TRANS-PACIFIC PARTNERSHIP AND INVESTOR-STATE DISPUTE SETTLEMENT

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Nearly eight years of negotiation on a Trans-Pacific Partnership (TPP) concluded in October 2015 with an agreement among 12 Asia-Pacific nations. The TPP is the most ambitious of all preferential "trade-and" agreements the United States has negotiated. Its 30 chapters establish rules in a wide range of issue areas, from competition policy to intellectual property rights. Annexes contain detailed market access and tariff commitments from all participating countries. (For full text and related information, see ustr.gov/tpp/#news.)

Although the TPP faces an uncertain fate in Congress—especially in this, an election year—state and local officials in the Rocky Mountain region should understand how the TPP's new rules might affect them and their work, particularly in the increasingly contentious area of natural resource extraction. This article focuses on investor-state dispute settlement provisions contained in Chapter 9 and its annexes.

Similar investment rules also are included in a pact with Europe that is still under negotiation (and a long way from completion). Expanding the reach of these rules to include firms from developed economies, which account for the majority of foreign investors in this region, increases the prospect that future investment disputes might end up in third party arbitration.

TPP Countries. The twelve countries included in the Trans-Pacific Partnership are: Australia, Brunei, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam.

Investor-State Dispute Settlement. Lambasted by liberals and libertarians alike, investor-state dispute settlement (ISDS) rules are among the most controversial of all TPP provisions. Similar investment language has been part of most U.S. trade agreements since the North American Free Trade Agreement in 1994, but provisions have become more complex and wide-ranging over the years.

The original purpose of investor provisions was to protect firms (especially from advanced economies) wishing to invest in other (especially developing) countries from expropriation or nationalization of their properties without compensation and from otherwise arbitrary or capricious actions by foreign governments. Indeed, the record of ISDS cases bears this out. U.S. firms have taken more cases to arbitration than any other country; and Argentina has faced more cases than any other country.

However, outright expropriation of private property occurs less often today than in the past; and the international investment climate has become more complex, thus the expanded breadth and complexity of rules.

Existing ISDS rules occasionally have been used to challenge regulatory and other decisions in the United States, but we have won all such cases so far (13 in all). However, because most ISDS cases globally involve natural resource extraction; and because TPP rules broaden the scope of existing rules, there is a real prospect that foreign firms may use the TPP's ISDS provisions in the future to challenge state and local actions affecting their investments.

First Some Facts. The TPP's investment chapter establishes rules to: 1) protect foreign investors against uncompensated expropriation of property, including indirect expropriation; 2) extend to foreign firms the same rights and privileges as domestic and other foreign firms operating in a TPP country; and 3) otherwise ensure "fair and equitable" treatment of foreign investors in a TPP country.

If a foreign investor feels that a host government (or agency or representative thereof) has violated the rules, that investor can seek to take the dispute to arbitration under one of a number of internationally recognized arbitration bodies, without first having to take the case to domestic courts. The most widely used "third party" arbitration bodies are the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank's International Center for Settlement of Investment Disputes (ICSID).

Once a case is accepted for review, arbitrators hear both sides of the dispute and, in most cases, eventually issue a ruling in favor of either the investor or the state, unless the disputing parties settle "out of court." States losing a case generally must pay the investor damages and attorneys' fees in an amount determined by the arbitrators.

More than 600 cases worldwide have been heard by third-party arbitrators since 1987. In too many cases, the ultimate rulings have remained secret, known only to the parties to the dispute. Moreover, arbitrators don't always rule the same way, even in cases with similar facts. These shortcomings make it difficult to draw lessons from cases, and they also draw fire from critics.

Implications for the Rocky Mountain region. Saying precisely how the TPP's investor protection rules might affect this region would be speculative at this point, and officials need to have their own attorneys look at the language. But here are some provisions warranting a closer look.

<u>Coverage</u>. TPP's investment rules apply to measures taken by federal, state, and local levels of government and by persons acting under authority of those governments. Although selected bilateral agreements (e.g., with Colombia, Korea, and Peru) include state and local governments, NAFTA does not. The Federal government in the United States generally would represent state and local governments in international arbitration. However, any litigation or threat thereof could tie up legal resources and funds of subnational governments and their agencies.

<u>Investment defined</u>. Investment is defined broadly as "every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, *the expectation of gain or profit*, or the assumption of risk" (with certain caveats contained in footnotes; italics added). Among the specific examples of what constitutes an investment, the TPP text offers among other definitions: licenses, authorizations, permits and similar rights.
A footnote further clarifies that: "an investor 'attempts to make' an investment when that investor has taken concrete action or actions to make an investment, such as channelling resources or capital in order to set up a business, or *applying for a permit or licence*" [italics added]. Thus, the very act of applying for a permit or license qualifies the foreign firm for coverage under these provisions.

Environment, health, and public welfare carve-out: The text makes it clear that governments may enact measures to ensure that investment is undertaken "in a manner sensitive to" environmental, health, and other regulatory objectives. However, language related to indirect expropriation (see below) adds a caveat to this carve-out not seen in previous trade agreements.

Indirect Expropriation: Annex 9-B states that: "Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations, *except in rare circumstances*" [italics added].

The addition of this "rare circumstances" caveat, not contained in any previous agreement, could open the door for creative attorneys to find new ways to challenge regulatory measures aimed at protecting public health and the environment. A number of cases involving challenges to public welfare measures are pending in international arbitration under existing ISDS rules.

Performance Requirements: Could language in Section 9.9 (h) (ii) prohibit regulators from denying or restricting the use of technologies, including fracking? That section reads:

> No Party shall…impose or enforce any requirement, or enforce any commitment or understanding. . . that prevents the purchase *or use of*…a particular technology. [italics added]

This question is highly relevant to an existing case in which an American firm, Lone Pine, has challenged Quebec's withdrawal of its fracking license. The alleged lack of due process is key to this case, which is currently pending before an international arbitration panel.

Transparency: New requirements for transparency and openness of arbitration proceedings are included in the text.

Conclusion. America's highly regarded guarantees of transparency and due process, applied at every level of government, reduce the chances that regulatory actions and other government measures will be successfully challenged by foreign investors, either in domestic courts or in third party arbitration bodies.

However, past is not always prologue. The fact that the United States has faced only 13 investor-state disputes under international arbitration does not mean that the prospects for challenge are not increased by the expansion of rules to cover greater numbers of foreign investors from countries not previously covered by these rules. In addition, some of the definitions and caveats added to the TPP text may open new avenues for litigation.

The best protection against future challenge is to ensure that regulatory actions and other government measures are undertaken in a fair, transparent manner, with opportunity for all affected parties to express their views as such measures are crafted.

(Note: Nothing in this article constitutes legal advice.)