1001 Pennsylvania Avenue, NW, Washington, DC 20004-2595 ■ p202 624-2500 ■ f202 628-5116

crowell moring

Testimony of Theodore R. Posner, Esq.
Partner, Crowell & Moring LLP

Before the Subcommittee on Trade
of the Committee on Ways & Means
of the U.S. House of Representatives
Hearing on
Investment Protections in U.S. Trade and Investment Agreements

May 14, 2009

Mr. Chairman, Ranking Member Brady, thank you for the opportunity to testify today on a topic that has occupied a lot of my professional attention over the past decade. My name is Ted Posner, and I am a partner in the international trade and international arbitration groups at the law firm of Crowell & Moring.

Prior to my return to private practice at the beginning of this year, I had the good fortune to work on the law and policy of international investment both in the Congress and in the Executive Branch. It was as your trade counsel, Chairman Levin, that I started to examine these issues. Then, as trade counsel to the Senate Finance Committee, I was deeply engaged in drafting the investment-related provisions of the Bipartisan Trade Promotion Authority Act of 2002. Those provisions established the framework for all of the investment negotiations that have occurred since then. And, as an attorney in the Office of the U.S. Trade Representative from 2002 to 2008, I participated in most of those negotiations, as well as in the 2004 revision of the U.S. Model Bilateral Investment Treaty.

In carrying out these responsibilities, I became very familiar with the interests and concerns of U.S. and foreign companies, U.S. regulators at all levels of government,

foreign governments, and non-governmental organizations. I have had frequent occasion to reflect on those diverse views. Today, I want to highlight three points I believe to be essential to a review of U.S. international investment policy:

- First, investment protections in bilateral investment treaties (BITs) and free trade agreements (FTAs), together with the availability of a neutral forum in which to assert those protections, provide an essential set of rights to U.S. persons doing business in a globalized economy. They facilitate precisely the kind of economic activity we should be encouraging in our efforts to reverse the economic downturn.

- Second, a sustainable international investment policy requires a balancing of interests. It must reflect the interests of the United States not only as a participant in the global economy, but also as a protector of the public welfare at home. That balance was achieved, after substantial deliberation and debate, in the articulation of investment-related negotiating objectives in the Trade Act of 2002. No developments since then warrant disrupting that balance.

- Finally, discussions of this topic frequently have been muddied by misunderstandings of what BITs and FTAs require of host governments. Critics of investment protections have asserted, for example, that they constrain the right to regulate in the public interest or otherwise jeopardize U.S. sovereignty. Such assertions are incorrect and get in the way of a productive discussion.

I will speak briefly to each of these points.

Investment Protections Facilitate Economic Growth

To appreciate the value of investment treaties and agreements, it is useful to consider the situation a U.S. investor faces in a foreign country in the absence of such instruments. As a practical matter, in the absence of treaty protections or domestic legislation providing for international remedies, that investor can rely only on the rights afforded by the domestic law of the host country. Often, those rights will not be easily accessible to an outsider. To defend its rights, the investor's only recourse usually will be the local court system, which will require the investor to be familiar not only with local substantive law, but also with all the technical aspects of local procedural law and customs. If that fails, the investor may seek the assistance of the U.S. government, in which case its interests will be competing with diplomatic, national security, and other interests. And, if the investor is doing business in multiple countries, its familiarity with its legal rights in one will give it no comfort in the others.

A treaty or agreement puts the relationship between the U.S. investor and a host country on an international law footing. Now, the investor is protected not only by the domestic laws of the host, but also by a set of rights that is common across multiple countries. And, the investor is able to assert those rights before a neutral tribunal under rules that will vary only slightly from agreement to agreement.

Thus, a U.S. company that has invested in Chile and understands its rights under the U.S.-Chile FTA will be able to invest in Peru or in Costa Rica, for example, confident of its entitlement to similar protections, regardless of differences in national law. Of course, the business and regulatory environment will vary from country to country, and these are significant factors in any investment decision. But, at a minimum, the investor knows it is entitled to certain basic protections that will remain relatively constant across jurisdictions that are parties to U.S. BITs or FTAs.

By facilitating investment in this way, investment protections serve as an engine of economic growth. While the existence of an investment treaty may not be decisive for a company contemplating an investment, there is empirical evidence to suggest that it does help.[1]

And, such encouragement to invest is absolutely vital in the current economic environment. The UN Conference on Trade and Development (UNCTAD) reported last week that foreign direct investment declined by 15% in 2008 and is likely to decline even more in 2009.[2] To reverse this trend, it will be essential to eliminate barriers to investment and provide investors a degree of legal security. BITs and FTAs are excellent tools for doing just that.

The Trade Act of 2002 Reflects a Carefully Crafted Balance of Interests

Critics of this view say that it gives undue weight to the interests of companies doing business abroad, while giving insufficient weight to the interests of investors and consumers in the U.S. market. The treaty obligations the United States negotiates are reciprocal. Critics argue that more attention should be paid to how those obligations constrain the United States as host to foreign investment.

In fact, there was a vigorous debate on this very issue during drafting of the Trade Act of 2002. Proponents of strong investment protections advocated for negotiating objectives similar to those contained in the previous grant of trade negotiating authority, in the Omnibus Trade and Competitiveness Act of 1988. Others pointed

---

[1] *See, e.g.,* Eric Neumayer and Laura Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?", 33(10) WORLD DEVELOPMENT 1567 (2005); The Economist and the Columbia Program on International Investment, "World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk" 96 (2007).

[2] "Deep declines in foreign investment expected in 2009 as crisis hits developing world, UNCTAD chief says," UNCTAD/PRESS/PR/2009/014/Rev.1 (May 4, 2009).

to claims then being brought under NAFTA – including claims against the United States – and to perceived flaws in the NAFTA procedures for investment arbitration and called for a major overhaul.

The outcome of that debate was a balancing of both sets of interests. The 2002 Act calls on negotiators to pursue investment protections similar to those contained in earlier treaties and agreements – protections such as national treatment, fair and equitable treatment, and compensation for expropriation under standards similar to those provided under U.S. law. But, the Act also takes account of U.S. "defensive" interests in several notable respects:

- It establishes the "no greater substantive rights" objective. According to this objective, negotiators are to seek to "ensur[e] that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States;"

- It calls on negotiators to seek standards for expropriation and compensation for expropriation and for fair and equitable treatment "consistent with United States legal principles and practice;"

- It calls on negotiators to seek dispute settlement procedures that eliminate and deter the filing of frivolous claims; and

- It calls on negotiators to ensure transparency in all aspects of investment dispute settlement.[3]

[3] Pub. L. No. 107-210, § 2102(b)(3), 116 Stat. 933, 995 (Aug. 6, 2002).

The message of the 2002 Trade Act with respect to investment was clear, and negotiations conducted under the Act's framework adhered closely to the Act's objectives. For example, the resulting agreements consistently included annexes elaborating on expropriation and fair and equitable treatment in light of those objectives. Similarly, the dispute settlement procedures in these agreements are completely transparent and provide for expedited dismissal of frivolous claims, as well as authorizing tribunals to sanction parties that pursue frivolous claims.

The question now is whether the balance in the 2002 Trade Act should be revised. I respectfully suggest that the answer is No. No developments in the intervening seven years suggest any reason to dispense with the balance reflected there and start again.

When the 2002 Act was agreed to, the United States had not lost a single investor-State arbitration. Seven years later that is still the case. Meanwhile, U.S. investors have come to rely increasingly on investor-State arbitration as a means of defending their rights overseas.

As a negotiator of free trade agreement investment chapters during my time at USTR, I had the experience of explaining the objectives in the 2002 Act to foreign counterparts. It is not easy. Urging transparency in dispute settlement, for example, is a hard sell. But, in the ten FTAs with investment chapters[4] and two BITs[5] concluded since 2002, the United States has succeeded consistently in achieving these objectives. Modifying those objectives – particularly in ways that are perceived as replacing international treaty standards with U.S. domestic legal

---

[4] FTAs with Colombia, Panama, Korea, Chile, Singapore, Australia, Morocco, Oman, Peru, and the Dominican Republic and Central American countries. (The U.S. FTA with Bahrain does not contain an investment chapter, due to a pre-existing, relatively recent BIT with Bahrain.)

[5] BITs with Uruguay and Rwanda.

standards – will increase the challenge substantially, perhaps insurmountably, leaving U.S. investors without the protections that their foreign competitors receive under other countries' BITs and FTAs.

Nevertheless, from time to time there have been calls to modify the current model in significant ways – for example, by limiting the right to compensation for expropriation or by severely curtailing or eliminating investor-State arbitration. Some of these calls are based on misunderstandings of what our investment treaties and agreements do and what they do not do. Accordingly, as my last point, I would like to address three of the more glaring misconceptions that have made their way into the public discourse.

A Productive Discussion Must Avoid Misunderstanding of Investment Treaty Obligations

First, some critics have argued that the standard for expropriation and compensation for expropriation under U.S. BITs and FTAs is more investor-friendly than the standard under the Takings Clause of the Fifth Amendment to the U.S. Constitution, exposing the United States to claims it would not face in a U.S. court. This is patently incorrect. Following enactment of the Trade Act of 2002, a consistent feature of BIT and FTA investment chapters has been a special annex elaborating on the expropriation provision. The annex sets forth principles drawn directly from U.S. takings jurisprudence. For example, the annex explains that an action is an expropriation only if it "interferes with a tangible or intangible property right or property interest in an investment," and it spells out factors to be considered in a fact-based inquiry as to whether a regulatory action is an indirect expropriation.

To the extent some find the annex on expropriation to be inadequate, their criticism may be based on a flawed understanding of the analogous U.S. law. For example,

one widely circulated report asserts incorrectly that "U.S. regulatory takings jurisprudence applies only to real property. . . ."[6] In fact, for at least the past 25 years the U.S. Supreme Court has recognized the applicability of the Takings Clause to property other than real property.[7]

Another criticism charges that BITs and FTAs tie the hands of Federal, State and local governments, constraining their ability to regulate in the public interest. This, too, is false. It is based in part on a focus on claims that private parties have asserted – some of them of questionable merit, some never actually litigated – as opposed to findings that arbitrators actually have made. The criticism also is based on a misreading of certain NAFTA cases. For example, the often-cited S.D. Meyers case was not about Canada's right to adopt environmental regulations – in that case, regulations concerning the destruction of PCBs. Rather, it was about actions "to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals."[8]

The fear of unduly constraining regulators also is based on a mischaracterization of the powers of arbitration panels. Contrary to that mischaracterization, these panels cannot compel governments to change laws or take any other specific actions. At most, they can find breaches of BIT or FTA obligations and award damages based on any harm resulting from such breaches.

Finally, from time to time, the debate on international investment policy has raised questions about the ability of the United States to defend its national security

---

[6] Public Citizen, NAFTA's Threat to Sovereignty and Democracy: The Record of NAFTA Chapter 11 Investor-State Cases 1994-2005 at viii-ix (Feb. 2005).

[7] *See, e.g.*, *Ruckelshaus* v. *Monsanto*, 467 U.S. 986 (1984) (recognizing trade secrets as protectable under Takings Clause);

[8] *S.D. Myers* v. *Canada*, Partial Award, para. 162 (Nov. 13, 2000).

interests once it undertakes obligations to foreign investors in BITs or FTAs. Some have suggested that the obligation to provide non-discriminatory access to investment in certain sectors, such as port services, would deprive the United States of the power to exclude a given investor on national security grounds. This claim, too, is false.

The United States routinely includes an "essential security" provision in its BITs and FTAs. Actions by a country that might otherwise be inconsistent with a BIT or FTA obligation are excused if "it considers" those actions to be necessary for the protection of its "essential security interests." The key phrase here is "it considers." That language makes clear that a country may determine for itself whether actions are necessary to protect its essential security. And, to eliminate any doubt whatsoever, the most recent FTAs state explicitly that upon a party's invocation of the essential security exception, an arbitration panel shall find that the exception applies.[9]

Conclusion

In conclusion, Mr. Chairman, the task the Administration has set for itself of "review[ing] the implementation of our FTAs and BITs to ensure that they advance the public interest" is an important task. The Congress is an essential participant in that review. The main message I want to leave with the Subcommittee is that the review should be undertaken on the basis of accurate premises. While that would seem obvious, it bears emphasis in light of some of the misconceptions surrounding investment protections.

[9] *See* U.S.-Peru FTA, art. 22.2(b), fn 2; U.S.-Colombia FTA, art. 22.2(b), fn 2; U.S.-Panama FTA, art. 21.2(b), fn 2; U.S.-Korea FTA, art. 23.2(b), fn 2.

On the whole, these protections have provided a significant degree of legal certainty that has facilitated investment and economic growth. At the same time, they have been crafted in a way that takes due consideration of U.S. interests as a host to foreign investors. It is my hope that participants in the review will recognize these facts, and that the Administration and the Congress will continue to be strong supporters of BIT- and FTA-based investment protections.

Thank you.