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The New U.S. Model Bilateral Investment Treaty:

A Public Interest Critique

On April 20, 2012, the Obama administration released the new model U.S. bilateral investment treaty (BIT), the template document that the United States uses as a starting point when negotiating a new BIT.[1] The new model is the output of a three-year review process that included gathering input from an official advisory committee.

This advisory committee was formed in June 2009 at the request of the State Department and USTR, as a subcommittee of the Advisory Committee on International Economic Policy (ACIEP). Co-chaired by Thea Lee, then Policy Director of the AFL-CIO, and Alan Larson, Senior International Policy Advisor at Covington & Burling, LLP, the members of the subcommittee were a diverse group of investment experts, with representation from business, academia, labor, environmental NGOs and the legal profession. The ACIEP submitted their report on September 30, 2009.[2]

Public interest organizations represented on the committee submitted an annex with 17 recommendations for the new model BIT.[3] The table below lists these detailed recommendations and analyses the extent to which the new model reflects this input.

Overall Analysis of the New Model BIT

The new U.S. model BIT does not go far enough to address the concerns that labor unions and environmental, development, and other nongovernmental organizations have raised consistently for many years. Some primary examples:

Jobs, Capacity and Technology: The new model BIT does little to address the need to reverse the devastating impacts of offshoring on U.S. workers and communities. Instead it will continue to facilitate and accelerate the off-shoring of U.S. jobs, capacity and technology by providing sweeping protections for U.S. investments abroad, without commensurate investor obligations to adhere, for instance, to internationally recognized worker rights.

Democracy: The model BIT continues to allow private foreign investors to bypass domestic courts entirely and take claims related to laws and regulations developed through the democratic process directly to international tribunals. When challenges are successful, the host government is compelled to pay compensation to the investor, which may deter future adoption or enforcement of meaningful safety, worker, and environmental standards.

Environment: The new model BIT continues to allow foreign investors to sue over legitimate environmental and health and safety protections. Many governments, including the United States, have already had to spend millions of dollars defending against such investor-state claims. The threat of such expensive lawsuits can also dissuade elected officials and regulators from taking responsible action to promote sustainable development, environmental protection, and human health and safety.

The new model BIT also fails to adequately address significant developments since the last review of the model in 2004 that make policy changes even more important:

The Global Financial Crisis: The new model BIT continues to restrict governments from placing even temporary controls on capital flows, despite the fact that many countries have used this policy tool effectively to prevent or mitigate financial crisis. We also have strong concerns that the financial services rules do not sufficiently protect responsible government actions to ensure financial system stability or to facilitate economic recovery.

Surge in Foreign Investment into the United States: The new model continues to emphasize the protection of U.S. investors abroad without adequately addressing concerns that U.S. laws and regulations will increasingly become the target of investor claims, given the dramatic increase in foreign investment inflows into the United States.

Comparison of Detailed Public Interest Recommendations vs. the New U.S. Model BIT[4]

Public Interest Recommendation	New US Model BIT
Making Dispute Settlement Consistent with the Public Interest	
1. Replace investor-state dispute settlement 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.	**The suggested reforms to the dispute settlement process were rejected.** The Obama Administration's decision to include investor-state dispute settlement (ISDS) is at odds with growing opposition among U.S. trade partners to the current system of ISDS. Australia, for example, has decided to reject ISDS in all future trade and investment agreements, and the European Parliament has passed a resolution calling for reforms to the investment dispute settlement process, including a requirement that foreign investors exhaust domestic legal remedies before bringing an investor-state claim.
Ensuring that Foreign Investors Do Not Have Greater Rights than U.S. Investors	
2. Codify the State Department's position in the *Glamis* case regarding the standard of proof for identifying principles of Customary International Law (CIL).	**This proposed reform was ignored.** Reform advocates had proposed that the new model BIT clarify that a foreign investor has the burden of demonstrating that a purported standard of protection under customary international law is based on actual state practice rather than on the unsupported assertions of previous investment tribunals.

3. Codify the State Department's position in *Glamis* regarding the content of the minimum standard of treatment.	**This proposed reform was rejected.** The minimum standard of treatment (MST) provision of investment treaties, which typically includes a right to "fair and equitable treatment" (FET), has become the most frequent basis for successful investment claims. MST provisions have been interpreted to include increasingly broad standards of protection, including a right to a stable and predictable legal environment, which allows investors to challenge laws that alter regulatory or tax standards. These broad interpretations of MST do not reflect the actual customary practice of states, and violate the principle that foreign investors should not receive greater rights than citizens. Accordingly, reform advocates urged the Obama Administration to codify the traditional, narrow standard for MST that the U.S. State Department advocated in the *Glamis Gold* dispute.
4. 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.	**This proposed reform was rejected.** Investment tribunals have interpreted language in investment agreements concerning "indirect expropriation" to require governments to compensate investors when public interest regulations have a "significant" or "substantial" adverse impact on the value of an investment. This approach to indirect expropriation provides foreign investors with greater rights than the standard of protection than is generally available under the domestic laws of nations, which typically require compensation only when a government seizes possession or control of property.
5. Narrow the definition of investment to include only the kinds of property that are protected by the U.S. Constitution. This would mean excluding the expectation of gain or profit and the assumption of risk. We also recommend excluding derivatives and caution against the inclusion of carbon offset contracts.	**This proposed reform was rejected.** Narrowing the scope of protected economic interests to correspond to the property rights that are protected under the U.S. Constitution would help bring future U.S. investment agreements into compliance with the principle that foreign investors should not be provided with greater rights than U.S. citizens.
6. Ensure that foreign investors may not use the most favored nation principle to assert rights provided by other investment agreements or treaties.	**This proposed reform was rejected.** The lack of clarity in the text of the 2004 Model BIT concerning MFN leaves open the possibility that foreign investors could claim greater rights than are provided under the BIT that was agreed to by their home country. Conversely, foreign investors who enjoy the right to MFN through an existing trade agreement or other treaty could wield that MFN obligation to demand the full new set of rights – both substantive and procedural – granted to

	foreign investors in the Model BIT. The unfettered application of the MFN clause in investment agreements would thus push towards a harmonized and enlarged system for the protection of investments, where investors could pick the most favorable standards and dispute settlement mechanisms.
7. Explicitly limit national treatment to instances in which a regulatory measure is enacted for a primarily discriminatory purpose.	**This proposed reform was rejected.** The broad scope of the "national treatment" non-discrimination principle in the 2004 Model BIT leaves the principle open to interpretations by international tribunals that could have negative consequences for environmental, health and safety laws. As has been the case in WTO jurisprudence, the principle can be interpreted by tribunals as prohibiting regulatory actions that result in "de facto" discrimination, even when there is no facial or intentional discrimination involved. For example, an otherwise neutral regulatory action to protect the environment that results in a disproportionate impact on a foreign investor could run afoul of this standard.
8. Revise Article 17 to ensure that foreign subsidiaries are not allowed to bring investment claims against a nation that is the home of their parent company.	**This proposed reform was rejected.** The 2004 Model BIT's language on Denial of Benefits contains a loophole that allows corporations to bypass their own country's domestic courts by filing investor-state claims through foreign subsidiaries located in a BIT partner nation. This is explicitly permitted in Article 17.2, so long as the corporation has "substantial business activities" in the other Party. Global corporations will inappropriately use this provision to avoid the normal "diversity of nationality" requirement for investor-state arbitration.
Protecting Health, Safety, and the Environment and Promoting Good Jobs	
9. Provide a stronger exception for health, safety and environmental measures by deleting the phrase "otherwise consistent with this Treaty" in Article 12.2.	**This proposed reform was rejected.** This means that the provision is of limited value, since a government only needs such a defense if its policies have already been found inconsistent with the Treaty.
10. Transform the hortatory and aspirational language in the "Investment and Environment" provision into a legal obligation subject to State-to-State dispute settlement. • In Article 12.1, the language "shall strive to	**The model BIT made some progress on environment but fell well short of expectations.** The new model does replace "strive to ensure" with the stronger language that "each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its environmental laws." However, it provides for no dispute settlement whatsoever but rather consultations already available under the 2004 model BIT. The proposal to delete the footnote that narrows the scope of

ensure that it does not waive or otherwise derogate from" should be replaced by a firm obligation: "shall not waive or otherwise derogate from". The footnote to this article should be deleted to expand the scope of Article 12 to all environmental laws. • The Investment and Environment Provision should be subjected to State-to-State dispute settlement by deleting Article 37.5 and deleting the last sentence of Article 12.1.	U.S. environmental laws covered by Article 12 was rejected. This means that some U.S. environmental laws will not enjoy even the weak protections offered by this provision.
11. Insert in the preamble language that clarifies that the broader objective of the Model BIT is to contribute to sustainable development.	**This proposed reform was rejected.** By including the objective of sustainable development, the new model BIT could have given guidance to dispute settlement panels to avoid investor-above-all interpretations that disregard the public interest.
12. Require Parties to adopt and maintain laws and regulations consistent with the ILO core labor rights, as defined by the core conventions, and to effectively enforce them, as well as laws and regulations related to acceptable conditions of work, and to provide an effective mechanism to enforce those and other labor commitments.	**The model BIT made some progress on labor rights but fell well short of expectations.** The main advances to Article 13 include: 1) the inclusion of the hortatory language found in pre-May 10, 2007 free trade agreements that parties "reaffirm" their obligations as members of the ILO and their commitments under the ILO Declaration; 2) creating an obligation not to waive or otherwise derogate from its labour laws, or offer to do so, where doing so would be inconsistent with the core labor rights (whereas the party previously only had to strive to do so); 3) labor laws now include the elimination of discrimination in employment and occupation; 4) parties cannot fail to effectively enforce their labor laws through a sustained or recurring course of inaction as an encouragement for the establishment, acquisition, expansion or retention of an investment in its territory; 5) provides that if a party requests consultations, the other party must respond in 30 days, and the parties should endeavour to reach a mutually satisfactory resolution; and 6) provides that parties may provide opportunities for public participation regarding matters arising under Article 13. The two major areas where the model BIT falls short of the labor proposal are that: 1) it does not require a party to bring its laws into line with minimum international labor rights, but

	only not waive or derogate from the labor laws already on the books or not fail to enforce those laws; and 2) provides for no dispute settlement whatsoever but rather consultations already available under the 2004 model BIT.
Preventing and Mitigating Financial Crises	
13. Undertake a thorough legal review of the potential that any of the measures that it has implemented (or is contemplating implementing) in response to the financial crisis might be inconsistent with any standard of investor protection contained in U.S. BITs.	**There is no sign that this legal review was carried out.**
14. Conduct a thorough legal review of the "prudential measures" exception. Based on the outcome of these legal reviews, the U.S. government should consider including a stronger prudential measures exception. Specifically, the U.S. government should consider eliminating the arguably self-canceling second sentence of Article 20.1, and including language indicating that the prudential measures exception is self-judging (similar to the language in the essential security provisions of recent FTAs).	**There is no sign that this legal review was carried out.** The new model BIT includes the problematic second sentence of Article 20.1. This means that governments will face significant uncertainty over whether actions to prevent future financial crises may be considered violations of the BIT. The new model does include new language in Article 20.8 that offers an extremely weak exception for measures "related to the prevention of deceptive and fraudulent practices or that deal with the effects of a default on financial services contracts." This is qualified by both: (1) a requirement that the measures be "necessary to secure compliance with laws or regulations that are not inconsistent with this Treaty," which is not only arguably self-cancelling, but also imposes a "necessity" standard, which generally means that the measures would have to be the least trade restrictive approach to achieving compliance, and (2) a requirement that the measures "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on investment in financial institutions," which imposes various other requirements (e.g., attempting to negotiate a resolution with affected companies before imposing the measure).
15. Allow the use of capital controls by including a safeguard provision for balance of payments and other financial crises that is not	**This proposed reform was rejected.** Article 7 on Transfers continues to include severe restrictions on the use of capital controls. This means that governments will face the risk of provoking expensive investor-state lawsuits if they use this legitimate and proven policy tool to prevent or mitigate

subject to investor-state dispute settlement.	financial crises. According to an IMF report, most BITs and FTAs of other countries either provide temporary safeguards on capital inflows and outflows to prevent or mitigate financial crises, or defer that matter to the host country's legislation.
16. Exclude "sovereign debt" from Article 1 definitions of an investment.	**This proposed reform was rejected.** This means that governments will face the risk of provoking expensive investor-state lawsuits if they seek to restructure their debts as part of a recovery process. This conflicts with the U.S. government's long history of advocating for sovereign debt restructuring as an alternative to IMF- or U.S. taxpayer-financed bailouts.
Creating a Level Playing Field Between State-Owned and Private Enterprises	
17. Include a provision to ensure that State-Owned Enterprises (SOEs) 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.	**This proposed reform was rejected.** This means that State-Owned or Controlled Enterprises investing in productive assets in the U.S. market would face no disciplines requiring them to operate in the U.S. based solely on commercial considerations but, instead, would give them free reign to receive from their home government financing at below market interest rates or other benefits (e.g., grants, equity infusions, inputs at below market prices) not otherwise commercially available in the marketplace. This would create damaging market distortions in the U.S. market to the detriment of similarly situated private actors competing in the U.S. and their workers in the U.S, and would not create a level playing field for all competitors.

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[1] http://www.state.gov/e/eb/ifd/bit/index.htm

[2] http://www.state.gov/e/eb/rls/othr/2009/131098.htm

[3] These advisory committee members included: 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; Martin Wagner, Earthjustice. Link to the annex: http://www.state.gov/e/eb/rls/othr/2009/131118.htm#b

[4] For a complete copy of the original recommendations, see: Link to the annex: http://www.state.gov/e/eb/rls/othr/2009/131118.htm#b