

## Memo

RE: Quick and Dirty Analysis of Changes of Final TPP Investment and Financial Services Chapters (and related Exceptions) Relative to January 2015 Draft TPP and Korea FTA

Date: November 5, 2015

### **INVESTMENT - LEAK V. FINAL TPP TEXT**

The final Trans-Pacific Partnership (TPP) investment chapter has a number of changes relative to the leaked text of January 2015. I group these in a few different buckets: pro-investor changes, pro-contract changes, pro-state changes, and cosmetic changes. (I include "pro-contract" as a separate category because investment tribunals have sometimes been willing to allow treaties to trump specific contractual commitments that states signed with investors.)

#### Pro-Investor Changes

- Australia no longer carved out from chapter; Australia's health policies no longer have a blanket carve-out; Canada's cultural policies don't have a blanket carve-out; Malaysia's procurement policies don't have blanket carve-out (only three year phase out, Annex 9-K).
- One or more TPP members had argued for a one-year pursuit of a domestic remedy before an investor could launch an ISDS claim (Article II.19.3 in leaked text). This was deleted in the final text.

#### Pro-Contract Changes

- Greater precision in definition of "investment agreement" to root more firmly in national contract law (Agreement must "create[] an exchange of rights and obligations, binding on both parties under the law applicable"....) Article 9.1 Renewal of pre-TPP contract not included in definition of investment agreement (fn 6).
- Clear authorization of counter-claims by state when a state's contract or authorization is at issue (Article 9.18.2). Thus, while a state cannot launch an ISDS claim against an investor, it is not kept from invoking its rights under a contract.
- More specific language that ensures that expedited procedures are available when a claim "is manifestly without legal merit" (Art 9.22.4).
- There is a clarification that the investor bears the burden of proof on its MST/FET claims (Article 9.22.7), including arguing the public international law dimensions.
- Further clarification that - when law of respondent is default rule (a rare case) - that domestic law includes law on damages, mitigation, interest and estoppel (fn 35).
- A brand new annex saying investors can't use TPP protections for investment agreements (i.e. contracts) if the underlying investment agreement itself envisions a different procedure. States can also consolidate a contract- and treaty-based claim when the two overlap. Investors with investment agreements can still bring claims alleging violations of rights under investment authorizations or investments. Canada, Mexico and Peru list some special exceptions in this regard (Annex 9-L). Indeed, it is unclear why investors that they would not simply re-characterize investment agreement related disputes as investment-related or authorization-related.

## Pro-State Changes

- A more specific listing of natural resource contracts that are covered under definition of investment agreement, including oil etc., but excluding land, water or radio (fn 8).
- To count as qualifying "investment authorization", public service contracts must be structured so that the end user is the public. This could eliminate claims for government contracts that put some service out into the world, but which is not directly consumed by public. Exclusion of "correctional services, healthcare services, education services, childcare services, welfare services or other similar social services" from list of covered public service investment agreements (fn 9).
- "Investment authorization" redefined to not include non-discriminatory licensing regimes and non-foreign-investment-authority-granted incentives (fn 10).
- The leaked version had a requirement that government enforcement of the terms of investment authorizations, but then subjected this to a requirement that it would not be a "disguised means" of violating the agreement. That limitation is now removed. (Article 9.18, fn 31)

## Cosmetic or Mixed Changes

- Scope of agreement does not include acts predating TPP (Article 9.2.3), although (as with other deals) the definition of investment does include investments an investor "has made" pre-TPP (Article 9.1).
- A clarification on fair and equitable treatment (FET) / minimum standard of treatment (MST) such that upset expectations alone or subsidy alterations alone are not violations.<sup>1</sup> This could rein in the tribunals that would have found on this basis alone, although I don't know that this is a real problem in the case law. Usually investors make some claim of past (rather than only prospective) damage. In any case, the new language would still allow investors and arbitrators to use upset expectations and subsidy changes as an element of an MST/FET violation.
- Modification or reduction of subsidies or grants is not alone an expropriation (Article 9.7.6). This adds to leaked version's statement that issuance, renewal and maintenance of same are not (on their own) expropriations. These could continue to be elements in expropriation claims.
- There is new language requiring litigants to ensure their appointees have subject matter expertise (Article 9.21.6). But verification of this is left up to the appointers.
- USTR had promised a Code of Conduct for arbitrators. The TPP text does not establish any clear commitments in that regard. Instead, the negotiators punted the code of conduct to a later date (Article 9.21.5).

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<sup>1</sup> "the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.... For greater certainty, the mere fact that a subsidy or grant has not been issued, renewed or maintained, or has been modified or reduced, by a Party, does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result". (Article 9.6.4-5)

- More explicit inclusion of various health issues (including health pricing) are among legitimate public welfare objectives in "rare circumstances" carve-out from definition of indirect expropriation (Annex 9-B, fn 37). It's not clear that adding more things to an indicative list changes much, especially when indirect expropriation claims are rarely successful in the first place.

## **INVESTMENT - KOREA FTA V. FINAL TPP TEXT**

In addition to the above, the TPP Investment Chapter has further changes relative to the Korea FTA - the most recent major pact signed by the Obama administration.

### **Pro-Investor Changes**

- Korea FTA had specific definitional language saying that "market share, market access, expected gains, and opportunities for profit-making are not, by themselves, investments". This language has been deleted in TPP.
- Denial of benefits language allows what would have otherwise been "home state" substantial business activities to be located anywhere in the TPP region (Article 9.14.1). This means that a company could claim to be American, but really only have substantial business presence in Canada, and challenge Singapore.

### **Pro-Contract Changes**

- For an "investment agreement" to be binding, it must be meaningful under national law and the investor must have acted in detrimental reliance on the promises. (Article 9.1)
- To be qualifying investor, must have "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." This establishes a higher (or at least clearer) threshold for when investors with minimal skin in the game begin to be protected. (Article 9.1)
- Sets a much firmer tone for non-disclosure of confidential information. This would seem to pose some obstacles to Wikileaks data being used for ISDS claims (Article 9.23.4).
- Investor can only recover for damages to self (Article 9.28.2). This gets around the original problem in Oxy II, where Oxy claimed for damages suffered to one of its business partners. This part of the ruling has since been annulled.
- In those cases where the only damage claimed is for being impaired in attempting to make an investment, a tribunal cannot award for damages beyond the immediate transaction costs the would-be investor made (Article 9.28.4). This could lead to cases where an investor wins on merits for what seems a speculative case, but then really not see that much of a payday as a result.
- Article 9.28.6 strengthens prohibitions on awarding punitive damages ("shall not" instead of "may not"). There are similar clampdowns on overly quick moves to enforce award rulings.
- The Customary International Law / MST / FET annex ties the rights that foreign investors get to their "investments" (which are presumably as defined by TPP), not the more amorphous "economic rights" (Annex 9-A).

- Public debt annex - unclear how much it does. It starts with a bold statement that suggests that certain negotiated restructurings could not be challenged. But this is not as meaty when you read that all a claimant would have to show is that the restructuring violated Section A (Annex 9-G). But there is a meaningful fork in the road for serious negotiated re-structurings and a cooling off period.
- Fork in the road for investment with some developing countries, but not developing nations (Annex 9-J).

#### Pro-State Changes

- Definition of claimant can't include national of host state (Article 9.1). This avoids the situation where a national can claim to be foreign for ISDS purposes to circumvent local courts.
- Most favored nations rules can't be used for procedural treaty protections, only substantive rights (Article 9.5.3). This will close off some treaty shopping opportunities.
- Post-strife compensation not required to be "prompt, adequate, and effective" , just appropriate (Art 9.6.2).

#### Cosmetic or Mixed Changes

- Definition of "investment" doesn't include inter-governmental loans. Unclear how meaningful. (Article 9.1)
- "Investment authorization" does not include "actions taken by a Party to enforce laws of general application, such as competition, environmental, health or other regulatory laws..." In Korea FTA, "competition laws" were the only ones specifically enumerated.
- National treatment provisions have language tying "like circumstances" to regulatory considerations (fn 14). This has long been a hobby horse of USTR at the WTO, although national treatment claims are rarely successful in investment arbitration.
- Expropriation "public purpose" tied to various domestic and international definitions (Article 9.7). I think tribunals have mostly followed this anyway.
- Non-renewal or non-issue of subsidy not in itself an expropriation (Art 9.7.6).
- Social insurance transfers exempted in part from transfers' obligations, provided they are non-discriminatory (fn 22). Unclear if this has ever been an issue.
- Technology and licensing issues added to performance requirement obligations, subject to some state defenses (Article 9.9.1(h-i), 9.9.3(h)).
- Clarification that performance requirement to employ local workers is allowed, provided that firms don't have to buy locally produced goods (Article 9.9.4), thereby limiting backward linkages channel of job creation.
- "Health and regulatory objectives" added to the empty "environmental" defense that green policies are allowed so long as they don't violate "otherwise consistent" measures (Article 9.15).
- The expropriation annex does not have meandering language that suggests that only heavily regulated sectors are likely to be exempt from definition of indirect expropriation. Relative to Korea FTA, specific example of real estate stabilization as subject of legitimate regulation is cut out, but a whole host of specifically enumerated health measures left in (like pricing and pharmaceutical policies) (as noted above) (Annex 9-B).

Since indirect expropriation claims are rare, this specific enumeration probably does not matter much.

- A specific land expropriation annex for Singapore and Vietnam added (Annex 9-C).
- Some country specific carveouts for investment authorization policies (Annex 9-H).

## **FINANCIAL SERVICES - KOREA FTA AND TPP FINAL TEXT**

### **Pro-Investor Changes**

- A big addition of MST/FET to financial services (Article 11.2.2).
- While national governments have to not discriminate on average between domestic and foreign producers, regional governments have to give foreign investors the best treatment given to anyone (could be a single firm - but unclear). (Article 11.3.3).

### **Pro-State Changes**

- Cross-border providers explicitly not eligible for subsidies and grants (Article 11.2.5).
- MFN language does not allow non-TPP treaty procedural protections to be imported in. By implication, substantive standards could be (Article 11.4.2).
- Prudential measures defense (PMD) much stronger. If a tribunal follows lead of only known precedent (the WTO Argentina-Panama case from this year), and finds that prudential includes basically anything under the sun, then the tribunal must stop the analysis and not award any damages (fn 11). Prudential reasons also expanded to include "financial and operational integrity of payment and clearing systems" (fn 10). However, overall scope of defense is somewhat scaled back for instances where prudential policies impact technical standards and goods trade (Article 11.11.1). Unclear exactly how this overlap would happen. Anti-circumvention second sentence somewhat tightened to be even more circular ("those provisions", i.e. expro, etc.).

### **Cosmetic or Mixed Changes**

- USTR's "in like circumstances" hobby horse updated to make sure regulatory conditions are part of likeness examination (fn 5).
- Tribunals have new role assessing IPR / TRIPS aspects of financial services when NT/MFN at issue (Article 11.10.4). Unclear exactly what this means or when it would come up.
- State-state disputes can (but needn't) get an assessment by a tribunal of financial services experts (Article 11.21.4); cross-retaliation in financial services requires consultation with FS experts (Article 11.21.5). Space for non-litigating governments to weigh in on FS disputes (Article 11.22.2, fn 14). Binding PMD report, unlike ambiguous language in Korea FTA (Article 11.22.3). Can't draw adverse inference against country when they fail to invoke PMD (Article 11.22.4).

## BALANCE OF PAYMENTS

The TPP includes a new safeguard for balance of payments. It is unlike what has been in past FTAs, but similar to a provision in the WTO's GATS. The below table compares the TPP to the comparable GATS provision.

Balance of payments, compared

GATS language	TPP Language	Comment
<p><b>Article XII: Restrictions to Safeguard the Balance of Payments</b></p> <p>1. In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments. It is recognized that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, <i>inter alia</i>, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.</p> <p>2. The restrictions referred to in paragraph 1:</p>	<p>1. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining restrictive measures with regard to payments or transfers for current account transactions in the event of serious balance of payments and external financial difficulties or threats thereof.</p> <p>2. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining restrictive measures with regard to payments or transfers relating to the movements of capital:</p> <p>(a) in the event of serious balance of payments and external financial difficulties or threats thereof; or (b) if, in exceptional circumstances, payments or transfers relating to capital movements cause or threaten to cause serious difficulties for macroeconomic management.</p> <p>Any measure adopted or maintained under paragraph 1 or 2 shall:</p>	<p>Similar emphasis on precedent conditions, although a bit more emphasis on development in GATS.</p>
<p>(a) shall not discriminate among Members;</p>	<p>a) not be inconsistent with Article 9.4 (National Treatment), Article 9.5 (Most-Favoured-Nation Treatment), Article 10.3 (National Treatment), Article 10.4 (Most-Favoured-Nation Treatment), Article 11.3 (National Treatment) and Article 11.4 (Most-Favoured-Nation Treatment)</p>	<p>Similar.</p>
<p>(b) shall be consistent with the Articles of Agreement of the International Monetary Fund;</p>	<p>b) be consistent with the Articles of Agreement of the International Monetary Fund;</p>	<p>Same</p>
<p>(c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member;</p>	<p>c) avoid unnecessary damage to the commercial, economic and financial interests</p>	<p>Same</p>

	of any other Party	
(d) shall not exceed those necessary to deal with the circumstances described in paragraph 1;	d) not exceed those necessary to deal with the circumstances described in paragraph 1 or 2	Same
(e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.	e) be temporary and be phased out progressively as the situations specified in paragraph 1 or 2 improve, and shall not exceed 18 months in duration;	No cap in GATS, 18 months default in TPP...
	however, in exceptional circumstances, a Party may extend such measure for additional periods of one year, by notifying the other Parties in writing within 30 days of the extension, unless after consultations more than one half of the Parties advise, in writing, within 30 days of receiving the notification that they do not agree that the extended measure is designed and applied to satisfy subparagraphs (c), (d) and (h), in which case the Party imposing the measure shall remove the measure, or otherwise modify the measure to bring it into conformity with subparagraphs (c), (d) and (h), taking into account the views of the other Parties, within 90 days of receiving notification that more than one half of the Parties do not agree;	... although this can be extended, subject to veto of majority of concerned TPP members.
	f) not be inconsistent with Article 9.7 (Expropriation and Compensation); (FN 5 - For greater certainty, measures referred to in paragraph 1 or 2 may be non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives as referred to in Annex 9-B(3)(b) (Expropriation).	There is no comparable obligation in GATS.
	g) in the case of restrictions on capital outflows, not interfere with investors' ability to earn a market rate of return in the territory of the restricting Party on any restricted assets; and (fn 6 - the term "restricted assets" in this subparagraph refers only to assets invested in the territory of the restricting Party by an investor of a Party that are restricted from being	Similar, although footnote 8 of the GATS has comparable obligations for countries that took relevant Mode 1 and 3 commitments. Difference in TPP would be negative list architecture.

	transferred out of the territory of the restricting Party)	
3. In determining the incidence of such restrictions, Members may give priority to the supply of services which are more essential to their economic or development programmes. However, such restrictions shall not be adopted or maintained for the purpose of protecting a particular service sector.	h) not be used to avoid necessary macroeconomic adjustment.	An insertion of TPP scrutiny into necessity of macroeconomic policy. A more sovereign determination in GATS.
	4. Measures referred to in paragraphs 1 and 2 shall not apply to payments or transfers relating to foreign direct investment (fn 7 - For the purposes of this Article, "foreign direct investment" means a type of investment by an investor of a Party in the territory of another Party, through which the investor exercises ownership or control over, or a significant degree of influence on the management of, an enterprise or other direct investment, and tends to be undertaken in order to establish a lasting relationship. For example, ownership of at least 10 percent of the voting power of an enterprise over a period of at least 12 months generally would be considered foreign direct investment.)	See above on rate of return. More restrictions in TPP.
	5. A Party shall endeavour to provide that any measures adopted or maintained under paragraph 1 or 2 be price-based, and if such measures are not price-based, the Party shall explain the rationale for using quantitative restrictions when it notifies the other Parties of the measure.	No similar language in GATS. In any case, hortatory in TPP.
4. Any restrictions adopted or maintained under paragraph 1, or any changes therein, shall be promptly notified to the General Council.  5. (a) Members applying the provisions of this Article shall consult promptly with the Committee on Balance-of-Payments Restrictions on	6. In the case of trade in goods, Article XII of GATT 1994 and the Understanding on the Balance of Payments Provisions of the GATT 1994 are incorporated into and made part of this Agreement, mutatis mutandis. Any measures adopted or maintained under this paragraph shall not impair the relative benefits accorded to the other	Different institutional proceedings. More multilateral and prescriptive in GATS. More bilateral in TPP.



<p>restrictions adopted under this Article.</p> <p>(b) The Ministerial Conference shall establish procedures<sup>(4)</sup> for periodic consultations with the objective of enabling such recommendations to be made to the Member concerned as it may deem appropriate.</p> <p>(c) Such consultations shall assess the balance-of-payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, <i>inter alia</i>, such factors as:</p> <p>(i) the nature and extent of the balance-of-payments and the external financial difficulties;</p> <p>(ii) the external economic and trading environment of the consulting Member;</p> <p>(iii) alternative corrective measures which may be available.</p> <p>(d) The consultations shall address the compliance of any restrictions with paragraph 2, in particular the progressive phaseout of restrictions in accordance with paragraph 2(e).</p> <p>(e) In such consultations, all findings of statistical and other facts presented by the International Monetary Fund relating to foreign exchange, monetary reserves and balance of payments, shall be accepted and conclusions shall be based on the assessment by the Fund of the balance-of-payments and the external financial situation of the consulting Member.</p> <p>6. If a Member which is not a member of the International Monetary Fund wishes to apply the provisions of this Article, the Ministerial Conference shall establish a review procedure and any other procedures necessary</p>	<p>Parties under this Agreement as compared to the treatment of a non-Party.</p> <p>7. A Party adopting or maintaining measures under paragraph 1, 2 or 6 shall:</p> <p>(a) notify, in writing, the other Parties of the measures, including any changes therein, along with the rationale for their imposition, within 30 days of their adoption;</p> <p>(b) present, as soon as possible, either a time schedule or the conditions necessary for their removal;</p> <p>(c) promptly publish the measures; and</p> <p>(d) promptly commence consultations with the other Parties in order to review the measures adopted or maintained by it.</p> <p>(i) In the case of capital movements, promptly respond to any other Party that requests consultations in relation to the measures adopted by it, provided that such consultations are not otherwise taking place outside of this Agreement.</p> <p>(ii) In the case of current account restrictions, if consultations in relation to the measures adopted by it are not taking place under the framework of the WTO Agreement, a Party, if requested, shall promptly commence consultations with any interested Party.</p>	
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