WILMERHALE

United States to Resume Bilateral Investment Treaty Negotiations on the Basis of a Revised Model Treaty

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The United States appears poised to begin or resume the negotiation of bilateral investment treaties ("BITs") with a number of countries, including the so-called "BRIC" countries (Brazil, Russia, India, and China). On May 4, 2012 the U.S. and China announced their intention to schedule a 7th round of talks on a BIT. The same week, both India and Russia publicly indicated that they were interested in talking to the U.S. about BITs. And, in late April, during a speech in Brasilia, Secretary of State Hillary Clinton said that the U.S. and Brazil should explore a BIT. Negotiations on BITs with Vietnam and Mauritius are also likely to resume soon.

U.S. investment negotiations have been on hold since 2009, when the Obama Administration initiated a review of the template document that the government uses in BIT negotiations. The Administration wanted to ensure that the Model BIT was consistent with the public interest and the Administration's overall economic agenda. The review solicited input from business, non-governmental organizations, Congress and the public and was intended to focus, in particular, on three topics: (a) dispute settlement provisions; (b) state-owned enterprises ("SOEs"); and (c) financial services issues.

On April 20, 2012 the U.S. Department of State and the Office of the U.S. Trade Representative announced the conclusion of the review and released a revised version of the U.S. Model BIT. The Obama Administration ultimately declined to adopt many of the modifications to the previous 2004 Model BIT requested by critics and proponents of U.S. investment treaties during the review. Most importantly, the 2012 Model BIT maintains language from the 2004 Model BIT regarding:

- **Core substantive investment law protections** (non-discriminatory treatment (Articles 3 and 4), treatment in accordance with customary international law (Article 5), and compensation for expropriation (Article 6)). Critics of investment treaties had asked the Administration to scale back these protections to further preserve host-States' ability to regulate in the public interest; while proponents of investment treaties had asked the Government to strengthen these protections. The Administration concluded that the language used in the 2004 Model BIT achieved a careful balance between these competing interests.

- **Dispute settlement provisions** (investor-State dispute settlement (Articles 23-36) and State-State dispute settlement (Article 37)). Critics of investment treaty arbitration had requested that the Government eliminate or significantly scale back investor-State arbitration. The Administration rejected these proposals.

However, the Obama Administration did make several important changes from the 2004 Model text, as summarized below. Among the more noteworthy changes in the 2012 Model BIT are revisions intended to address concerns about the BIT's application to SOEs and financial services, to increase transparency and public participation, and to strengthen the protection of labor rights and the environment. A number of these changes are likely to be particularly salient during BIT negotiations with China and India.

The text of the 2012 U.S. model BIT can be found here.

A. State-Owned Enterprises

During the Administration's review, a number of participants raised concerns about the protection of investments in "state-led economies" – *i.e.*, countries that organize economic activity on the basis of SOEs and other state-controlled mechanisms – and the protection of investments by States or SOEs in the U.S. Building upon innovations already included in the 2004 Model BIT, the Administration made three additions to the text of the 2012 Model to extend the protection given to U.S. investments in state-led economies. However, it declined to adopt proposals for an inward screening mechanism for investments by States or SOEs under the BIT,[1] or to limit investor-State arbitration claims by States or SOEs that act as investors.

- **Delegated government authority.** Article 2(2)(a) of the Model BIT provides that a Party's substantive obligations under the BIT apply "to a state enterprise or other person when it exercises any regulatory, administrative, or other governmental authority delegated to it by that Party." A footnote was added to this provision in the 2012 version of the Model BIT to clarify that governmental authority can be delegated by any "action transferring . . . governmental authority." This language is intended to ensure that SOEs to which government authority is transferred through informal means are subject to the treaty's investment disciplines.
- **Performance requirements.** The 2012 Model broadens the prohibition against performance requirements set forth in Article 8 of the BIT to encompass requirements that an investor must purchase, use, or accord a preference to host-State technology or must not purchase, use, or accord a preference to particular technology. This prohibition on protectionism is subject to possible exceptions, including with respect to the WTO TRIPS Agreement, government procurement, or enforcement of competition or environmental laws.
- **Participation in standard-setting.** Article 11(8) of the 2012 Model BIT establishes a new requirement that foreign investors be allowed to participate in the development of product standards and technical regulations by central governmental bodies in host-States. It also instructs host-States to recommend that non-governmental standardizing bodies open

participation to foreign investors. These requirements do not apply to sanitary and phytosanitary measures or to government procurement, and are subject to State-State dispute resolution, rather than investor-State arbitration. They are intended to ensure that standards are not developed in an opaque, unpredictable, or discriminatory fashion that favors domestic producers or technologies.

B. Financial Services

Some participants in the BIT review expressed concern that treaty claims might be filed against the U.S. in relation to the Government's response to past or future financial crises, particularly by sovereign wealth funds or other SOEs with investments in the financial services industry. The Administration ultimately determined that, subject to three changes, the language of the 2004 Model BIT provides host-States with sufficient policy space regarding financial services to deter such claims or to enable host-States successfully to defend against them.

- **Measures taken for prudential reasons.** Article 20(1) of the Model BIT provides that a host-State "shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors . . . or to ensure the integrity and stability of the financial system." A footnote to that article in the new version of the Model BIT clarifies that the term "prudential reasons" includes measures taken not only with regard to individual financial institutions, but also for "the maintenance of the safety and financial and operational integrity of payment and clearing systems." Article 20(8) of the new version also clarifies that, as a general matter, a Party is permitted to adopt or enforce measures "related to the prevention of deceptive or fraudulent practices or that deal with the effects of a default on financial services contracts."
- **Determination of whether measures were prudential.** Article 20(3) of he Model BIT provides that the competent financial authorities of both Parties will jointly decide whether the host-State took measures relating to financial services for prudential reasons. Under Article 20(3)(c)(iii) of the new version of the BIT, an arbitral tribunal is not to draw an inference regarding the validity of a host-State's defense if the competent authorities fail to make such a determination. However, the tribunal is directed to resolve any issues left unresolved by the competent financial authorities promptly under Article 20(3) of the new BIT.

C. Transparency and Public Participation

During the BIT review, both business groups and NGOs emphasized the importance of transparency and public participation with respect to host-State laws and regulations regarding investors and investments. NGOs also emphasized the importance of transparency and public participation with respect to the investor-State dispute resolution process. The Administration responded by revising the Model BIT in several important ways.

- **Transparency consultations.** While Article 11(1) of the 2004 Model BIT required the Parties simply to establish contact points to facilitate communications, the same provision of the 2012 BIT requires them to consult periodically on ways to improve their transparency

practices, both in the context of developing and implementing laws, regulations, and other measures affecting investment, and in the context of investor-State dispute settlement.

- **Notice and comment procedures.** Article 11(2) of the BIT requires the Parties to publish in advance and to permit comments on any proposed laws, regulations, procedures, and administrative or adjudicatory rulings of general application. The 2012 version of the BIT also includes a new Article 11(3), which expands upon the notice and comment procedures, making them similar to U.S. domestic rulemaking procedures. Under that article, a publication about a proposed regulation must include an explanation of the regulation's purpose and rationale. Host-States also must address substantive comments provided by stakeholders and explain any substantive revisions that were made to a regulation at the time it is finally adopted. Article 20 of the new BIT also establishes transparency and publication obligations with respect to the regulation of financial services in particular.
- **Appellate procedures.** The 2004 Model BIT required the Parties to strive to reach an agreement to have arbitral awards rendered pursuant to the BIT reviewed by any multilateral appellate body that might be established (Article 28(10)) and to commence negotiations over an appellate mechanism for investment arbitration within three years of the entry into force of the BIT (Annex D). These requirements were removed from the 2012 Model, perhaps reflecting States' seeming lack of interest in establishing appellate mechanisms for investment arbitration in recent years. In place of these requirements, Article 28(10) of the 2012 BIT provides that the Parties shall strive to ensure that any appellate mechanism they do eventually consider adopting provides for transparency of proceedings similar to the requirements for transparency of investor-State arbitral proceedings set out in Article 29 of the BIT.

D. The Environment and Labor Rights

Environmental groups, labor unions and other NGOs sought changes to the environment and labor provisions of the 2004 Model BIT, which used aspirational language and did not include any enforcement mechanisms. Those groups argued for mandatory standards, and for making the standards enforceable directly by affected parties or by State-State dispute resolution as provided for in the most recent U.S. free trade agreements (FTAs) (with the Republic of Korea, Panama, Colombia and Peru). A number of business groups argued for dropping the environment and labor rights provisions all together, fearing that they would prevent the conclusion of important BITs. In the end, the Administration chose to strengthen the terms of the environment and labor provisions of the Model BIT, but not to go as far as the corresponding provisions in the U.S.'s most recent FTAs.

- **Specification of obligations.** Under Articles 12(1) and 13(1) of the 2012 Model BIT, the Parties recognize the importance of multilateral environmental agreements and reaffirm their commitments under the International Labor Organization (ILO) Declaration on Fundamental Principles and Rights at Work. By contrast to this passive language, in the most recent U.S. FTAs, each party is required to adopt and maintain laws to fulfil its obligations under a list of multilateral environmental agreements and to protect the labor rights enumerated in the ILO Declaration.

- **Waiver and derogation.** Under Articles 12(2) and 13(2) of the 2012 Model BIT, each Party "shall ensure that it does not waive or otherwise derogate" from its domestic environmental and labor laws as an encouragement for investment. This new language goes further than the 2004 Model, in which each Party was merely required to "strive to ensure" that it did not waive or derogate from its laws, and is similar to language found in the most recent U.S. FTAs.
- **Effective enforcement.** The revised Model BIT also imposes, in Articles 12(2) and 13(2), a new obligation on each of the Parties not to fail to effectively enforce their domestic labor and environmental laws in order to encourage investment. Similar language is used in the most recent U.S. FTAs.
- **Consultations procedure.** Finally, Articles 12(6) and 13(4) permit a State Party to request a consultation with its counterparty regarding "any matter arising under" the environment and labor provisions. Under Articles 12(7) and 13(5), each Party may provide opportunities for public participation regarding such matters. Whereas the environment and labor provisions of recent FTAs are subject to State-State dispute settlement mechanisms, there is no enforcement mechanism besides the consultation procedure for the environment and labor provisions of the new Model BIT.

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The conclusion of new BITs, particularly with the BRICs, could have dramatic effects for U.S. companies. On the one hand, new BITs would promote and protect U.S. investments in foreign markets by imposing investment disciplines on host-governments, prohibiting performance requirements and providing for investor-State arbitration. They would help level the playing field for U.S. companies by harmonizing transparency, environmental and labor standards. On the other hand, new BITs would promote and protect inbound investments in the U.S., thereby increasing competition for U.S. companies, including with SOEs, and exposing the U.S. government to the threat of investor-State arbitration.

Our firm is uniquely positioned to advise clients on the legal and policy implications of U.S. BIT negotiations and to represent clients in disputes arising under BITs. Our attorneys include former senior officials from both the State Department and USTR -- including former U.S. Trade Representative, Ambassador Charlene Barshefsky --who have first-hand knowledge and experience of negotiating and implementing BITs. In addition, we offer one of the world's premier international arbitration practices, which is headed by Gary Born and has extensive experience representing clients in BIT arbitrations.

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[1] The Foreign Investment and National Security Act of 2007 (FINSA) already requires that the Committee on Foreign Investment in the United States (CFIUS) give closer scrutiny when a foreign State or SOE acquires and gains control of a U.S. business where national security may be affected.

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