rights," but could be interpreted as "contractual rights." [italics added]

These footnotes are found in CAFTA and the Australia, Chile, Morocco, Oman, Peru and Singapore FTAs, as well as the proposed FTAs with Colombia, Korea and Panama. The provisions seem to attempt to pare back an overreaching definition of investment to prevailing domestic practices. This is a wise attempt. There is substantial evidence that the Founding Fathers had a very limited view of the types of property rights that could give rise to compensable taking claims,[40] even though the Supreme Court has expanded this list over the years.[41] At the same time, the Court has noted that "a mere unilateral expectation or an abstract need is not a property interest entitled to protection,"[42] and "business in the sense of the activity of doing business, or the activity of making a profit is not property in the ordinary sense."[43]

However, the footnotes in the past agreements may create more problems than they solve, by attempting to freeze in pseudo-treaty form the moving target of conjunctural domestic legal and political compromises – and to do so in an era of conservative judicial opinions. Also, the current prevailing domestic legal standards have vacillated greatly, between considering the property as the "parcel as a whole" in the *Tahoe* case, to deviations in the *Lucas* case.[44] They have also been roundly rejected by both environmentalists *and* property rights advocates, who have variously described it as "an unworkable muddle," an incoherent doctrine that go beyond international legal norms,[45] and asked "Of all things made in America, why are we exporting" our current property doctrines?[46]

For this reason, a more lasting fix to U.S. FTAs – that will ensure a prompt end to the stale debates of the past – may be to adopt the principles of the TRADE Act by simply "hyperlinking" to the domestic legal standards, as we show above.

Third Approach: Specific Thresholds and Exclusions

The third approach to fixing the problem of foreign investors having greater rights would be yet more complicated. U.S. law permits compensation for direct takings of a greater range of property than for indirect taking, for which compensation rights are quite limited. Thus, an approach based on limiting the exemplary

list of types of investment could too greatly limit the forms of investment that should be safeguarded against direct expropriation, if the aim is to remove the forms of investment that should not be subject to indirect takings claims. The way around this problem would be to establish two definitions of investment, with the more limited definition applying to those investments subject to indirect expropriation claims.

There are also certain categorical exclusions that should be made. CAFTA and the Chile, Morocco, Singapore and Panama agreements have provided for investor-state actions against host countries for breaches of "investment agreements."[47] The Korea, Colombia, Oman and Peru FTAs specifically expand the scope of this provision to include sensitive subject matter over which countries need to maintain policy space, such as "natural resources that a national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale; supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or telecommunications; and infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government." Annex 10-H of the Peru FTA goes the furthest of all, subjecting certain so-called "legal stability agreements" between Peru and foreign investors to investor-state arbitration. Such agreements can lock in the tax, labor, exchange rate, transfers and other commercial terms to be accorded to a foreign investor[48] – even when initially made by outgoing governments that have lost re-election.[49]

If trade pacts are to include any investor-state enforcement system, expanding the scope of its coverage to such "investment agreements" is inappropriate. Even by the muddled standards of U.S. takings law, the standards for compensable takings for exactions (i.e. conditions placed on development permits) and changes in private contracts with governments are particularly difficult to nail down, and typically subject to judicial balancing tests, in which administrative or legislative prerogatives weigh heavily.[50] Such deference is unlikely to take place in international tribunals, where there is no separation of powers serving as an ultimate check on judicial overreach.

By excluding "investment agreements" from TPP investor-state enforcement, we avoid a situation where a new government is sued because it seeks to alter the outgoing government's (perhaps ethically compromised) overly generous terms with foreign investors.[51]

Beyond What Is an Investment, What Is an Investor

Past trade agreements' definition provisions have simply defined an "investor" as a person or legal entity that makes an investment as defined in the pact. However, one of the lessons of the NAFTA investment cases is that this is not sufficient. One obvious threshold that should be included in the definition of "investor" is that person or entity's actual business activities or commitment of capital in the host country (for instance a foreign firm operating in the United States) should be substantial in dollar terms and involve actual substantial business activities.

The *S.D. Myers v. Canada* NAFTA case highlights why such improvements are needed. S.D. Myers was a U.S. corporation dedicated to importing Canadian toxic waste (PCBs) into the United States for processing. It challenged a Canadian ban on toxic exports, claiming that this impaired the firm's Canadian investment. But the U.S. corporation had very limited *investment* in Canada proper. It had obtained some market share for its services in Canada. It presented the tribunal with a Canadian address. But its waste processing facilities and its management were in the United States. Yet, under the old definition of investor, Canadian policies were successfully challenged and $5 million in compensation was paid by the Canadian government to the U.S. firm, even thought the U.S. firm had no real investment in Canada!

Such an outcome is deeply unfair. One way to avoid this problem is to set a substantial business activities test and an economic threshold within the definition of "investor" within the TPP. This could be accomplished by adding a footnote to the definition of "investment" that reads:

> "In order to claim benefits under this Chapter, an investor must have employed natural persons, and made purchases or sales within, the potential respondent Party's territory that are at least 20 percent the annual average per capita employment of natural persons, and purchases or sales of goods or services, realized in its primary market in the six years prior to the alleged injury."[52]

Allow Policies to Prevent and Mitigate Financial Crises

Existing U.S. FTAs and BITs undermine global financial stability in numerous ways that threaten the livelihoods of working families in the United States and its trading partners. The financial services chapters of FTAs promote a deregulatory approach that could prevent the use of legitimate policy tools to prevent and mitigate future crises. This section focuses on the investment chapters of FTAs (and similar rules in BITs), highlighting three key areas that relate to financial stability: 1) restrictions on capital controls and financial speculation taxes; 2) the inclusion of sovereign debt as a "covered investment;" and 3) the prudential measures defense provision. It makes recommendations about how the Obama administration could have better standards in the context of the TPP.

Restrictions on Capital Controls and Financial Speculation Taxes

The "transfers" sections of U.S. FTAs and BITs require governments to permit all transfers relating to a covered investment to be made "freely and without delay into and out of its territory." In effect, these rules promote capital account liberalization between the FTA or BIT partners, regardless of the implications for financial stability.[53]

Problems:

- **Prohibiting capital controls conflicts with contemporary economic thinking.** A February 2010 IMF report found that nations which deployed controls on inflows before the current crisis were among the least hard hit. The IMF concluded that capital controls are a legitimate policy tool for preventing and mitigating crises, a view echoed by the Asian Development Bank and United Nations. IMF, World Bank, and Cornell University research over a longer timeline has found no correlation between capital account liberalization and economic growth in developing countries.[54]
- **Such provisions are inconsistent with other treaties.** The IMF has long argued for safeguard measures to allow capital controls on inflows or outflows to prevent or mitigate crisis. Recent UN research shows that the trade and investment agreements of virtually every other major capital exporter include such a safeguard.[55]
- **Existing rules could prohibit financial speculation taxes.** There is growing momentum in the United States and around the world behind proposals to apply small transactions taxes on stock, derivatives, currency, and other financial instruments as a way to curb speculation and generate revenue for jobs and other urgent needs. Under existing FTAs, foreign investors could argue that such taxes violate their right to transfer investments "freely and without delay." (Indeed, the European Commission has noted this conflict.)[56] And while some FTAs carve out many types of taxation from expropriation obligations, they do not explicitly exempt them from transfers provisions.[57]
- **Special exceptions in some U.S. agreements are inadequate.** U.S. FTAs and BITs allow private foreign investors to sue governments in supra-national tribunals that have no public accountability, standard judicial ethics rules, or appeals process. A handful of recent U.S. trade agreements have included a special dispute settlement procedure for investor-state claims related to transfers. Annex 10-E of the U.S.-Peru FTA, for example, limits damages arising from certain restrictive measures on capital inflows to the reduction in value of the transfers. Investors may not demand compensation for the loss of profits or business. In addition, there is an extended "cooling off" period before investors may file claims. While a step in the right direction, these provisions still place undue restrictions on the authority to use capital controls. Similarly, the Korea FTA (among others) has a provision that states that a government "may prevent a transfer through the equitable, non-discriminatory, and good faith application of its laws relating to" certain bankruptcy, criminal and other matters. But macroeconomic, monetary or exchange rate policy is not on this list of allowed measures.

Sovereign Debt

Many governments enter a financial crisis with high debt levels. Still more borrow on bond markets for bailouts or stimulus programs and then experience slow growth and low tax revenues that push them to the brink of default. The U.S. government has long advocated sovereign debt restructuring as an alternative to IMF- or U.S. taxpayer-financed bailouts.

Problems:

- **Recent U.S. trade and investment agreements treat sovereign debt as an "investment" and therefore may restrict governments' ability to restructure debt and recover from crises.** Restructuring, by definition, reduces the value of a sovereign bond and can thus be seen as a violation of not only the transfers provisions, but also of "fair and equitable treatment" and "expropriation." By filing investor-state claims under FTAs or BITs, bondholders can circumvent official restructuring processes. For example, Italian bondholders sued Argentina to recoup the full value of their original bonds.
- **Special exceptions in some U.S. agreements are inadequate**. Some recent deals include annexes that do not permit debt-related claims during a restructuring unless the measures violate national treatment or most favored nation provisions. However, a nation in crisis may be justified in giving domestic bondholders priority to protect the banking system or ensure fulfillment of wage and pension commitments.

Both the capital control and sovereign debt provisions in U.S. FTAs and BITs threaten livelihoods in trading partner nations – and in the United States. As we have learned from the contagious meltdowns in Iceland, Greece, and this country, global financial markets are extremely integrated. Thus, U.S. working families are made vulnerable when governments anywhere lack the tools they need to prevent and mitigate crisis. The European debt crisis has devastated an important U.S. export market (as did the 1997 Asian financial crisis) – at great cost to American jobs. U.S. foreign investors also face risks. Uncontrolled massive capital flight often leads to significant currency depreciations, which reduce the value of U.S. investors' revenues in the host country and increase the cost of any imported inputs. The impact on our trading partners can be even graver, as a crisis can set back a nation's financial system and halt growth, employment, and poverty reduction for years to come.

Recommendations:

U.S. trade agreements and bilateral investment treaties should not restrict a government's authority to use capital controls and restructure sovereign debt to prevent and mitigate financial crisis. At a minimum, changes should be made to:

1. allow a government to restrict a transfer through the equitable, non-discriminatory, and good faith application of its laws related to macroeconomic, monetary, or exchange rate policy.

2. establish safeguard mechanisms for financial crises that are not subject to investor-state dispute settlement. At most, the provisions should be subject to state-to-state dispute settlement and even then such procedures should only be available after a consultation process.

3. exclude short-term investment ("hot money") and sovereign debt from the definition of investment.

Prudential Measures

Most U.S. trade and investment agreements have provisions or whole chapters related to financial services. They typically contain language that appears designed to protect a government's authority to enact "prudential measures" to ensure the stability of their financial system. For example, the proposed Korea FTA reads:

> …a Party shall not be prevented from adopting or maintaining measures for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.

The second sentence of that provision is unclear and could be interpreted in a manner that would undermine the overall prudential exception. It's worth noting that this potentially "self-canceling" sentence is absent from an otherwise similar section of North American Free Trade Agreement (Article 1410.1). Yet even the NAFTA provision has been interpreted as permitting tribunals to review financial measures to determine whether they are "reasonable" or "arbitrary."[58]

This provision should be strengthened in the TPP to provide a more meaningful safeguard for financial stability measures. This could be done by making it self-judging, as was successfully pushed for by House Ways & Means Democrats in the U.S.-Peru FTA's essential security defense mechanism.[59] Alternatively, the prudential measures defense language could be altered to shift the burden of proof, along the lines of the following language:

> … a Member shall not be prevented from adopting or maintaining measures relating to financial services it employs for prudential reasons, including for the protection of consumers, 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. For greater certainty, if a Party invokes this provision in the context of consultations or an arbitral proceeding initiated under the Dispute Settlement Understanding, the exception shall apply unless the Party initiating a dispute can demonstrate that the measure is not intended to protect consumers, investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or is not intended to ensure the integrity and stability of the financial system.

Add a General Exception for Environmental and Labor Protections

An across the board exception for health, safety and environmental measures is needed in the TPP to allow the U.S. government and the governments of our trading partners to protect people and environment. Without a general exception for health, safety and environmental measures in our free trade agreements, our public interest laws are vulnerable to challenges.

The closest the current U.S. model bilateral investment treaty (BIT) comes to a general exception is Article 12.2, which states that: "Nothing in this Treaty shall 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 (emphasis added)." However, such an exception does not solve the problem, as it only protects health, safety, and environmental laws that should not be challenged by investors in the first place because they are consistent with the investor protections in the agreement.

U.S. trade agreements currently have a patchwork of exceptions for public interest laws. For instance, in Article 8 of the Model BIT regarding performance requirements, there is 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 (Article 8.3). While this exception is no doubt important in this particular context, an exception for these measures should be designed to apply to the whole agreement. The fact that the exception only applies to performance requirements leads the FTA or BIT interpreter to question whether the drafters intended to have provisions in other areas of the agreement always trump public interest laws.

The omission of a general exception introduces a high level of uncertainty regarding the legality of measures adopted by governments to protect their people and environment from threats to people or the environment. It becomes a matter of interpretation where one tribunal could decide one way, and another decide a different way, and no decision sets an official precedent for future decisions. 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 government. This uncertainty reduces the ability of the government to effectively respond to risks. A general exceptions clause would make 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 (GATT), contains general exceptions 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 helped the United States defend measures to protect the environment and natural resources, for instance, in the *US-Shrimp Turtle* case. The US-Peru Free Trade Agreement included general exceptions for laws to protect human, animal, or plant health or life modeled after the GATT's general exceptions.[60]

However, Peru's general exception for health, safety, and environmental measures only applies to Chapters 2-7 and 11, 14, and 15. It does not apply to the investment chapter, Chapter 10.

In addition, in the Peru FTA, the burden of proof remains on the governments to prove that their public interest laws are legitimate environmental laws and not discriminatory, rather than on the investors. Only in the FTA's general exception for essential security (added thanks to the hard work of the Ways & Means Committee in 2007) does the text state that "For greater certainty, if a Party invokes Article 22.2 in an arbitral proceeding initiated under Chapter Ten (Investment) or Chapter Twenty-One (Dispute Settlement), the tribunal or panel hearing the matter shall find that the exception applies." In other words, it is automatically ensured that a challenge to a law protecting a country's essential security will be dismissed. It would be extremely beneficial to extend such certainty to the realm of health, safety, and environment. If however, a form of proof is required, the burden should fall on the investor bringing the suit to show that a public interest law is discriminatory in nature.

The US Model BIT, the TPP, and every future US trade or investment agreement should include a general exception for health, safety, and environmental measures that applies to the entire agreement, and that shifts the burden of proof for defending their public interest laws away from governments.

The Peru FTA's essential security provision has been combined with a general public interest exception in the TRADE Act, which states that future trade deals shall:

> (A) include an essential security exception that permits a country that is a party to the trade agreement to apply measures that the country considers necessary for the maintenance or restoration of international peace or security, or the protection of its own essential security interests, including with respect to infrastructure, services, manufacturing, and other sectors;
>
> (B) explicitly state that if a country invokes the essential security exception in a dispute settlement proceeding relating to any matter other than compliance with the agreement's worker rights, environment, human rights, health, or safety provisions, the dispute settlement body hearing the matter shall find that the exception applies;
>
> (C) include a provision that gives priority to the implementation of bilateral or multilateral agreements relating to public health, human and labor rights, the environment, or other public interest goals in the event of any inconsistency between the trade agreement and such bilateral or multilateral agreement; and
>
> (D) include in its list of general exceptions the following language: Notwithstanding any other provision of this agreement, a provision of law that is nondiscriminatory on its face and relates to domestic health, consumer safety, the environment, labor rights, worker health and safety, economic equity, consumer access, the provision of goods or services, or investment, shall not be subject to challenge under the dispute resolution mechanism established under this agreement, unless the primary purpose of the law is to discriminate with respect to market access.

Eliminate the Subsidiary Loophole

The "Denial of Benefits" language in FTAs and BITs delineates certain circumstances under which governments may deny FTA or BIT rights to investors that otherwise meet the definition of an "investor" having an "investment." The language is ostensibly aimed at giving governments certain tools to limit investor abuse of these rights. **But despite (or arguably, because of) their "Denial of Benefits" provisions, existing U.S. FTAs and BITs allow investors from countries that are not signatories to the agreement – as well as subsidiaries of U.S. corporations operating in trade partner countries – to enjoy the new rights and protections provided in the pacts.** The past language thus allows such entities to take advantage of the FTA/BIT rights to skirt U.S. courts and law and launch investor-state challenges against U.S. laws and regulations in World Bank and United Nations tribunals using FTA or BIT law… without giving governments adequate means to deter abuse of such provisions. Diverse commentators on all sides of the trade debate have noted this feature of recent FTAs and BITS.[61]

The relevant language included in the U.S.-Korea FTAs is:

> "1. A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:
>
> > (a) does not maintain normal economic relations with the non-Party; or
> > (b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.
>
> 2. A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such other Party and to investments of that investor *if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise.* If, before denying the benefits of this Chapter, the denying Party knows that the enterprise has no substantial business activities in the territory of the other Party and that persons of a non-Party, or of the denying Party, own or control the enterprise, the denying Party shall, to the extent practicable, notify the other Party before denying the benefits. If the denying Party provides such notice, it shall consult with the other Party at the other Party's request." [italics added]

A wide range of investor-state tribunals – including some issuing rulings about other countries' Bilateral Investment Treaties which have nearly identical "denial of benefits" clauses to recent U.S. FTAs or BITs – have issued extremely troubling rulings on the matter. These tribunals have allowed unfair "nationality-shopping" practices.[62] ("Nationality shopping" describes the process whereby companies re-incorporate abroad, or incorporate subsidiaries abroad, with the primary or partial motivation of taking advantage of special tax, regulatory or investment treatment.)

The worrying "Denial of Benefits" language is contained in not only the Korea FTA, but also the FTAs with Panama and Colombia – all signed by the Bush administration. In contrast, the TPP negotiations offer an opportunity to craft a 21st century trade agreement that can more fairly and definitively deal with that most 21st century of issues: how to deal with complex international corporate structures[63] in a way that encourages sustainable investment flows, and discourages "free riding" and "treaty shopping" on the part of multinational corporations. Multinationals often incorporate subsidiaries in diverse jurisdictions so as to minimize exposure to their home country's tax and regulatory jurisdiction; it would be fundamentally unfair to then reward them by maximizing the investment protection they can derive from the practice. Moreover, in at least one case under CAFTA, a Canadian firm that would not have had standing under CAFTA, Pacific Rim Mining Corp., reincorporated in the United States shortly before filing a CAFTA investor-state case against El Salvador.[64]

There are several problems that need to be solved:

1. How to define "substantial business activities" so that they have a real-world, economic basis, rather than merely reflecting legal artifices, and also eliminate the current wide discretion provided tribunals;

2. How to define the relevant duration of these "substantial business activities", so as to avoid opportunistic "nationality planning" (for instance re-incorporations aimed at newly obtaining standing) in the lead-up to initiation of arbitral proceedings;
3. In the case of bilateral agreements like the Korea FTA, how to ensure that potential claimants have substantial business activities in both their home and host country, for instance weeding out firms from countries that are not signatories to the pact but have incorporated in a signatory country in an attempt to gain the new investor rights;
4. In the case of plurilateral agreements (like the TPP), how to ensure that potential claimants have substantial business activities in the specific home and host countries they are claiming in their "Notice Of Intent", rather than in other countries that are party to the agreement but are not cited in the "Notice of Intent";
5. In both cases, how to ensure that nationals of a given country are not challenging their own country's regulations using offshore subsidiaries and FTAs or BITs;
6. How and when is an agreement's "denial of benefits" clause triggered. Investor-state arbitral tribunals have ruled that a government must affirmatively invoke the denial of benefits provisions. In the *Plama v. Bulgaria* case under the ECT, for instance, a tribunal ruled that governments must invoke denial of benefits before the investor even makes the investment. The tribunal noted that, if the negotiating governments wanted to allow for a later invocation of denial of benefits, they could have drawn from the precedent of other pacts. They cited NAFTA, which allows for a consultation period before denial of benefits, apparently even after the investment is made; and the ASEAN services agreement, which states simply that "the benefits of this Framework Agreement shall be denied to" shell corporations (using the definition from the Korea FTA above). Given that the issues surrounding ownership and control by shell companies are so complicated, it would behoove negotiators to come up with a better formulation. Host governments may not know who ultimately controls a shell corporation; a key advantage to international arbitration from a public policy perspective is that a tribunal (rather than the respondent government) could help the parties figure out who controls the investor;
7. What binding guidance is required in FTAs and BITs to give arbitral panels direction on when and how deeply to "pierce the corporate veil" to determine ultimate beneficial ownership; and
8. How to allocate the burden of proof on these matters. In other words, is it the government or the investor who has to show that "substantial business activities" are being conducted in the country of incorporation?

Leaving aside the paragraph in U.S. FTAs dealing with non-recognition of countries like Cuba,[65] the TPP "Denial of Benefits" Article could read as in the left column of the table below, with commentary in the right column:

PROPOSED NEW LANGUAGE FOR TPP	EXPLANATION
2. Under this Article, the investor rights provided by this chapter shall apply with respect to an investor of a single home Party in regards to their investment in a single host Party. The benefits of this Chapter shall be denied to an investor of the home Party that is an enterprise of such home Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the home Party, or persons of a non-Party, or of the host Party, are its beneficial owners.	This provision would ensure that, for instance, a U.S. subsidiary established in Korea (ie. "home Party") would be denied benefits of the agreement vis a vis its investments in the United States (ie. "host Party"). The passage "The benefits of this Chapter shall be denied to an investor…" copies the ASEAN Framework Agreement on Services, which makes inherent sense, given that the TPP is partially aimed at deepening ties between the U.S. and Asian countries.[66] This language also eliminates the ambiguity that may arise as to whether a potential respondent government has to affirmatively take action to deny benefits. In fact, the tribunal in *Hulley Enterprises v. Russia* explicitly stated that the parties to the Energy Charter would have had to include such language if they wanted denial of benefits to be self-invoking.[67] Finally, an investor will be denied benefits of the agreement if it has "no substantial business activities" in the country of incorporation (a standard

	defined more explicitly below), *or* if (from the example of the U.S.-Korea FTA) Chinese or U.S. subsidiaries are claiming "Korean" nationality to challenge U.S. regulations.
(a) For the purposes of this Article, "substantial business activities" means average per capita employment of natural persons, and purchases or sales of goods or services, in the territory of the home Party that is at least 20 percent the annual average per capita employment of natural persons, and purchases or sales of goods or services, realized in its primary market (which may be either the host Party, home Party, or non-Party), in the six years prior to the date of the alleged injury. (b) An investor shall be considered to be of the host Party and not of the home Party if, in the six years prior to the date of the alleged injury, it has, on an annual average, purchasing power parity-adjusted basis, conducted greater purchases or sales of goods or services in the territory of the host Party than in the territory of the home Party.	Subparagraphs a and b establish several economic, real-world thresholds for the definition of "substantial business activities." These tighter definitions address the problem from the *AMTO v. Ukraine* case, where the presence of two employees and a small paper trail in Latvia was seen as evidence of "substantial business activities" in the claimed home Party.[68] The thresholds consider either purchases *or* sales, recognizing that many investors may not make wholesale or retail sales. For such firms, a purchase-based threshold of goods and services may be more appropriate. Subparagraph (a) addresses the problem of a Chinese investor using a Korean subsidiary to attack U.S. regulations related to their U.S. investments. It is only a *de minimis* threshold of purchases or sales in the home Party, so as to not overly interfere with business prerogatives: an investor could still do the vast majority of its operations in third Party markets and still be considered as originating in the home Party if it had complied with relevant home country requirements. Subparagraph (b) addresses the problem of an investor whose primary market is the U.S. using a Korean subsidiary to attack U.S. regulations related to their U.S. investments. It establishes a higher threshold for defining whether an investor is suing what should effectively be considered its own government, since the abuse more clearly cuts against the purpose of BITS: there must be greater purchases or sales in the home Party than in the host Party. In both cases, the TPP could adopt the six year requirement referenced by tribunalists Daniel Price and Piero Bernardini from the *Tokios Tokelés* case, which thought that an enterprise incorporation six years prior to the attempt to access investor-state arbitration was evidence that the corporation was not engaging in "an abuse of legal personality."[69]
(c) The existence of "substantial business activities" in a Party that is neither the home Party nor host Party shall not constitute "substantial business activities" for the purposes of this Article. For the purposes of determining beneficial ownership, "non-Party" includes Parties that are neither the home Party nor the host Party.	This contains a method for guarding against aggressive "nationality planning" in larger regional or plurilateral agreements, like the TPP. So, if a tribunal denied benefits to a Vietnamese investor in a challenge to U.S. regulations because the investor was not controlled by Vietnamese persons (or had no substantial business activities in Vietnam), then the fact that the investor was controlled instead by Australians (or had substantial business activities in Australia) would not function to reestablish standing… even though Australia is also party to the TPP. (As noted above, this has been a problem in various Energy Charter Treaty cases.)
(d) The term "beneficial owner" means all natural or	Several things are worth noting about these

juridical persons who, directly or indirectly, exercise substantial control over the covered investment, or have a substantial interest in or receive substantial economic benefits from the investment, on the date of the alleged injury or the date of consent to arbitration or the date of the Final Award. For greater clarity, an investor must disclose the names and contact information for all of its ultimate beneficial owners in its Notice of Arbitration. (e) Once a tribunal has found a basis for denying benefits under this article, an investor may attempt to prove that this conclusion was wrongly arrived at, by, for instance, proving that beneficial ownership belongs to a natural person of the home Party.	provisions. First, an investor must furnish information to the tribunal about all the natural persons who are its beneficial owners, so that the tribunal can make a rebuttable determination about whether denial of benefits is appropriate. Under past BITs, tribunals had to wrestle with whether the government *or* the investor was tasked with the burden of proving or disproving, for instance, whether an investor was owned or controlled by nationals of the country of incorporation. Subparagraphs a, d and e help make the TPP a 21st century trade agreement: the arbitral panels actually help both parties with matters related to the discovery of beneficial ownership. If an investor's beneficial ownership – once established by the arbitral tribunal – would disqualify it from standing under the TPP, the tribunal (rather than the government, which faces asymmetric information problems) can deny the investor benefits. Second, the definitions for "beneficial ownership" are based on language on transparency legislation now being discussed in Congress. As noted above, if U.S. or Chinese persons are the ultimate beneficial owners, but are claiming to be "Korean" to challenge U.S. regulations under the U.S.-Korea FTA, for instance, those persons will be denied the FTA investor rights. Unlike in past FTAs (which used a mere "own or control" standard), the language referencing "beneficial ownership" requires tribunals to clearly "pierce the veil" all the way through. This codifies the approach taken by Judge Abner Mikva and the panel in *Loewen v. U.S.* under NAFTA, who pierced the veil through layers of holding companies to establish U.S. beneficial ownership of the erstwhile Canadian investor.[70] Third, there is a requirement of "continuous nationality" from the date of the alleged injury, all the way through to the final award. This too codifies the *Loewen* approach, of requiring continuous "home country nationality" is required through the date of the award.[71]

To restate, under this new TPP language, there are two ways that a U.S. investor would be barred from challenging U.S. regulations by (misleadingly) claiming to be "foreign." The first is if the allegedly foreign investor could be shown to be ultimately owned or controlled by U.S. persons (i.e. have U.S. beneficial owners). The second is if the investor has greater business activities in the U.S. than in their allegedly home country. The first is a legal hurdle; the second is an economic hurdle. These are not cumulative hurdles: either can be disqualifying.

Note that a variation of this language could simply be incorporated into the TPP's definition of "investor" and "enterprise" of a Party. The Korea FTA (like other past FTAs) utilizes a sort of two-stage process for determining standing. First, Korean subsidiaries of U.S. and Chinese corporations that go on to invest in the United States are presumed to be "investors" for the sake of the FTA. Second, governments are given an opportunity to "deny benefits" to such investors for the specified set of reasons. While this memo suggests fixes to the "Denial of Benefits phase" (i.e. the back end), a more direct approach might be on the front end: simply incorporate this memo's principles of what constitutes a legitimate investor into the TPP's definition of "investor" or "enterprise."

ENDNOTES

1 For more information, see: **Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty – Annex B, September 30, 2009**. Collective statement by Sarah Anderson, Institute for Policy Studies; Linda Andros, United Steelworkers; Marcos Orellana Cruz, Center for International Environmental Law; Elizabeth Drake, Stewart and Stewart; Kevin P. Gallagher, Boston University and Global Development and Environment Institute; Owen Herrnstadt, International Association of Machinists and Aerospace Workers; Matthew C. Porterfield, Harrison Institute for Public Law - Georgetown Law; Margrete Strand Rangnes, Sierra Club; and Martin Wagner, Earthjustice. Available at: http://www.state.gov/e/eeb/rls/othr/2009/131118.htm

2 Ibid.

3 Ibid.

4 Interhandel Case (Switz. v. U.S.), 1959 I.C.J. Rep. 5, 27 (Mar. 21).

5 See U.S. Department of State, Bilateral Investment and Other Bilateral Claims, available at http://www.state.gov/s/l/c7344.htm:
Under international law and practice the United States does not formally espouse claims on behalf of U.S. nationals unless the claimant can provide persuasive evidence demonstrating that certain prerequisites have been met. The most important of these requirements [include] that all local remedies have been exhausted or the claimant has demonstrated that attempting to do so would be futile ... .

6 See "Governance Matters 2009: Worldwide Governance Indicators, 1996-2008", available at http://info.worldbank.org/governance/wgi/index.asp. For 2008, for the governance indicator "rule of law," New Zealand scored in the 97%, Australia in the 95%, Singapore in the 94%, and the United States in the 92%. For the governance indicator "control of corruption" or 2008, for the governance indicator "control of corruption," New Zealand scored in the 98%, Australia in the 96%, Singapore in the 100%, and the United States in the 92%.

7 See, e.g., El Oro Mining and Railway Co. Case (Gr. Brit. v. Mex.), 5 Int'l Arb. Awards 191, 198 (Perm. Ct. Arb. 1931).

8 See, e.g., Panevezys-Saldutiskis Railway (Est. v. Lith.), 1939 P.C.I.J. (ser. A/B) No. 76, at 18 (Feb. 28) ("There can be no need to resort to the municipal courts if those courts have no jurisdiction to afford relief . . .") See also generally The Finnish Ships Case (Finland v. United Kingdom), 3 R. Int'l Arb. Awards 1484 (1934) (domestic judicial appeal not required where it would not afford a basis for reversing determination of British Admiralty Transport Arbitration Board that the British government had not requisitioned certain Finnish ships).

9 Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1989 I.C.J. 15, 45-46 (July 20) (exhaustion requirement satisfied where "the substance of the claim" brought in domestic court "is essentially the same" as the international claim).

10 Trade Act of 2002, H.R. 3009, 107th Cong. § 2102(b)(3) (2002).

11 See Office of the United States Trade Representative, Bipartisan Agreement on Trade Policy: Investment (May 2007), available at http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file146_11282.pdf

12See Pennsylvania Fair Trade Coalition, 2008 Presidential Candidate Questionnaire, answer of Sen. Barack Obama, question 10, available at http://www.citizenstrade.org/pdf/QuestionnairePennsylvaniaFairTradeCoalition040108FINAL_SenatorObamaResponse.pdf. Secretary of State Clinton also endorsed the no greater rights principle during the 2008 campaign. See Texas Fair Trade Coalition, Presidential Candidate Questionnaire, Answer of Sen. Hilary Rodham Clinton, question 6 ("I will ensure that foreign companies do not have greater rights than American companies."), available at http://www.texasfairtrade.org/documents/HillaryClintonQuestionnaireResponse.pdf

13 RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, § 102(2) (1987).

14 See generally Matthew C. Porterfield, An International Common Law of Investor Rights? 27 U. Pa. J. Int'l Econ. L. 79 (2006).

15 See Counter- Memorial of Respondent United States of America, Glamis Gold v. United States of America at 221 (Sept. 19, 2006), available at http://www.state.gov/documents/organization/73686.pdf (footnotes omitted):

Sufficiently broad State practice and opinio juris have thus far coincided to establish minimum standards of State conduct in only a few areas. Article 1105(1) embodies, for example, the requirement to provide a minimum level of internal security and law and order, referred to as the customary international law obligation of full protection and security. Similarly, Article 1105 recognizes that a State may incur international responsibility for a "denial of justice" where its judiciary administers justice to aliens in a "notoriously unjust" or "egregious" manner "which offends a sense of judicial propriety." In addition, the most widely-recognized substantive standard applicable to legislative and rule-making acts in the investment context is the rule barring expropriation without compensation, but that obligation is particularized in the NAFTA under Article 1110.

16 See U.S. Counter-Memorial at 233:
While the minimum standard of treatment under customary international law requires compensation in the event of an expropriation, there is no such rule requiring compensation for actions that fall short of an expropriation but that frustrate an alien's expectations. Certainly, Glamis has made no showing that States refrain out of a sense of legal obligation from taking regulatory action that may frustrate an alien's expectations. Indeed, most, if not all, regulatory action is bound to upset the expectations of a portion of the populace. If States were prohibited from regulating in any manner that frustrated expectations – or had to compensate everyone who suffered any diminution in profit because of a regulation – States would lose the power to regulate.

17 See U.S. Counter-Memorial at 227 ("Glamis has also failed to present any evidence of relevant State practice to support its contention that Article 1105(1) imposes a general obligation on States to refrain from 'arbitrary' conduct.")

18 See U.S. Counter-Memorial at 234 and note 1017 ("United States law does not compensate plaintiffs solely upon a showing that regulations interfered with their expectations, as such a showing is insufficient to support a regulatory takings claim . . . It is inconceivable that the minimum standard of treatment required by international law would proscribe action commonly undertaken by States pursuant to national law.")

19 Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 n.9. (1983) (rejecting suggestion that “the arbitrary and capricious standard [under the APA] requires no more than the minimum rationality a statute must bear in order to withstand analysis under the Due Process Clause. We do not view as equivalent the presumption of constitutionality afforded legislation drafted by Congress and the presumption of regularity afforded an agency in fulfilling its statutory mandate.”)

20 United States v. Carolene Products, 304 U.S. 144, 152 (1938). In the context of exercises of executive authority, the Supreme Court has indicated that conduct that “shocks the conscience” violates substantive due process. See County of Sacramento v. Lewis, 523 U.S. 833, 846 (1998). Although the Court has not applied this standard to economic legislation, it is arguably comparable to the current deferential standard of substantive due process review of economic regulations. Accordingly, given the similarity of the “conscience shocking” formulation of substantive due process to the traditional Neer test for the minimum standard of treatment, the Neer standard could be interpreted as consistent with the “no greater rights” principle.

21 Sujit Choudhry, The Lochner Era and Comparative Constitutionalism, 2 Int'l J. Const. L. 1, 3 (2004).

22 Counter- Memorial of Respondent United States of America, Glamis Gold v. United States of America at 222 (Sept. 19, 2006), available at http://www.state.gov/documents/organization/73686.pdf lable at http://www.state.gov/documents/organization/82700.pdf

24 See 2004 Model BIT, Annex B, para. 1.

25 See 2004 Model BIT, Annex B, para. 2.

26 Id., para 4(b).

27 See generally, Matthew C. Porterfield, International Expropriation Rules and Federalism, 23 Stanford Envt'l L. J. 3, 43-62 (2004) (comparing international standard for regulatory expropriation with U.S. regulatory takings doctrine).

28 See 2004 Model BIT, Article 21 (Taxation).

29 See generally Thomas W. Wälde and Abba Kolo, Taxation and Modern Investment Treaties, in The Oxford Handbook of International Investment Law at 347 - 352 (2008).

30 See, e.g., Pittsburgh v. Alco Parking Corp., 417 U.S. 369, 373 (1974) (rejecting a takings challenge to a tax on gross receipts from parking facilities, and noting that “the Court has consistently refused either to undertake the task of passing on the ‘reasonableness' of a tax that otherwise is within the power of Congress or of state legislative authorities, or to hold that a tax is unconstitutional because it renders a business unprofitable.”)

31 See Eduardo Moisès Peñalver, Is Land Special? 31 Ecology L.Q. 227, 231 (2004) (“it is almost beyond dispute that . . . the [Supreme] Court has focused overwhelmingly on regulations affecting land and that landowners bringing regulatory takings claims stand a greater chance of prevailing in the Supreme Court than the owners of other sorts of property”); Molly S. McUsic, The Ghost of Lochner: Modern Takings Doctrine and Its Impact on Economic Legislation, 76 B.U. L. Rev. 605, 647, 655 (1996) (“Economic interests, such as personal property, trade secrets, copyright, and money, are all recognized by the Court as ‘property’ under the Fifth Amendment, but receive little protection against government regulation.”) J. Peter Byrne, Ten Arguments for the Abolition of Regulatory Takings Doctrine, 22 Ecology L.Q. 89, 127 (1995) (“the Supreme Court has shown absolutely no interest in applying the regulatory takings doctrine to assets other than land”).

32 Lucas v. South Carolina Coastal Comm’n, 505 U.S. 1003, 1027-28 (1992). The Supreme Court’s decision in Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984), which involved a claim that the disclosure of trade secrets by the federal government constituted a taking, is sometimes cited as an example of the application of the regulatory takings analysis outside the context of real property. The Court in Monsanto, however, stressed that “[w]ith respect to a trade secret, the right to exclude others is central to the very definition of the property interest. Once the data that constitute a trade secret are disclosed to others, or others are allowed to use those data, the holder of the trade secret has lost his property interest in the data.” Monsanto, 467 U.S. at 1012. Accordingly, “Monsanto is a case in which the government conduct in question was the functional equivalent of a direct appropriation of the entire piece of property, as opposed to a mere regulation of that property.” Eduardo Moisès Peñalver, Is Land Special? 31 Ecology L.Q. 227, 231, n. 20 (2004).

33 Andrew Newcombe, The Boundaries of Regulatory Expropriation in International Law, 20:1 ICSID Review – FILJ at 4 (2005) (noting that “under the ‘orthodox approach’ [a regulatory] expropriation occurs when a foreign investor is deprived of the use, benefit, management or enjoyment of all or substantially all of its investment” rather than whether the government has actually appropriated the investment for its own use).

34 See A.J. Van der Walt, Constitutional Property Clauses: A Comparative Analysis (1999) at 17 (“the distinction between police-power regulation of property and eminent-domain expropriation of property is fundamental to all [constitutional] property clauses, because only the latter is compensated as a rule. Normally, the will be no provision for compensation for deprivations or losses caused by police-power regulation of property.”) United States law is an exception in this regard, and under certain circumstances – most notably in the “rare circumstance” when a regulatory measure destroys all value of real property – requires compensation even when there has been no appropriation of the property by the government. See Lucas v. South Carolina Coastal Comm’n, 505 U.S. 1003 (1992).

35 The definition in past U.S. FTAs has generally been: “investment means 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. Forms that an investment may take include:

(a) an enterprise;

(b) shares, stock, and other forms of equity participation in an enterprise;

(c) bonds, debentures, other debt instruments, and loans;1

(d) futures, options, and other derivatives;

(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;

(f) intellectual property rights;

(g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law;35 3 and

(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.4

For purposes of this Agreement, a claim to payment that arises solely from the commercial sale of goods and services is not an investment, unless it is a loan that has the characteristics of an investment.

1 Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt are less likely to have such characteristics.

2 Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the law of the Party. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law. For greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment.

3 The term "investment" does not include an order or judgment entered in a judicial or administrative action.

4 For greater certainty, market share, market access, expected gains, and opportunities for profit-making are not, by themselves, investments.

36 Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Annex B, Anderson et. al collective statement, Sept. 30, 2009. Available at: http://www.state.gov/e/eeb/rls/othr/2009/131118.htm

37 "The protections against expropriation only apply if government action "interferes with a tangible or intangible right or property interest in an investment."[8] This restrictive language was introduced into the 2004 Model BIT based on the U.S. Constitution's Takings Clause jurisprudence. Earlier U.S. BITs defined expropriation in terms of "investment" (not in terms of "property") and thus provided a broader scope of coverage for U.S. investors overseas." See Statement of Linda Menghetti, Emergency Committee for American Trade, Before Committee on Ways & Means, May 14, 2009. Available at http://waysandmeans.house.gov/Hearings/Testimony.aspx?TID=8180.

38 Statement of Linda Menghetti, Emergency Committee for American Trade, Before Committee on Ways & Means, May 14, 2009. Available at http://waysandmeans.house.gov/Hearings/Testimony.aspx?TID=8180.

39 Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Sept. 30, 2009. Available at: http://www.state.gov/e/eeb/rls/othr/2009/131098.htm

40 William Michael Treanor, "The Origins and Original Significance of the Just Compensation Clause of the Fifth Amendment," Yale Law Journal, 94:3, January 1985.

41 See Ruckelhaus v. Monsanto Co., 467 U.S. 986, 1003 (1984)

42 Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980).

43 See College Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 675 (1999).

44 Vicki Been and Joel Beauvais, "The Global Fifth Amendment? Nafta's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine," New York University Law Review, April 2003, at 64.

45 See J. Peter Byrne, "Ten Arguments for the Abolition of the Regulatory Takings Doctrine," Ecology Law Quarterly, 22, 1195.

46 Anthony B. Sanders, "Of All Things Made in America, Why are We Exporting the Penn Central Test?" March 2007.

47 In CAFTA, these are defined as:

"investment agreement means a written agreement12 that takes effect on or after the date of entry into force of this Agreement between a national authority13 of a Party and a covered investment or an investor of another 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;"

The footnotes read:

"12 "Written agreement" refers to an agreement in writing, executed by both parties, that creates an exchange of rights and obligations, binding on both parties under the law applicable under Article 10.22.2. For greater certainty,
(a) a unilateral act of an administrative or judicial authority, such as a permit, license, or authorization issued by a Party solely in its regulatory capacity or a decree, order, or judgment; and (b) an administrative or judicial consent decree or order, shall not be considered a written agreement.
13 For purposes of this definition, "national authority" means an authority at the central level of government."

48 Annex 10-H lays out the circumstances under which the legal stability agreements could be subjected to investor-state arbitration: "A stability agreement referred to in paragraph 1 may constitute one of multiple written instruments that make up an "investment agreement," as defined in Article 10.28. Where that is the case, a breach of such a stability agreement by Peru may constitute a breach of the investment agreement of which it is a part. Where a stability agreement is materially identical to the illustration set forth in Appendix 10-H.A or 10-H.B, and does not constitute one of multiple instruments that make up an "investment agreement," as defined in Article 10.28, a breach of such a stability agreement by Peru shall not constitute a breach of an investment agreement."

49 The sample legal stability agreements offered in Annex 10-H read: "This Legal Stability Agreement shall remain in force for ten years from the date of on which it is concluded. It may not, therefore, be unilaterally amended by either of the parties during such period, even if domestic legislation is amended or if changes more beneficial or more detrimental to either of the parties are incorporated therein." An alternative version reads: "This Legal Stability Agreement may be amended only by mutual consent of the Parties. It shall not be possible to amend the term established in Article Five, or the investment amount under the limit established in (specify pertinent regulation)."

50 Brad Schwartz, "Development Agreements: Contracting for Vested Rights," Boston College Environmental Affairs Law Review, 719, 2001.

51 That said, just because the TPP would not provide for investor-state arbitration on such contracts doesn't mean that investors can't access such protection, for instance by negotiating such arbitration as part of their contracts with the government (acting in its private capacity as a contract counterparty). For further discussion of these notions, see Gus Van Harten, Investment Treaty Arbitration and Public Law, (Oxford: Oxford University Press, 2007), at 62; Jason Webb Yackee, "Do We Really Need BITS? Toward a Return to Contract in International Investment Law," Asian Journal of WTO & International Health Law and Policy, 3:1, March 2008. However, it is inappropriate to condition a country's ability to obtain the actual trade benefits of a TPP on the government's advance willingness to agree to such arbitration with respect to all investment contacts with a large set of foreign investors.

52 The six year requirement references the conclusion by tribunalists Daniel Price and Piero Bernardini from the Tokios Tokelés case, which thought that an enterprise incorporation six years prior to the attempt to access investor-state arbitration was evidence that the corporation was not engaging in "an abuse of legal personality. "We are satisfied, however, that none of the Claimant's conduct with respect to its status as an entity of Lithuania constitutes an abuse of legal personality… The Claimant manifestly did not create Tokios Tokelės for the purpose of gaining access to ICSID arbitration under the BIT against Ukraine, as the enterprise was founded six years before the BIT between Ukraine and Lithuania entered into force." Majority Opinion in Tokios Tokelés v. Ukraine case, at 24.

53 Anderson, Sarah. Policy Handcuffs in the Financial Crisis, Institute for Policy Studies, February 2009. Available at: http://www.ips-dc.org/files/329/Policy%20Handcuffs%20in%20the%20Financial%20Crisis.pdf; and Comments on the U.S. Model Bilateral Investment Treaty before the U.S. State Department and USTR, July 17, 2009. Available at: http://www.ips-dc.org/files/1366/IPS%20comments%20on%20Model%20Bilateral%20Investment%20Treaty.pdf

54 Kose MA, Prasad E and Taylor AD (2009). Thresholds on the Process of International Financial Integration. NBER Working Paper 14916. Cambridge, MA, National Bureau of Economic Research.

55 Gallagher, Kevin P (2010). Policy space to Prevent and Mitigate Financial Crises, UNCTAD-G-24 Discussion Paper #58, Geneva: UNCTAD. Available at: http://www.ase.tufts.edu/gdae/Pubs/rp/KGCapControlsG-24.pdf

56 European Commission staff working document, "Innovative financing at a global level," SEC(2010) 409 final, April 1, 2010. Available at: http://ec.europa.eu/economy_finance/articles/international/2010-04-06-global_innovative_financing_en.htm

57 And even the annexes that carve out some taxation measures from the expropriation disciplines do not explicitly carve out law enforcement measures, such as those contained in the Stop Tax Havens Abuse Act co-sponsored by then-senator Obama, designed to compel compliance with such taxation measures.

58 See Fireman's Fund Insurance v. United Mexican States, ICSID Case No. ARB(AF)/02/01 (Award of July 17, 2006), paras. 166-68.

59 House Democratic leadership ensured that this provision…:

> "Article 22.2: Essential Security: Nothing in this Agreement shall be construed: (a) to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or (b) to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests."

… Included this footnote:

> "For greater certainty, if a Party invokes Article 22.2 in an arbitral proceeding initiated under Chapter Ten (Investment) or Chapter Twenty-One (Dispute Settlement), the tribunal or panel hearing the matter shall find that the exception applies."

See: http://www.ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file841_9542.pdf

60 Article 22.1: General Exceptions: 1. For purposes of Chapters Two through Seven (National Treatment and Market Access for Goods, Textiles and Apparel, Rules of Origin and Origin Procedures, Customs Administration and Trade Facilitation, Sanitary and Phytosanitary Measures, and Technical Barriers to Trade), Article XX of the GATT 1994 and its interpretive notes are incorporated into and made part of this Agreement, mutatis mutandis. The Parties understand that the measures referred to in Article XX(b) of the GATT 1994 include environmental measures necessary to protect human, animal, or plant life or health, and that Article XX(g) of the GATT 1994 applies to measures relating to the conservation of living and non-living exhaustible natural resources. 2. For purposes of Chapters Eleven, Fourteen, and Fifteen1 (Cross-Border Trade in Services, Telecommunications, and Electronic Commerce), Article XIV of the GATS (including its footnotes) is incorporated into and made part of this Agreement, mutatis mutandis. The Parties understand that the measures referred to in Article XIV(b) of the GATS include environmental measures necessary to protect human, animal, or plant life or health.

61 Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Annex B, Anderson et. al collective statement, Sept. 30, 2009. Available at: http://www.state.gov/e/eeb/rls/othr/2009/131118.htm. Statement of Linda Menghetti, Emergency Committee for American Trade, Before Committee on Ways & Means, May 14, 2009. Available at http://waysandmeans.house.gov/Hearings/Testimony.aspx?TID=8180. Mark Kantor, "International investment law protections for Chinese investment into the US," in Karl Sauvant, ed., Investing in the United States: Is the US Ready for FDI from China? (Northampton, MA: Edward Elgar, 2010), at 142, 146

62 See discussion in Rachel Thorn & Jennifer Doucleff, "Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of 'Investor'", in Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung, and Claire Balchin (eds.), The Backlash against Investment Arbitration, (Netherlands: Kluwer Law International, 2010) Moreover, rulings under the plurilateral Energy Charter Treaty (ECT) have ruled that ECT respondent state A will have a hard time denying benefits to an investor that claims to be from ECT state B – but is controlled by nations outside ECT state B and/or lacks substantial business activities in ECT state B – if it can be shown that some layer of its corporate veil (not even necessarily the veil indicating ultimate beneficial ownership) comes from ECT states C and D. In Hulley

Enterprises v. Russia, the claimants claimed to be from Cyprus and Isle of Man. Isle of Man is a crown dependency of the U.K., and both Cyprus and Isle of Man are notorious tax and regulatory havens. After an examination of the evidence, the tribunal determined that the claimants were in fact owned and controlled by investors incorporated in Gibraltar and Guernsey – the former a U.K. overseas territory and the other a crown dependency, and also both tax and regulatory havens. Because the U.K. is in the ECT, it didn't matter that the investors were not from where they said they were. Russia argued that the beneficial owners of the Gibraltarian and Guernsey investors were Russian or Israeli nationals. The tribunal ruled that Russian investors would not be prohibited from challenging Russian regulations under the "denial of benefits" provisions of the ECT, and did not specifically determine the claim about Israeli beneficial ownership. PCA Case No. AA 226, In The Matter Of An Arbitration Before A Tribunal Constituted In Accordance With Article 26 Of The Energy Charter Treaty And The Uncitral Arbitration Rules 1976 Between Hulley Enterprises Limited (Cyprus) And The Russian Federation, Interim Award On Jurisdiction And Admissibility, Nov. 30, 2009, at paras 537-55. In AMTO v. Ukraine, the Latvian corporation had owners or boardmembers in Latvia, Liechtenstein, the U.S., and Cyprus, and the tribunal determined in was ultimately controlled by a Russian. Because Russia is also party to the ECT (along with Latvia and Ukraine), the tribunal seemed ready to accept standing (but did not rule because of an equally troubling determination on "substantial business activities" – see below).

63 Indeed, the Aucoven v. Venezuela tribunal noted, with regard to complex holding company structures, what the respondent state alleged to be a "mere formality is the fundamental building block of the global economy." Quoted in Thorn and Doucleff, at 18.

64 "CAFTA Investor Rights Undermining Democracy and the Environment: Pacific Rim Mining Case," Public Citizen, May 2010. Available at: http://www.citizen.org/documents/Pacific_Rim_Backgrounder1.pdf

65 This is noted in the first paragraph of the Korea FTA language noted above.

66 That Agreement states that, "The benefits of this Framework Agreement shall be denied to a service supplier who is a natural person of a non-Member State or a juridical person owned or controlled by persons of a non-Member State constituted under the laws of a Member State, but not engaged in substantive business operations in the territory of Member State(s)" [italics added] See http://www.aseansec.org/6628.htm

67 http://ita.law.uvic.ca/documents/HELvRussianFederation-InterimAward-30Nov2009.pdf at 165.

68 Arbitration Institute Of The Stockholm Chamber Of Commerce, Arbitration Number 080/2005, In The Matter Of: An arbitration pursuant to the Energy Charter Treaty and the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce: Limited Liability Company Amto (Claimant) v. Ukraine (Respondent), Final Award, March 26, 2008, at para 69. Available at: http://ita.law.uvic.ca/documents/AmtoAward.pdf.

69 "We are satisfied, however, that none of the Claimant's conduct with respect to its status as an entity of Lithuania constitutes an abuse of legal personality… The Claimant manifestly did not create Tokios Tokelės for the purpose of gaining access to ICSID arbitration under the BIT against Ukraine, as the enterprise was founded six years before the BIT between Ukraine and Lithuania entered into force." Majority Opinion in Tokios Tokelés v. Ukraine case, at 24.

70 This point was noted by panelists Daniel Price and Piero Bernardini in their Decision on Jurisdiction on Tokios Tokelés v. Ukraine case.

71 For a discussion of these concepts, see Maurice Mendelson, "The Requirement for Continuous Nationality," in Federico Ortino, et. al. (eds.), Investment Treaty Law: Current Issues II: Nationality and Investment Treaty Claims and Fair and Equitable Treatment in Investment Treaty Law, (London: British Institute for International & Comparative Law, June 2007).