The U.S.- Korea Free Trade Agreement

Report of the
Trade and Environment Policy Advisory Committee (TEPAC)

April 25, 2007

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Advisory Committee Report to the President, the Congress and the United States Trade Representative on The U.S.-Korea Free Trade Agreement

I. Purpose of the Committee Report

Section 2104(e) of the Trade Act of 2002 requires that advisory committees provide the President, the U.S. Trade Representative (USTR), and Congress with reports required under Section 135(e)(1) of the Trade Act of 1974, as amended, not later than 30 days after the President notifies Congress of his intent to enter into an agreement.

Under Section 135(e) of the Trade Act of 1974, as amended, the report must include an advisory opinion as to whether and to what extent the Agreement promotes the economic interests of the United States and achieves the applicable overall and principal negotiating objectives set forth in the Trade Act of 2002. The report must also include an advisory opinion as to whether the Agreement provides for equity and reciprocity within the sectoral or functional area of the particular committee.

Pursuant to these requirements, the Trade and Environment Policy Advisory Committee ("TEPAC" or "the Committee") hereby submits the following report, which the Committee recommends be included in Congress's record of deliberation on the Agreement, so that, among other things, it might provide guidance to deliberative bodies which will later examine the Agreement's specific provisions on which we comment.

II. Preliminary Statement

In every report TEPAC has produced since passage of the Trade Act of 2002, it has unanimously stressed that 30 days is an insufficient period of time for it to thoroughly review, analyze, and provide its opinion on free trade agreements. USTR and/or the White House have, on occasion, provided some relief to this very tight timeline by providing TEPAC with a final version of the negotiated text prior to providing official notification to Congress. Unfortunately, that was not the case in this situation. Indeed, in the case of the U.S.-Korea Free Trade Agreement (FTA), a final version of the text was not made available to TEPAC until well after notification.

Given that Congress will soon be debating reissuance of the President's Trade Promotion Authority, TEPAC unanimously recommends that Congress consider increasing this review period to at least 45 days.

III. Executive Summary of the Committee's Report

A majority of the Committee's members support the conclusion that the Agreement provides adequate safeguards to ensure that Congress's environmental negotiating objectives will be met. As it has frequently noted, TEPAC does not believe that "one size fits all" with regard to Free Trade Agreements (FTAs). A majority of the committee is pleased to see that this FTA has significant public participation provisions and notes that USTR went to great lengths to secure TEPAC's input prior to tabling the public participation text. TEPAC believes that the inclusion of the public participation framework significantly increases the likelihood that the Agreement's environmental provisions will be fully and effectively implemented. As addressed below, there were minority views regarding this point.

A majority of TEPAC is very concerned with the language regarding expropriation in the Agreement and urges Congress to modify it. The majority believes that much of this language is new, conflicts with the language in the U.S's model Bilateral Investment Treaty and Supreme Court precedent, and may allow arbitrators to create new tests for what constitutes an indirect expropriation. The majority believes that the new language increases the possibility that there will be successful challenges to attempts to implement more stringent bona fide environmental controls, thus providing greater, and unwarranted, protection to foreign investors. Most importantly, the majority believes that paragraph 3(b) of Annex B creates two new tests for what constitutes an indirect expropriation: (1) whether the regulatory action is "extremely severe" and (2) whether the regulatory action is "disproportionate in light of its purpose or effect" - - tests that have no antecedent in international law, provide great discretion to arbitrators to strike down good faith laws and provide foreign investors greater rights than U.S. investors have under our laws. The majority is also concerned about other new language (i.e., an inaccurate footnote and a Korean law concept of "special sacrifice" that is unknown to U.S. and international law and could also be read as a new test for whether an expropriation had occurred) as well as by the dropping of a paragraph referring to customary international law. Finally, the majority is concerned by language in a side letter that, for the first time in a U.S. investment treaty or free trade agreement, declares all contract rights to be property rights subject to investor-to-State arbitration.

TEPAC also wants to make clear that it was not consulted about, and did not have the opportunity to review the new language of concern to the majority referred to above. TEPAC regards this as a very important issue and encourages Congress to seek broad-ranging advice on this matter.

A majority of the Committee's members are pleased to see environmental issues integrated into the drafting of a free trade agreement. This majority continues to believe that trade agreements can create opportunities to enhance environmental protection. Trade opens markets, creates business and employment opportunities, and can increase economic growth. This can lead to increased wealth, which provides opportunities to enhance environmental protection, including the creation of a political will in favor of

such protection. However, trade can create and amplify adverse externalities which require enhanced regulatory oversight.

As discussed above, a majority of TEPAC is pleased to see enhanced public participation provisions in the FTA. As it has stated in previous reports, TEPAC believes that public participation helps ensure that an agreement's provisions operate as intended and greatly increases opportunities to guarantee the effective enforcement of environmental laws and to enhance capacity building and sustainable development efforts. It is pleased to see that steps are being made to increase public participation and urges USTR and Congress to review the implementation of these provisions. It is also pleased that USTR went to great lengths to secure TEPAC's input prior to tabling the public participation text and would hope that this type of consultation occurs in the future on the full range of issues on which TEPAC is mandated to provide USTR with policy advice. For example, as noted above, TEPAC was not consulted with, or given notification of, the changes discussed above to the investment language, despite TEPAC's long-standing interest in FTA investment provisions.

A similar majority of the members believes the dispute resolution procedures will help ensure that the FTA meets Congress's environmental objectives. The majority would have preferred, however, that the public submission process reflect a mandatory, rather than permissive, requirement that dispute resolution panels accept submissions from civil society.

A majority believes that the Agreement's monetary penalties of up to $15 million per year for instances of non-compliance with rulings confirming violations of enforcement requirements is not an adequate compromise position, but does not believe that this failure will result in a failure to achieve Congress' environmental objectives.

A majority of the Committee believes that once signed by both Parties, the Environmental Cooperation Agreement between the Governments of Korea and the United States (ECA), will provide a reasonable basis for the fulfillment of Congress's objectives regarding capacity building and sustainable development. The Committee is pleased to see that the parties have entered into a workplan which provides specific areas of cooperation at a detailed level that affords guidance on the subjects which will receive the parties' focus. For example, the workplan provides specific approaches to ensure compliance with CITES. A majority of TEPAC is concerned about CITES compliance and is please to see the Parties agree to a framework on this issue. It strongly encourages the Parties to carry through under that framework.

Moreover, a majority of TEPAC agrees that the ECA would be improved if it were an integral part of the Agreement rather than a side agreement and if it had an available dedicated funding source. Finally, the Committee notes that without a dedicated funding source, achievement of the goals of the ECA is, at best, ephemeral. Given the substantial resources of both of the Parties, each should contribute to that funding source.

The majority believes that the Agreement's tariff reductions fulfill Congress's mandate to seek market access, through the elimination of tariffs and nontariff barriers, for United States environmental technologies, goods, and services.

A majority believes that the FTA should include statements on biological diversity and promoting sound corporate stewardship The majority seeks clarity on certain ambiguous terms in the sanitary and phytosanitary measures, as set forth below. It also supports the establishment of the Joint Fisheries Committee while noting that there are a number of issues, more fully discussed below, which should be considered during its formation.

Nevertheless, several differing viewpoints exist among committee members. These include the beliefs that1) the Investment Chapter provides strong protection for U.S. investors and investment in Korea; 2) The Agreement's investment provisions weaken traditional protections for U.S. investors; 3) The Agreement excessively relies on trade as a means of advancing environmental objectives; 4) Congress should consider Korea's importance as a friend of the U.S.; 5) The public participation provisions are too broad ; 6) The investment provisions should be included in a separate agreement; 7) The investment provisions are adequate; 8) The language setting forth sanitary and phytosanitary standards is not of concern; and 9) No dedicated funding source should be provided for environmental cooperation between the two countries.

IV. Brief Description of the Mandate of TEPAC

As described in its charter, TEPAC's mandate is to (1) provide the U.S. Trade Representative with policy advice on issues involving trade and the environment and (2) at the conclusion of negotiations for each trade agreement referred to in Section 102 of the Act, provide to the President, to Congress, and to the U.S. Trade Representative a report on such agreement which shall include an advisory opinion on whether and to what extent the Agreement promotes the interests of the United States.

V. Negotiating Objectives and Priorities Relevant to the Report

As is made clear from its mandate, this committee's primary focus is on issues involving trade and the environment. In the Trade Act of 2002, Congress elucidated the principal trade negotiating objectives related specifically to environmental matters:

> (A) to ensure that a party to a trade agreement with the United States does not fail to effectively enforce its environmental. . . laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the United States and that party after entry into force of a trade agreement between those countries;
>
> (B) to recognize that parties to a trade agreement retain the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other. . . environmental matters determined to have higher priorities, and to recognize

> that a country is effectively enforcing its laws if a course of action or inaction reflects a reasonable exercise of such discretion, or results from a bona fide decision regarding the allocation of resources, and no retaliation may be authorized based on the exercise of these rights or the right to establish domestic. . . levels of environmental protection;
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> (C) to strengthen the capacity of United States trading partners to protect the environment through the promotion of sustainable development;
>
> (D) to reduce or eliminate government practices or policies that unduly threaten sustainable development;
>
> (E) to seek market access, through the elimination of tariffs and non-tariff barriers, for United States environmental technologies, goods, and services; and
>
> (F) to ensure that. . . environmental, health, or safety policies and practices of the parties to trade agreements with the United States do not arbitrarily or unjustifiably discriminate against United States exports or serve as disguised barriers to trade.

Moreover, two environmental objectives appear in Congress's overall negotiating objectives:

> (G) to ensure that trade and environmental policies are mutually supportive and to seek to protect and preserve the environment and enhance the international means of doing so, while optimizing the use of the world's resources; and
>
> (H) to seek provisions in trade agreements under which parties to those agreements strive to ensure that they do not weaken or reduce the protections afforded in domestic environmental. . . laws as an encouragement for trade.

Finally, the Trade Act also provides for the promotion of certain environment-related priorities and associated reporting requirements, including:

> (I) conducting environmental reviews of future trade and investment agreements consistent with Executive Order 13141 and its relevant guidelines and reporting to the Committees on the results of such reviews; and
>
> (J) continuing to promote consideration of multilateral environmental agreements and consult with parties to such agreements regarding the consistency of any such agreement that includes trade measures with existing exceptions under Article XX of the GATT 1994.

In addition to these environmental objectives, which are core objectives relevant to TEPAC's mandate, there are other Congressional trade objectives which affect the achievement of these objectives. These other objectives, which have been the subject of frequent discussion and comment by the members of TEPAC, include those related to

investment, transparency, dispute resolution, capacity building, technical barriers to trade, intellectual property, agriculture, and sanitary and phytosanitary measures. With regard to investment, the Trade Act of 2002 requires, among other things, that trade agreements "ensur[e] that foreign investors are not accorded greater substantive rights with respect to investment protections than United States investors in the United States…."

VI. The Committee's Advisory Opinion on the Agreement

As expressed in its reports on other recent FTAs, a majority of the Committee continues to believe that trade agreements can create opportunities to enhance environmental protection. Trade opens markets, creates business and employment opportunities, and can increase economic growth. This can lead to increased wealth, which provides opportunities to enhance environmental protection, including the creation of a political will in favor of such protection. It is also noted that trade can create and amplify adverse externalities which require enhanced regulatory oversight. A majority of TEPAC notes with satisfaction that environmental issues continue to be addressed in the text of free trade agreements. Further, it is pleased to see that this agreement contains enhanced public participation provisions. A majority of TEPAC is very concerned, however, about new language in the agreement relating to indirect expropriations.

A. Strict Compliance With Congress's Mandated Objectives and The Need For Effective Implementation

TEPAC recognizes that the Agreement incorporates the ten environmental trade negotiation objectives outlined above. Six of the ten ("A" through "D," "H," and "J" above) are explicitly referenced, almost verbatim, in the Environmental Chapter of the Agreement[1], one more ("F") is generally referenced in the Agreement's environmental definition provision, another ("I") has been accomplished through the conduct of an environmental review for the FTA, the ninth ("H") would be achieved through the general implementation of the Chapter, and the remaining one ("E") is reflected in the Agreement's tariff reduction schedules.

As it has for other reports, in examining the Agreement for consistency with Congress's environmental trade objectives, TEPAC has looked beyond the issue of whether the Agreement simply recites those objectives to the question of whether those objectives will come to fruition.

However, the question of whether those objectives will actually be achieved requires effective implementation. This in turn, requires not only adequate and efficient implementation measures, but also adequate funding and adequate enforcement measures. In the analysis of these factors, the Committee's unanimity breaks down. In examining these issues, some committee members believe that the provisions and mechanisms are adequate, while others believe that they are too weak or, conversely, too

[1] The draft text which was provided to TEPAC for its review does not contain chapter numbers. Chapters are therefore identified in this Report by their name.

strong. As there was no unanimity in these analyses, they have not been presented as such. Instead, the opinion of the majority or minority is presented. Where a lengthy minority opinion was provided, that separate opinion is summarized and the full opinion attached hereto to give the reader a more detailed explanation.

B. Actual Achievement of the Mandate

1. Background

Historically, the most contentious trade agreement provisions relating to the environment have been those relating to investment protection and dispute resolution. The Committee members' analysis of the environmental implications of these provisions is based largely on their and others' experience with NAFTA, bilateral investment treaties, and the emerging jurisprudence thereunder. Congress, for example, gave specific instructions to U.S. trade negotiators as a result of its concern that NAFTA's investment protection and dispute resolution provisions might hinder a Party's attempts to implement more stringent (but bona fide) environmental controls. By "bona fide," we refer to environmental controls which are not adopted for the purpose of arbitrarily or unjustifiably discriminating against imports or foreign investors or are not simply disguised barriers to trade or foreign investment.

In recent years, TEPAC has also placed increasing importance on public participation. TEPAC believes that public participation is an integral aspect of the implementation and ongoing operation of the environmental provisions of FTAs. In addition to helping to ensure that the provisions operate as drafted, public participation greatly increases opportunities to guarantee the effective enforcement of environmental laws and enhances capacity building and sustainable development efforts.

2. General Conclusion

a. General

With this background, a majority of the Committee believes that the Agreement's dispute resolution provisions are an improvement over those in NAFTA. The Committee believes that these provisions reduce the possibility of successful challenges to attempts to implement more stringent bone fide environmental controls while simultaneously protecting investment. The Agreement gives appropriate attention to integrating the achievement of enhanced environmental protection into more traditional notions of bilateral investment and trade, although this attention must be further nurtured.

b. Investment

As with the other recent FTAs, one improvement is the fact that the definition of investment is more precise. Most significantly, the issue of "indirect expropriation" or what we in the United States call regulatory takings has been clarified by changing the terminology from "tantamount" to "equivalent."

Also noteworthy are the concepts which motivate Article 11 and Paragraph 1 of Article 2 of Section A in the Investment Chapter, particularly when combined with the other language in the Agreement cited above. Paragraph 1 of Article 2 of Section A states that in the event of an inconsistency between the Investment Chapter and another chapter (like the chapter on the environment), the other chapter (the Environment Chapter) trumps the Investment Chapter. As the majority of TEPAC reads these provisions, any bona fide environmental requirement at odds with an investment-related requirement will trump that latter requirement. Similarly, Article 11 of Section A of the Investment Chapter expressly precludes reading the Investment Chapter to prevent environmental protections taken pursuant to the chapter on the environment. Additionally, Article 3 of Section A of the Investment Chapter applies National Treatment; Article 4 of Section A of the Investment Chapter requires Most Favored Nation treatment; and Article 5 of Section A of the Investment Chapter requires a minimum standard of treatment that invokes due process in terms that seem expansive, and thus inclusive, of U.S. notions of due process.

Also, a majority of TEPAC is very concerned with the language regarding expropriation in the Agreement and urges Congress to modify it. That language, in the Expropriation Annex (Annex B) and in a Confirming Letter, differs in important respects from language in preceding U.S. agreements, including the corresponding annex in the U.S. Model Bilateral Investment Treaty and other recent FTAs. The language in the Model Annex was crafted to achieve the proper balance between protecting foreign investors and protecting the United States' (and other countries') ability to take regulatory actions, including those to protect the environment, public health, and safety, so changes to the Model Annex must be given close scrutiny. The background for the majority's concerns, as well as a more complete discussion of them, is more fully described in the Separate Statement Further Elucidating the TEPAC Majority's Views Regarding Expropriation , attached hereto. Briefly, the majority's concerns are as follows.

Most importantly, paragraph 3(b) of Annex B creates two new tests for what constitutes an indirect expropriation: (1) whether the regulatory action is "extremely severe" and (2) whether the regulatory action is "disproportionate in light of its purpose or effect." These new tests have no antecedent in international law, provide great discretion to arbitrators to strike down good faith laws and provide foreign investors greater rights than U.S. investors have under our laws. In fact, as expressed in previous reports, the majority of TEPAC believes the "rare circumstances" language should even be strengthened for greater clarification. The majority is also concerned that a footnote has been added to Paragraph 3(a)(ii) which strikes us as inaccurate. Also, sub-paragraph 3(a)(iii) includes a new sentence introducing the Korean law concept of "special sacrifice" that is unknown to U.S. and international law and could also be read as a new test for whether an expropriation had occurred. All of these new tests are unprecedented and inconsistent with the U.S. Supreme Court's decision in the Penn Central case and the carefully crafted Model Annex, as well as with the Trade Act of 2002's admonition not to provide foreign investors with greater rights than United States investors have in the United States.

In addition, the first paragraph of the Model Annex is missing. That paragraph reads: "Article [XX] is intended to reflect customary international law concerning the obligation of States with respect to expropriation" and sets the context for the entire expropriation analysis. It places the expropriation analysis firmly within customary international law (CIL) and thus provides boundaries to the analysis and to arbitrators' power to declare environmental, health and safety regulations to be expropriations requiring compensation. TEPAC's concerns regarding the missing paragraph will be assuaged if the two countries agree that CIL applies to the expropriation article by virtue of footnote 5 to article 6.

The majority has a final concern related to the Confirming Letter Regarding Property Rights that relates to indirect expropriations. The Confirming Letter, for the first time in a U.S. investment treaty or FTA, provides that all contract rights are property rights and thus are eligible to be investments subject to investor-to-State arbitration. Contract claims can involve challenges to environmental, health and safety licenses or permits, but arbitral tribunals are not competent to decide these questions.

Especially in light of how this term is defined in the side letter, TEPAC remains concerned about identifying protected interests with the phrase "a tangible or intangible" property right or interest. There is a lack of clarity regarding the definition of this term and there is no comparable U.S. jurisprudential concept. This raises the possibility that the resolution of disputes under the Agreement could be inconsistent with U.S. law. To further enlighten the appropriate development of this now more refined concept, we urge the respective national governments to exchange soon, and in an appropriately formal manner, exemplars of what currently constitutes such an "indirect expropriation" in each of their respective legal regimes in order to better inform each national perspective as to the current application of this critical concept in the other's jurisdiction. These exemplars should also be made available to any empanelled arbitral panel for appropriate reference.

TEPAC wants to underscore that it did not have any opportunity to review or comment on some of the new language of concern to the TEPAC majority mentioned above, including the creation of the two new tests for indirect expropriation and the declaration that all contract rights are property rights. USTR did not consult TEPAC about any of the new language, and the only way TEPAC learned about much of it was when it was posted on the secure website after negotiations were over and Congress had been notified. TEPAC regards this as a very important issue and encourages Congress to seek broad-ranging advice on this matter

c. Public participation and implementation of the chapter

As it has stated in all of its previous reports, TEPAC believes that public participation is an integral aspect of the implementation and ongoing operation of the environmental provisions of FTAs. As with the other recent FTAs, the Korea Agreement includes a significant public participation provision. Indeed, USTR went to great lengths to secure TEPAC's input prior to tabling the public participation text and is pleased to see that a

good amount of that input was eventually adopted in the final text.[2] For example, this majority welcomes the requirement for the formation of an Environmental Affairs Council (with attendant public participation provisions) and the provisions in Articles 6 providing additional opportunities for public participation. The majority also welcomes the mandatory requirement for the convening of a national environmental advisory committee in Section 6(3). In addition, Article 6.2(a) provides that parties will seek to accommodate requests for information or to exchange views regarding implementation from persons of any party, rather than just persons of their own party. A majority of TEPAC is pleased to see that steps are being made to increase public participation and urges USTR and Congress to review the implementation of these provisions.

d. Dispute resolution

A similar majority of the members believes the dispute resolution procedures will help ensure that the FTA meets Congress's environmental objectives. If fully implemented, the Agreement maintains the positive steps taken in prior Agreements regarding transparency and, to some degree, in the participation of civil society during the settlement of disputes in trade cases. The majority is pleased to see that the public submission process reflects the possibility for acceptance of such statements but would like that such acceptance be mandatory, not permissive. It believes that public participation in the dispute settlement process will enhance the likelihood that Congress' objectives will be met.

As with the other recent FTAs, the provisions regarding transparency and participation of civil society during the settlement of disputes in trade cases are significant improvements over historic practices. Also significant is the inclusion in Article 9.4 of the Dispute Resolution Chapter of the bracketed text requiring that members of panels examining environmental disputes have "expertise or experience relevant to the subject matter that is under dispute." TEPAC strongly urges that Congress requires the adoption of this language, which has been included in almost every recent FTA and TPA.

TEPAC specifically draws to Congress' attention the existence of a side letter on environmental dispute resolution which notes the Parties' understanding that "before initiating dispute resolution under this Agreement for an [environmental] matter. . . a party should consider whether it maintains environmental laws that have substantially equivalent scope to those that would be the subject of the dispute." TEPAC is unsure of the meaning and /or implication of this side letter and a majority of the Committee suggests that Congress determine what it means before there is agreement to it.

Finally, contrary to prior FTAs, the majority does not believe that the Agreement's monetary penalties of up to $15 million per year for instances of non-compliance with

[2] TEPAC would hope for future FTAs to see similar consultation in this and other areas of concern to it. As noted above, TEPAC had little to no opportunity to consider or express its opinion to USTR regarding the changes to the FTA's language regarding expropriation.

rulings confirming violations of enforcement requirements is an adequate compromise position. This $15 million penalty is an insignificant amount when compared to the overall resources of the governments of the first and eleventh largest economies in the world. In 2005, South Korea had a Gross Domestic Product (GDP) of approximately $787,567,000,000 and the United States $12,455,825,000,000. The $15 million penalty for non-compliance with rulings confirming violations of enforcement requirements is 0.002 percent of South Korea's GDP and 0.0001 percent of the United States' GDP. By way of comparison, El Salvador, with a 2005 GDP of approximately $16,974 million (and ranked eight-fourth in the world in economic terms), is subject to the same penalty. In comparative terms, El Salvador's penalty is 46 times larger than South Korea's. A majority believes that a penalty in the range of $50 million would be more appropriate given the financial resources of the parties.

Notwithstanding that the majority believes the penalty is insufficient, it does not believe that this inadequacy will result in a failure of the TPA to achieve Congress's mandated environmental objectives. This majority has previously noted the importance of finding a proper balance between the size of the penalty on the one hand and the strength of environmental cooperation (and associated funding commitments) mandated by the Agreements and the need to ensure that parties commit the requisite resources to enforce domestic environmental laws and regulations on the other hand. The majority believes that, notwithstanding the inadequate monetary impetus to ensure environmental compliance, other factors will so ensure. These include a proven commitment to environmental protection, the potential embarrassment of being found not to be adequately enforcing environmental laws, and the policing of compliance by the public at large.

e. Capacity building

A majority of the Committee believes that the Environmental Cooperation Agreement between the Governments of Korea and the United States (ECA) provides a reasonable basis for the fulfillment of Congress's objectives regarding capacity building and sustainable development. Moreover, a majority of TEPAC is pleased that associated with the ECA is an extensive workplan identifying specific areas of cooperation. For example, the workplan provides specific approaches to ensure compliance with CITES. A majority of TEPAC is concerned about compliance with CITES. It is pleased to see the parties agree to a framework on this issue and strongly encourages the parties to carry through under that framework.

As with other agreements, the majority would strongly prefer that Congress provide a dedicated funding source to ensure that the potential inherent in the ECA is realized. Without a funding source, achievement of the goals of the ECA is at best ephemeral. This issue is becoming increasingly significant as more FTAs are executed. Each FTA has contained capacity building provisions, but no funds have been set aside. Soon, these agreements will be competing with each other for scarce funds. A majority believes there is too much competition for funds and too often environmental projects are not afforded

appropriate priority. One possible designee of this dedicated funding might be the Office of Environmental Policy in the State Department.

A majority of TEPAC believes that this and future FTAs should contain provisions for dedicated funding and technical assistance from governments and international financial institutions as well as funding commitments for public/private sector ventures, This is necessary to both ensure adequate funding of projects to be implemented in the short- and medium-term as well as projects to be developed over the long term. Given the substantial resources of both of the Parties, a majority of the Committee believes that each should contribute to the dedicated monies necessary to fund the ECA and workplan. Also, the majority believes that an agreement with the significance of the ECA should be an integral part of the FTA rather than a side agreement.

f. Market access

In order to determine whether the Agreement fulfills Congress's mandate to seek market access, through the elimination of tariffs and nontariff barriers, for United States environmental technologies, goods, and services, TEPAC requested that USTR identify the extent of the Agreement's tariff reductions for such items. While USTR did not provide specific figures, it provided TEPAC with its view that the tariff reductions for such items would be similar as those for past FTAs, all of which TEPAC has concluded fulfill Congress's mandate on this issue. Presuming the accuracy of USTR's beliefs, the majority of TEPAC concludes that the tariff elimination schedule will fulfill Congress's mandate on this issue.

g. Other concerns

i. Corporate stewardship

Some prior FTAs, including the Singapore FTA (Art 18.9) and the Chile FTA (Art 19.10) include a statement on promoting sound corporate stewardship. No such provision appears in the text of the Korea environment chapter. While there is text (in Article 4(1.b) of the Environment Chapter) on incentives (such as market-based incentives and public recognition), a majority of the Committee is of the opinion that this language is not a sufficient replacement for a more active provision promoting good corporate behavior. This majority continues to believe a corporate stewardship provision should supplement the incentives provision in future FTAs.

ii. Biological diversity

A majority of TEPAC was disappointed to see that an article on biological diversity was not included in the FTA's environment chapter despite its inclusion in certain other TPAs. This majority suggests that future FTAs include such a provision.

iii. Sanitary and Phytosanitary Matters

A majority notes that language within the chapter on sanitary and phytosanitary (SPS) matters differs from that contained in previous free trade agreements, including those with CAFTA-DR, Panama and Chile. TEPAC supports the provision on rights and obligations stating that the Parties affirm their existing rights and obligations with respect to each other under the WTO's SPS Agreement. However, there is concern with ambiguity in the language of paragraph 3(a) which states that the FTA's SPS committee shall: "recognize that scientific risk analysis shall be conducted and evaluated by the relevant regulatory agencies of each Party." A majority believes that paragraph 3(a) should not be construed to suggest that any risk analysis in the U.S. should involve and be evaluated by South Korean agencies or vice versa.

Allowing such intervention could contravene the U.S.'s right to set its own appropriate level of sanitary or phytosanitary protection as expressed by the WTO's SPS Agreement. Such measures are to be supported by scientific justification and an assessment of risks (SPS Articles 3 and 5), and the performance of the risk assessment is generally regarded as an internal domestic matter. The majority support the use of risk assessment by designated agencies as a basis for national SPS measures, as well as the need for transparency in making and reporting these decisions (SPS Annex B). However, the conduct of risk assessments is a sovereign procedure that should not as a matter of course allow for intervention by other States.

iv. Joint Fisheries Committee

The U.S.-Korea FTA contains an Annex which establishes a Joint Fisheries Committee. There are important national and international economic and environmental concerns related to fisheries and fisheries are an important part of the Environmental Cooperation Agreement. Both Korea and the United States have significant fishing industries, both in terms of revenue and overall catch. TEPAC supports the establishment of the Joint Fisheries Committee as an opportunity to promote greater environmental cooperation between the governments on Korea and the United States by establishing a dedicated forum for the discussion of fisheries issues. However, there are a number of issues raised by TEPAC members related to the operation of this Committee that should be considered and addressed during its formation.

The areas open to discussion by the Committee, particularly "(a) policies on commercial activities within the Exclusive Economic Zones ("EEZ") of the Parties" should be broadly construed to include issues related to the fishery resource, including conservation and environmental measures. Related to that same section, TEPAC also understands from USTR that this Committee will not be a vehicle for making changes in domestic fishing policy, but serve as an entity to promote dialogue between the countries on fisheries issues. The Committee must also ensure public participation in its activities, including informing the public about its members, meetings, activities, and results as well as providing ample opportunity for public input into its discussions. Finally, the

Committee should seek to coordinate its activities with the implementation of ocean and fisheries work undertaken as part of the ECA to the extent possible.

3. Other Points of View

As stated above, several committee members hold views which run contrary to and/or supplement the majority views presented above. They are summarized below and presented more fully in the memoranda attached hereto.

a. The Investment Chapter provides strong protection for U.S. investors and investment in Korea

A minority of TEPAC believes that the Korea FTA investment chapter provides strong protection for U.S. investors and investment in Korea. The investment protection included in the agreement essentially provides U.S. investors in Korea the same level of substantive rights that area already available in the U.S. This minority considers the expropriation provisions of the agreement consistent with U.S. legal principles and practice even though some changes were made to the text to accommodate Korean concerns. This minority also strongly disagrees with those TEPAC members who appear to believe that references to customary international law included in the investment chapter somehow narrow protections already recognized in U.S. jurisprudence. Accordingly, it is important that expropriation protection remain consistent with well established U.S. legal principles and practice.

b. The Agreement's investment provisions weaken traditional protections for U.S. investors

A minority disagrees with the majority view that the investment provisions of the Agreement are an "improvement" over NAFTA. On the contrary, this minority believes the Agreement weakens the protections traditionally afforded U.S. investors under NAFTA and BITS. The Agreement again uses the "minimum standard of treatment of aliens" language first adopted in 2001 as a NAFTA clarification and subsequently incorporated into the agreements with Chile and Singapore. This minority believes this is too narrow a standard, which is not in keeping with the congressional mandate to negotiate fair and equitable treatment consistent with U.S. legal practice and law. The Agreement also inappropriately narrows the protection to " a tangible or intangible property right or interest" rather than to an investment. This could have adverse implications for U.S. investors abroad, which are more likely to face a more restrictive definition of "property" than foreign investors enjoy in the U.S. Finally, this minority also notes that the phrase "in rare circumstances" in the Annex creates a potential loophole because it gives Parties too much discretion in deciding what constitutes an indirect expropriation without providing any recourse to the foreign investor.

c. The Agreement excessively relies on trade as a means of advancing environmental objectives.

A minority believes that the Agreement excessively relies on trade as a direct means to advance various environmental objectives. This minority agrees with the majority in that trade can create wealth, and, in that sense, the most effective means of advancing environmental objectives around the world is to move toward free trade.

d. Congress should consider Korea's importance as a friend of the U.S.

CEI would urge Congress to review the trade agreement in light of its exceeding the environmental mandates of the Trade Act of 2002, but also look beyond that to Korea's importance as a friend of the U.S. Korea negotiated the agreement with the U.S. in good faith and under current laws and mandates. If Congress, changes this good-faith agreement, with new requirements and mandates in the chapter on the environment, such actions could do great damage to U.S.-Korea relationships at the same time that other countries are courting Korea. This could harm the U.S. not only economically but also strategically.

e. The public participation provisions are too broad

A minority believes that individual countries –because of their culture – may have approaches to encouraging public participation that differ markedly from those in the U.S. One can debate which countries are "better" than others in promoting public participation.

f. The investment provisions should be included in a separate agreement

A minority believes that concerns about investments are better dealt with in a separate investment agreement--if countries wish to do so--but should not necessarily be part of a bilateral trade agreement.

Already, important but separate issues are being included in trade agreements (environment, labor, intellectual property, investment, etc.). Those issues would be better advanced by dealing with them in other fora dedicated to those issues. Using trade as a "big stick" to force agreement on those separate issues undermines the importance of trade in advancing economic growth, which can enable countries to address those issues directly and with greater vigor.

g. The investment provisions are adequate

A minority believes that investment rules and challenges to domestic regulations should be considered, as far as possible, in the domestic legal systems of those countries. Countries that fail to adequately address the concerns of investors will likely face

economic consequences in lower levels of foreign investments. While closer cooperation and facilitation between the Parties might help to bridge different concepts of investment and its protection, enforcement outside of the domestic legal system can pose significant problems and concerns relating to public acceptance, the rule of law, and national sovereignty.

h. The language setting forth sanitary and phytosanitary standards is not of concern .

A minority does not share the majority's reading of paragraph 3 (a): "recognize that scientific risk analysis shall be conducted and evaluated by therelevant regulatory agencies of each Party." It seems clear that this provision was inserted to ensure that each country would undertake scientific risk assessment on matters affecting trade within their own domestic regulatory structures. Such a provision is critical in ensuring that negative claims about a country's products are not arbitrary.

i. No dedicated funding source should be provided for environmental cooperation between the two countries.

A minority believes that dedicated funding source for cooperative activities for environmental improvements and monitoring would mean that other more urgent U.S. budget priorities may receive short shrift or that needed funds for trade capacity-building for Panama would not be available. That would harm both the people of Panama and not allow them to experience the economic growth that trade can bring – and with it – greater wealth to deal with environmental concerns.

j. The Agreement's intellectual property, pharmaceuticals and medical devices provisions are inadequate

A minority of the Committee believes that the Chapters on Intellectual Property and on Pharmaceuticals and Medical Devices will reduce consumers' access to affordable medicines

IV. Membership of Committee

Name	Organization
Anne Alonzo	National Foreign Trade Council
Dennis Avery	Hudson Institute
Joseph G. Block (Chair)	Venable LLP
Nancy Zucker Boswell	Transparency International
William A. Butler	Audubon Naturalist Society
Patricia Forkan	Humane Society International
Frank H. Habicht	Global Environment & Technology Foundation
Thomas B. Harding	Agrisystems International

Jennifer Haverkamp	REIL (Renewable Energy & International Law Project)
Rhoda Karpatkin	Consumers Union
Daniel B. Magraw	Center for International Environmental Law
Naotaka Matsukata	Alston & Bird, LLP
Frederick O'Regan	International Fund for Animal Welfare
Peter Robinson	U.S. Council for International Business
Jeffrey J. Schott	Institute for International Economics
Andrew F. Sharpless	Oceana
Frances B. Smith	Competitive Enterprise Institute
William J. Snape, III	Endangered Species Coalition
Alexander F. Watson	Hills & Company
Durwood Zaelke	Institute for Governance & Sustainable Development

Attachment 1

Supplemental Statement Further Elucidating the TEPAC Majority's Views Regarding Expropriation

The majority of TEPAC objects to the language regarding expropriation in Annex 'B: Expropriation and in the Confirming Letter Regarding Property Rights, both of which relate to the Investment Chapter of the Agreement, including to indirect expropriations. Annex B differs in important respects from the corresponding annex in the U.S. Model Bilateral Investment Treaty and other recent FTAs, and thus represents a major change in U.S. foreign investment policy that favors foreign investors at the expense of the United States' ability to protect the environment, health and safety. The Confirming Letter also is such a change in U.S. policy.

Overview

Most significantly, Annex B creates two new and dangerous tests for what constitutes an indirect expropriation, allowing an arbitral tribunal to find an expropriation if it believes a regulatory action is either "extremely severe" or "disproportionate in light of its purpose or effect". These new tests have no antecedent in international law, provide great discretion to arbitrators to strike down good faith laws and regulations, and provide foreign investors greater rights than U.S. investors have under our laws, thus violating the Trade Act of 2002's admonition not to provide foreign investors with greater rights than United States investors have in the United States. The creation of these tests constitutes a major grant of power to foreign investors, at the expense of the United States' and other countries' ability to protect the environment, public health, and safety (including consumer safety and worker safety).

Annex B is also objectionable because it contains a footnote that is inaccurate and could lead to unwarranted findings that a regulation constitutes an indirect expropriation and. Also, sub-paragraph 3(a)(iii) includes a new sentence introducing the Korean law concept of "special sacrifice" that is unknown to U.S. and international law and could also be read as a new test for whether an expropriation had occurred. The inclusion of "special sacrifice" concept is inconsistent with U.S. Supreme Court jurisprudence (including its decision in the *Penn Central* case[3]) and the carefully crafted Model Annex, as well as with the Trade Act of 2002's admonition not to provide foreign investors with greater rights than United States investors have in the United States.

In addition, the first paragraph of the Model Annex is missing. That paragraph reads: "Article [XX] is intended to reflect customary international law concerning the obligation of States with respect to expropriation" and sets the context for the entire expropriation analysis. It places the expropriation analysis firmly within customary international law (CIL) and thus provides boundaries to the analysis and to arbitrators' power to declare environmental, health and safety regulations to be expropriations requiring compensation. This concern will be assuaged if the two countries agree that CIL applies to the expropriation article by virtue of footnote 5 to article 6.

[3] *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 130-31 (1978)

The Confirming Letter Regarding Property Rights relating to indirect expropriations significantly expands the set of claims subject to investor-to-State arbitration in a manner detrimental to the proper implementation and enforcement of regulatory authority. For the first time in a U.S. investment treaty or FTA, the Confirming Letter provides that all contract rights are property rights and thus are eligible to be investments subject to investor-to-State arbitration. Contract claims can involve challenges to environmental, health and safety licenses or permits, but arbitral tribunals are not competent to second-guess how good faith legislatures and regulators decide these questions. This expansion thus has significant adverse implications for the proper implementation and enforcement of regulatory systems.

Annex B

Annex B makes major changes to the Model Annex in ways that favor foreign investors at the expense of U.S. regulatory authority. It is helpful to understand the provenance of the Model Annex in order to appreciate the significance of the changes to it.

The treatment of expropriation in free trade agreements is a major concern to environmental, health and safety non-governmental organizations (NGOs), as is well known. For example, civil society's concern over the proposed expropriation provision in the Multilateral Agreement on Investment (MAI) in the Organization for Economic Co-operation and Development was a major factor leading to the failure of negotiations in the late 1990s. Briefly put, NGOs are worried that arbitral panels in investment disputes will interpret the expropriation provision in ways that unduly restrict host countries' ability to protect the environment, public health and safety (both consumer safety and worker safety), thus eliminating domestic policy space necessary to protect our society and future generations. This concern is based both on the imprecise content of the expropriation law and on our belief that arbitral tribunals are not institutionally competent to judge the efficacy or appropriateness of environmental, health and safety measures adopted by the United States and its state and local governments. For example, investment arbitral tribunals tend to be composed of experts in international investment law with no expertise in laws regarding protection of the environment, health or safety; the operation of arbitral tribunals is not subject to the same transparency and public participation as are courts in the United States and most other countries; and their judgments are for all relevant purposes not subject to appeal or review.

The MAI experience, as well as the contemporaneous realization that the expropriation provision in Chapter Eleven of the North American Free Trade Agreement (NAFTA) raised serious interpretation questions, led the U.S. government to conduct an extensive review of NAFTA's expropriation provisions and of expropriation provisions generally. This review was both internal and external, eventually involving hundreds of hours of meetings among takings and expropriation experts from across the U.S. government, as well as seminar-like meetings with expropriation experts from the Canadian and Mexican governments.

These discussions, which occurred over several years in the administrations of Presidents Bill Clinton and George W. Bush, led to an agreement on specific language explaining the U.S. position on expropriation. That language was painstakingly drafted to include a balanced set of considerations with respect to protecting foreign investors and maintaining the necessary policy space for governments to regulate, including with respect to the environment, public health, and safety, as well as to avoid terminology that could be misapplied by arbitrators. It was included as an annex in the U.S. Model Bilateral Investment Treaty and in subsequent U.S. free trade agreements, including those with Chile and Panama and the CAFTA-DR agreement. It is this language that is changed in the U.S.-Korea FTA. More important than the fact that changes were made, however, is the radical substantive content of those changes.

Creating Two New Tests for Indirect Expropriation. The most important and radical change from the Model Annex is that paragraph 3(b) of Annex B creates two new and dangerous tests for what constitutes an expropriation. Paragraph 3(b) provides that an indirect expropriation will occur if a regulatory action is either "extremely severe" or "disproportionate in light of its purpose or effect". The Model Annex consciously avoided language of this type – i.e., a specific example or test – because such language can so easily be misapplied by an arbitral tribunal and because it would undercut the careful balance sought to be struck in the preceding paragraph of the Model Annex.

The new tests are objectionable on at least three grounds. First, they have no antecedent in U.S. or international law, so this annex is making new law. Second, the tests, especially the second one, provide great discretion and latitude to arbitrators to strike down good faith laws enacted by Congress and signed by the President to protect the environment, health and safety: all that is required is that two of the three arbitrators believe that the measure is extremely severe or is disproportionate in light of either its purpose or its effect. Third, the tests obviously provide foreign investors greater rights than U.S. investors have under our law, because, for example, the U.S. Supreme Court has never held that an expropriation or taking can be found simply because judges believe that the measure is disproportionate. The U.S.-Korea agreement thus violates the Trade Act of 2002's prohibition against providing foreign investors with greater rights than United States investors have in the United States.

Paragraph 3(b) also contains new language about "real estate price stabilization". We understand that Korea requested the inclusion of this language. We do not know enough about Korean laws in this respect to have an opinion on it.

It was suggested to us by a USTR negotiator that paragraph 3(b) has no legal significance because it is only an observation, and thus does not affect paragraph 3(a). We cannot understand how this could be the case, given the text involved. Our discussions with other U.S. government lawyers reinforce our conclusion. We would need an opinion from the Office of the Legal Adviser of the Department of State to be reassured on this point. Even if it were the case, we would find the new language objectionable because it states new expropriation tests that would severely undermine the

sovereign prerogative of governments to protect health, safety and the environment and provide foreign investors more protection than U.S. investors have.

Weakening the Definition of Indirect Expropriation. Paragraph 3(a) provides a description of what constitutes an indirect expropriation, a vitally important issue for environmental, health and safety NGOs. This portion of the Model Annex is based on the U.S. Supreme Court's opinion in the *Penn Central* case, in light of succeeding U.S. Supreme Court jurisprudence. Any changes from the corresponding paragraph in the Model Annex thus raise questions. In fact, paragraph 3(a) has been changed in two respects.

The first change is the addition of footnote 19 to sub-paragraph (ii). The first sentence in the paragraph appears to be unobjectionable, although we do not know why it was added. The second sentence, however, strikes us as being inaccurate in a way that could lead to unwarranted findings of indirect expropriation and is therefore objectionable. The footnote assumes that regulatory changes are more likely to occur in heretofore heavily regulated sectors than in heretofore lightly regulated sectors. This generalization ignores elements such as the novelty of a sector and potential changes in scientific understanding of risks. The more heavily regulated a sector, for example, the more likely it may be that the regulatory system is based on a complete understanding of the societal risks and regulatory techniques involved and thus the more probable that it is accomplishing its purposes and unlikely to need changes in regulations. In that event, a more heavily regulated sector is unlikely to need change, thus making changes to it less likely than in a heretofore lightly regulated novel sector about which risks and regulatory approaches are uncertain. We doubt generalizations like the one in footnote 19 can be made. In any event, this one is wrong.

In addition, sub-paragraph (iii) includes a new sentence: "Relevant considerations could include whether the government action imposes a special sacrifice on the particular investor or investment that exceeds what the investor or investment should be expected to endure for the public interest." Some environmental groups have suggested that more definition be given to this sub-paragraph, particularly with respect to what is meant by "character". Whether or not one agrees with this as a general matter (the drafters of the Model Annex did not include more detail because they could not identify language that did not raise more questions than it solved), the new language is objectionable on three counts. First, it introduces a new concept – "special sacrifice" – that is unknown to U.S. and international law. We understand that "special sacrifice" is a Korean legal concept, based on German law. In any event, its application in international investment arbitration is purely speculative. Second, the sentence could easily be read as a test that arbitrators can apply to determine whether an indirect expropriation had occurred. As discussed above, such tests – including this one -- are unprecedented, dangerous and objectionable. Third, this language is inconsistent with *Penn Central* and thus upsets the careful drafting of the Model Annex, in the process both making it more likely that a regulations will be held to be an indirect investment and bringing the agreement into conflict with the Trade Act of 2002.

The Missing First Paragraph. The U.S.-Korea FTA drops the first paragraph of the Model Annex. That paragraph reads: "Article [XX] is intended to reflect customary international law concerning the obligation of States with respect to expropriation." That paragraph is critical because it sets the context for the entire expropriation analysis, placing it firmly within customary international law (CIL) and thus providing boundaries to the analysis and to arbitrators' power to declare environmental, health and safety regulations to be expropriations requiring compensation. Because CIL includes the so-called Police Power Exception (according to which, for example, the United States is not held to commit an expropriation when it seizes property used in the commission of a crime), this language ensures that the Police Powers Exception and other international jurisprudence relating to expropriation is looked to, and hopefully followed, by investment arbitrators.

It has been suggested that footnote 5 to Article 6.1 reintroduces the dropped first paragraph. That footnote reads: "Article 6 shall be interpreted in accordance with Annexes A and B." Annex A defines CIL; Annex B is the expropriation annex discussed here. Although important in other respects, however, that footnote does not address the question of when CIL is applicable (which is what the dropped paragraph would have done). We understand that the footnote was originally intended to provide transparency regarding the existence of Annexes A and B, and not to compensate for the absence of the dropped first paragraph. That reading is consistent with the fact that other U.S. free trade agreements, including the U.S.-Panama agreement, include both the footnote and the first paragraph of the Model Annex. Nevertheless, this concern will be assuaged if the two countries agree that CIL applies to the expropriation article by virtue of footnote 5 to article 6.

It was also stated by a USTR lawyer that the first paragraph of the Model Annex was dropped because Article 6.1 does not reflect CIL, arguing that domestic law considerations, which could differ from country to country, can also be relevant to an expropriation analysis. We agree with the possible role of domestic law, e.g., with respect to whether a claimant has a property interest; but we believe domestic law can be relevant because CIL provides that it can be relevant, not by virtue of any other source or rule. Thus we do not understand how this could be a reason for deleting the first paragraph of the Model Annex.

We realized during our exploration of this issue that the first paragraph of the Model Annex is also missing in the corresponding annexes in the U.S.-Peru and U.S.-Columbia Trade Promotion Agreements. We understand that this had been done in those agreements because both Peru and Columbia objected that the dropped paragraph implied that "prompt, adequate and effective" standard of compensation is part of CIL: they did not object to that standard being in the U.S. agreement but did not want it to affect their other trade and investment agreements via the reference to CIL. The "prompt, adequate and effective" issue does not directly affect environmental protection, but we nevertheless profess our surprise that the United States would do anything that could be interpreted as undercutting the universal application of this standard, which has been a

cornerstone of U.S. investment policy for at least 60 years, is strongly supported by the business community, and strikes us as unassailable on grounds of either law or policy. We suggest that the elimination in the U.S.-Korea FTA of the first paragraph of the Model Annex is problematic on this ground, just as it is on the health, safety and environmental grounds described above. This comment also applies to the U.S.-Peru and U.S-Columbia Trade Promotion Agreements.

Confirming Letter Regarding Property Rights (Confirming Letter)

The Confirming Letter, for the first time in a free trade agreement or bilateral investment treaty, provides that all contract rights are property rights and thus are eligible to be investments subject to arbitration. Contract claims can involve challenges to the granting or refusing of environmental, health and safety licenses or permits, and to the acceptability of conditions on licenses and permits. Arbitral tribunals are not competent to decide these questions, which normally are decided in U.S. courts under U.S. administrative law and related jurisprudence. Moreover, many contracts are already covered under the definition of investment in the agreement, so we see no reason to further expand the reach of the arbitral tribunals and correspondingly remove all contract disputes involving foreign investors and the United States, at the whim of those investors, from the checks and balances, laws and jurisprudence of the U.S. judicial system.

Procedural Problems

The majority of TEPAC also wants to make clear to Congress that the changes described above were never brought to its attention for discussion. It is well known that TEPAC is concerned about investment, including the expropriation provision. Yet the changes in the U.S.-Korea expropriation provisions were never raised with TEPAC or its liaisons. The same was true with the dropping of the first paragraph in the Peru and Columbia Trade Promotion Agreements. When we asked about this, USTR staff pointed out that the Peru and Columbia annexes were posted, as was the proposed deletion of the first paragraph from the Korea annex. This strikes us as a "gotcha" form of consultation: text is posted and we have no chance to discuss it if we do not notice a change. Normally, USTR does much better than this; but in this instance a serious mistake occurred. Changes of this magnitude should be raised expressly with TEPAC, just as we understand they were with the investment trade advisory committee.

Moreover, the changes in paragraph 3(b) and the Confirming Letter were never discussed with TEPAC or posted until after the negotiations were completed and the notice sent to Congress, leaving us to find out by reading the final text, even though we understand that the issues were discussed with another USTR advisory committee. USTR staff explained this to us by stating that these proposed changes only surfaced in the final hours, which essentially means the final 36 hours of negotiations since USTR staff had the opportunity to discuss them with us in a conference call on March 29, during which we raised the question of the deleted first paragraph in the expropriation annex, and did not do so.

Attachment 2

Statement of TEPAC Member Peter M. Robinson
United States Council for International Business
On the Investment Chapter in U.S.-Korea Free Trade Agreement

The Agreement's investment chapter includes generally strong protections for U.S. investors and investment in Korea that are critically important to promote access for U.S. farm and manufactured goods and U.S. services. The investment protections included in this Agreement essentially provide U.S. investors in Korea the same level of substantive rights that are already available in the United States. That result is critical to ensure that U.S. investors in Korea are not disadvantaged compared to Korean investors in the United States. In particular, the Agreement provides core provisions with respect to national and most-favored-nation treatment, compensation for expropriation, restrictions on performance requirements, fair and equitable treatment, full protection and security, and the free transfer of capital. Very importantly, the Agreement includes an investor-state dispute settlement mechanism, which applies to breaches of the core investment protections and breaches of an investment agreement or authorization. Each of these provisions is viewed as extremely important by U.S. investors.

With regard to expropriation, the provisions of this Agreement are consistent with U.S. legal principles and practice, as Congress sought through the Trade Act of 2002. The Expropriation Annex of this Agreement details the case-by-case analysis for indirect expropriation as set forth in the leading Supreme Court case of *Penn Central Transp. v. New York City* (1978). While some changes were made in the precise language of paragraph 3(b) to accommodate Korean requests, we strongly believe that those changes continue to reflect the core indirect expropriation protections already provided in the United States. In particular, the side letter to the Investment Chapter clarifies that, as in the United States, expropriation protections apply to rights under contract and all other property rights in an investment. This additional language was necessary to ensure that U.S. investors have the same substantive rights as are available in the United States, which has a very broad definition of property. Language added with respect to paragraph 3(b) of the Annex does not modify the test for indirect expropriation included in paragraph 3(a), but merely provides an additional example of when an indirect expropriation can occur, focusing, as does the *Penn Central* test on purpose and effects. We agree with USTR that the language in 3(b) does not represent a different test for when an indirect expropriation occurs, but remains a factual statement that governmental regulatory activity to protect legitimate public welfare objectives does not rise to the level of an indirect expropriation, unless of course it meets the standard under paragraph 3(a).

Nor do we believe that the deletion of the customary international law language that had originally been included Paragraph 1 of the Expropriation Annex of the model U.S. investment chapter changes how this Agreement will be interpreted since it merely stated that the expropriation article itself is "intended to reflect customary international law. . . ." We note that footnote 5 of the Agreement provides interpretive direction (in addition to the governing law provisions of the investment chapter), stating that the expropriation article itself should be interpreted consistently with Annex A, which sets forth the

definition of customary international law. We also very strongly disagree that any of the customary international law references were ever included in the investment chapter for the purposes of somehow narrowing protections already recognized in U.S. jurisprudence, as other TEPAC members have suggested. It is very important that the expropriation protection remain consistent with well-established U.S. legal principles and practice, as sought and mandated by the U.S. Congress.

Attachment 3

Additional Views of Humane Society International
TEPAC Report: U.S.-Korea FTA
April 25, 2007

Humane Society International (HSI) would like to submit the following additional views regarding the U.S. – Korea Free Trade Agreement (KORUS or Agreement). These comments are intended to be included as an addendum to the Trade and Environment Policy Advisory Committee (TEPAC) report on the Agreement.

HSI joins in the unanimous conclusion of TEPAC Members to stress that 30 days is an insufficient period of time for Members of the Committee to thoroughly review, analyze, and provide opinions on free trade agreements (FTA). In the case of the KORUS, the final texts negotiated by the Administration were not made available for comment until after the Agreement had been notified to Congress. Furthermore, recent elections have caused a shift of power in Congress and the newly-elected majority has indicated through numerous press reports that they are seeking the addition of language that further protects the environment to all FTA texts before they will allow a vote on these agreements. This situation has left TEPAC Members in a precarious situation unable to determine exactly what the final text of the KORUS will entail, while at the same time facing a congressionally mandated deadline to submit a report within 30 days of the President's notification to Congress that he intends to sign the Agreement.

For this reason, HSI would like to make clear that the conclusions expressed throughout this submission are based solely on text of the KORUS as of the date the TEPAC report is presented to Congress. HSI, therefore, reserves the right to modify opinions presented in this submission if the text of the Agreement were to change due to the Administration's ongoing negotiations with Congress. As a result of the current circumstances, HSI joins the majority of TEPAC Members who are expressing their increasing frustration concerning the limited time frame provided to perform the complex task of creating a report, particularly given the divergent viewpoints of TEPAC Members. The current statutory scheme neither provides an adequate period of time to perform this review, nor is it flexible enough to deal with the current political environment.

Based on the text of the KORUS as of this date, HSI agrees with the majority of TEPAC members in supporting the conclusion that the Agreement provides adequate safeguards to ensure that Congress's environmental negotiating objectives will be met. HSI applauds the inclusion of the requirement that both Parties effectively enforce their domestic environmental laws, including those that implement commitments under

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Multilateral Environmental Agreements (MEA). In addition, HSI would specifically like to acknowledge the efforts on the part of USTR to work with TEPAC in crafting acceptable public participation provisions for the Agreement. HSI strongly believes that the inclusion of an effective enforcement framework supported by sensible public participation and trade capacity building provisions will significantly increase the likelihood that the KORUS environmental provisions will be fully and effectively implemented.

While HSI does not believe that FTAs should be negotiated on a "one size fits all" basis, we are displeased with the fact that the current text of the Agreement does not include a biodiversity provision in the Environment Chapter. Such a provision was included in the recently negotiated Colombia and Peru TPAs, and would have been a welcome addition to the KORUS. By enshrining both Parties' recognition of the importance of the conservation of biological diversity and its role in sustainable development (specifically that of plants, animals, and habitat), both the Colombia and Peru TPAs represented a substantial achievement in the Environment Chapters of free trade agreements. The failure to include this important provision in the KORUS is a substantial step backwards from these agreements and represents a missed opportunity for the United States to demonstrate its commitment to environmental protection on a global level.

The exclusion of a biodiversity provision is disappointing. However, other portions of the Environment Chapter remain strong and should the KORUS enter into force it is incumbent on the Governments of both the United States and the Republic of Korea to ensure that the Agreement does more than just put words on paper. Provisions contained in the Environment Chapter and those in the concurrently negotiated Environmental Cooperation Agreement (ECA) require long-term financial backing and support from *both* Parties in order to achieve their desired results. Recognizing the importance of strengthening the capacity in each Party to protect the environment and promote sustainable development, the ECA provides a foundation for long-term cooperation and assistance on environmental issues, programs, and policies. While HSI is aware of the need to be fiscally responsible, environmental cooperation is an area where we can achieve a great deal of good and improve the life and health of people and animals in addition to increasing economic opportunities.

As both the U.S. and Korea are members of the developed world, it is incumbent upon *both* Parties to provide equal and adequate funding if these cooperative efforts are to be successful. HSI is hopeful that the ECA accompanying the KORUS will provide a strong basis for ongoing environmental cooperation, and urges Congress to ensure that the U.S. provides its adequate share to fund the ECA programs and priorities in the United States.

HSI remains concerned, however, that at present Korea continues to have problems either enforcing or strengthening its environmental laws when it comes to protection of animals. In particular, HSI noted in submissions to USTR on March 31 and October 3, 2006, and January 17, 2007, that Korea continues to engage in practices such as the incidental killing of whales, and the illegal trade in wildlife and the trade in bear

parts in violation of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). HSI is pleased that the current work program specifically provides for CITES implementation initiatives and believes that the Government of Korea needs to adequately fund ECA programs and priorities to work towards solving these and other environmental issues in Korea.

As noted above, HSI would like to make clear that the views expressed above are based on text of the KORUS as of the date of this submission. HSI, therefore, reserves the right to modify our opinion if the text of the Agreement is altered based on the Administration's ongoing negotiations with Congress.

HSI would like thank the Chairperson of TEPAC for the opportunity to incorporate this submission as an addendum to the official TEPAC report for the KORUS FTA.

Attachment 4

CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW (CIEL)

Separate Comments of TEPAC Members on the U.S.-Korea Free Trade Agreement

Daniel Magraw, President, Center for International Environmental Law
Joined by
Rhoda H. Karpatkin, President Emeritus, Consumers Union of U.S., Inc.
William A. Butler, Audubon Naturalist Society
Durwood Zaelke, Institute for Governance & Sustainable Development

April 25, 2007

The Korea Free Trade Agreement (FTA) is critically inadequate with respect to its investment provisions, which contain troublesome substantive rules and investor-state dispute settlement procedures and fail to provide an appellate procedure to curb errant arbitral panels.

I. General Comments on the Investment Chapter

The approach to international investment rules embodied in the Korea FTA contains some incremental improvements over the North American Free Trade Agreement (NAFTA) and model Bilateral Investment Treaty (BIT) approaches, but also contains dangerous new tests for what constitutes an indirect expropriation and other objectionable language, as is described in the TEPAC majority's Supplemental Statement Regarding Expropriation also appended to this TEPAC report. It is clear that the provisions we have reviewed do not comply with the direction from Congress that new international investment rules not provide foreign investors with "greater substantive rights" than domestic investors enjoy under U.S. law[4]. Nor does the approach address the fundamental problems environmental groups and others have identified with the NAFTA/BIT approach. In addition, the failure to include an appellate review process ensures that investor-initiated disputes will continue to threaten to stretch traditional international law concepts in ways that undermine national regulatory powers and frustrate efforts, particularly in developing countries, to achieve sustainable development.

Threat to good governances; public welfare and rule of law. Experience with cases being brought under existing agreements (chiefly NAFTA and numerous BITs) demonstrates that individual investors are pushing for expansive readings of the

[4] Part III below addresses in more detail the failure of the agreements to meet the "no greater substantive rights" standard.

substantive obligations in those agreements. Further tilting international investment rules in favor of investors at the expense of the ability of governments to regulate in the public interest is a threat to good governance and public welfare. The reliance on domestic courts in the first instance, and on state-to-state dispute settlement only if needed, provides more appropriate fora for protecting the rights of investors. In addition, requiring investors to rely in the first instance on domestic legal remedies helps build the rule of law by allowing national legal regimes to resolve any legitimate claims by investors. Allowing investors to remove disputes from national legal systems, as is the case in the Korea FTA, stunts the development of those systems.

Greater substantive rights. The Korea agreement creates two new dangerous tests for what constitutes an indirect expropriation (i.e., whether a regulatory action is "extremely severe" or is disproportionate in light of its purpose of effect"); contains a new, inaccurate footnote (no. 19); incorporates a Korean law concept ("extreme sacrifice") into the analysis of what constitutes an indirect expropriation; and declares all contract rights to be property rights. The majority of TEPAC objects to these new elements, as is indicated in the text of the TEPAC report and explained in more detail in the Supplemental Statement on Expropriation (to the report).

The explicit limitation of the minimum standard of treatment provision to "customary international law" corrects one serious flaw with the NAFTA approach, which referenced only "international law." Of course, the content of customary international law with respect to the treatment of aliens is not crystal clear, and arbitral panels have applied this standard in idiosyncratic fashion, e.g., Occidental v. Ecuador and CMS Gas v. Argentina.

The agreement references international law concepts as the guideposts for interpreting the substantive obligations – leaving substantial interpretive room for arbitrators to exploit. The inclusion of terms like "fair and equitable" provide arbitral panels with standards that do not exist in U.S. law. The lack of an appellate process and the lack of any oversight role for U.S. courts inhibit the development of a clear jurisprudence consistent with U.S. investor protections. There can thus be no assurance that either expropriation or minimum standard of treatment provisions will be applied in a manner consistent with the U.S. legal norms as required by the Trade Act of 2002. Part III below details a number of specific ways in which the expropriation and minimum standard of treatment provisions fail to meet the "no greater substantive rights" standard.

Constitutional issues. Some have raised the question of whether or not the investor-state dispute mechanism is consistent with the U.S. Constitution given that it can decide cases otherwise subject to the Constitution's provisions on the judiciary.[5] Given that the need for this mechanism is not clearly established, why should the U.S. enter into agreements that might embody an unconstitutional delegation of judicial power?

[5] See, John Echeverria, "Who will Decide for Us?" LEGAL TIMES, March 8, 2004.

Regulatory effects not adequately understood. The bulk of the concerns expressed by environmental groups and others involve the regulatory effects of the investment rules. In other words, the rules and the investor-state process have been used to challenge domestic regulations designed to protect the environment and public health or advance other important social objectives. The failure to fully understand the impact of the proposed rules on domestic regulation (either domestically or abroad) undermines assertions that these agreements will support sustainable development.

Exacerbation of imbalance. Finally, we see the continuation of an imbalanced approach to the treatment of investors (most of which are corporate actors) as opposed to citizens generally in U.S. foreign economic policy. Investors are given explicit rights and enforcement mechanisms to hold governments accountable—indeed, as noted above this imbalance is worsened by a massive shift of power to foreign investors vis-à-vis regulatory authorities. But the investment rules do not even mention, much less require, minimum standards of corporate conduct on investors acting abroad.

II. Specific Concerns with the Investment Chapter

Definitions. The definition of investment differs markedly from that in NAFTA and appears to be even broader in scope. The effect of this definition is not clear, but at a minimum it raises questions as to the types of property interests the agreement seeks to protect and whether those notions are consistent with the limited concept of protected property interests under the U.S. Constitution and case law. The reference in the expropriation annex to "a tangible or intangible property right or property interest" does little to elucidate the precise scope of property interests protected by the agreement for purposes of ensuring consistency with the "no greater substantive rights standard."

Distinguishing investors based on environmental criteria. In the non-discrimination provisions (national treatment and most favored nation treatment) there is no clarity regarding the extent to which environmental criteria can be used as the basis to fairly distinguish between investors. In particular, there is no explanatory note that would ensure that future panels are guided by a notion of "like circumstances" that would accept environmental criteria as an important part of the like circumstances analysis. The classic example is in regulating point source pollution of a river. The absorptive capacity of the river system could, for example, allow five sources of pollution without significant harm, but a sixth could create too heavy a load and result in significant environmental harm. Would national treatment require the sixth facility (identical in everyway to the first five, but for foreign ownership) to be compensated if it is not allowed to operate? The negotiators have demonstrated at numerous points in the text a willingness to try to provide panels with guidance, and the failure to do so here is puzzling – particularly, as noted below, when there is no general environmental exception for the investment chapter.

Lack of environmental exception. The failure to include a general environmental exception to the investment chapter is a further indication that international investment

rules remain a significant threat to environmental and other policies enacted by governments to further the public interest. If, as the supporters of strong investment protections argue, such rules pose no threat to legitimate environmental regulations or actions of government, then why not ensure that result by clearly carving out such regulations from the ambit of the rules? The approach in Article XX of the GATT, if applied to investment, would ensure that governments are not required to compensate investors for the consequences of entirely legitimate and reasonable environmental regulation. As noted above, the failure to explicitly include environmental factors in the like circumstances analysis heightens the need for an effective environmental exception.

Less favorable treatment than is provided to tax measures. In addition, the Korea FTA text includes a carve-out from the expropriation provision for tax laws (Article X.3). This includes a mechanism by which the home and host countries can agree to disallow a claim for expropriation based on a tax measure. In our view, environmental and public health regulations serve societal objectives every bit as important as tax structures. The willingness to create a mechanism for governments to preclude an expropriation challenge for tax laws but not environmental laws again raises a question of whether the agreements strike the proper balance among the economic and non-economic objectives of government.

Performance requirements. The performance requirements section includes a puzzling environmental exception for some but not all of its provisions. The exception singles out some paragraphs and not others and directs that they not be construed in a way to prevent a Party from adopting or maintaining legitimate environmental measures. Does this mean that the paragraphs not mentioned may be construed to prevent a Party from adopting or maintaining legitimate environmental measures? If not, then why not apply the exception more broadly?

Expanding Arbitral Jurisdiction: Investment Authorizations and Investment Agreements. The Investment Chapter subjects investment authorizations and investment agreements to the compulsory jurisdiction of arbitral tribunals. The magnitude and implications of these jurisdictional grants have not been adequately assessed, but it is immediately evident that they will have significant negative effects. This language undermines domestic legal systems by removing an important class of disputes from them, opens whole new areas of potential investor challenges to domestic regulatory programs, and provides foreign investors better treatment than U.S. domestic businesses have.

The investment agreements covered by them are not commercial disputes, but involve important policy questions regarding public assets, including natural resources such as oil, gas, and timber; public services, including water treatment and distribution and power generation and distribution; and infrastructure projects, such as roads, bridges, canals, dams and pipelines.

In particular, we are concerned about the role of the U.S. judiciary and the administration in upholding the rule of law. Whether a party is in breach of investment

agreements or authorizations should be determined under applicable U.S. law, and through the statutorily mandated process of administrative courts followed by appeal, if necessary, to U.S. federal courts. That comprehensive body of law defines the competence, rights and obligations of the U.S. government regarding its contracts, including those concerning natural resources, public services, and infrastructure projects. Similarly, procedural system ensures fairness and consistency in dealing with the multitude of issues involved in U.S. government contracting. It is also critically important that legitimate U.S. regulatory decisions (e.g., regarding health, environmental, communications, energy, and nuclear issues) be tested in the U.S. court system and be subject to U.S. laws, not subject to second-guessing by ad hoc arbitrators.

If it is problematic for foreign investors to take disputes over U.S. contracts and administrative and regulatory measures out of the established domestic processes designed to review them, then it is equally problematic for U.S. investors abroad to bypass the national judicial system of the host country to challenge that country's administrative and regulatory systems, absent a showing of futility. Respect for the rule of law requires that domestic legal processes be given the opportunity and responsibility to work.

The inclusion of a separate jurisdictional grant in the Investment Chapter is also unnecessary, because rights conferred by these investment authorizations and agreements are already protected, to the extent that they are included in the definition of investment by substantive expropriation disciplines. What the new jurisdictional grants do is to make any dispute and all issues arising out of these agreements actionable for damages before unaccountable, ad-hoc arbitral tribunals.

This expansion of the investor-state arbitration is problematic, in part because these disputes can involve the collection of royalties over natural resource extraction, and because they can involve challenges to measures adopted by U.S. agencies to implement and enforce their regulations governing public services.

III. The Investment Provisions of the Korea FTA Fail to Meet the "No Greater Substantive Rights" requirement of the Trade Act of 2002

The Trade Act of 2002 requires that investment provisions "ensur[e] that foreign investors are not accorded greater substantive rights with respect to investment protections than United States investors in the United States…." Section 2102(b)(3).

Like the Chile and Singapore FTAs, the Korea FTA clearly reflects a departure from the investment provisions in previous agreements to which the U.S. is a party, including NAFTA Chapter 11; however, those changes fail to meet the standard articulated by Congress. While there are potentially helpful elements in the proposals, they fail to adequately reflect U.S. law, or even international law, in many respects – including the particular Supreme Court decision, *Penn Central*, on which USTR intended to base much of the standard for expropriation.

The Korea FTA cannot ultimately comport with the "no greater rights" congressional mandate if foreign investors are able to bring claims that would be decided by ad hoc panels that are not trained in or bound by U.S. Supreme Court precedent and that would not be subject to review by U.S. courts to ensure that they do not in fact deviate from U.S. law and grant greater rights to foreign investors. The prospects of such panels engaging in subjective balancing tests, and on the basis of those, imposing financial liability on the U.S. for legitimate regulatory and other actions is extremely troubling.

The agreements are also flawed, however, in failing to do what they purport to do – that is, reflect U.S law. A number of particular concerns regarding the standards for expropriation and minimum treatment are addressed below.

Expropriation. Of utmost importance is the fact, noted above and objected to by the majority of TEPAC, that the Korea agreement includes several new elements protecting foreign investors that have no countraypart in U.S. law. We will not reject those here.

In addition, attempting to define a standard for indirect expropriation, the agreement fails to include critical standards established in U.S. jurisprudence that preclude findings of compensable expropriations, and leaves unclear in a problematic manner some of those that it has chosen to reference. For example, the agreement (Annex B, paragraph 3) does not include the critical Supreme Court principle that a governmental action must permanently interfere with a property in its entirety in order to meet a threshold requirement to constitute a taking.[6] Simply listing some of the factors the Supreme Court discussed in *Penn Central*, but without the essential explanations and limitations that were set forth in that case and in subsequent rulings, provides no assurance that foreign investors will not in fact be granted greater rights than U.S. investors. This failure to provide explanations and limitations for critical standards includes the use of the "character of government action" as a factor in expropriation analysis. "Character of government action" is ambiguous and could easily be misapplied by tribunals that are neither trained in nor bound by U.S. precedent.[7] In addition, the

[6] The Supreme Court has clearly stated that takings analysis must be based on the effect of the government action on the parcel as a whole, not its segments. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 130-31 (1978). This standard prevents segmenting a property, whether measured in terms of area or time, as clearly articulated in the Supreme Court's *Tahoe-Sierra* case, which rejected a taking claim arising out of a temporary moratorium on development. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 122 S. Ct. 1465 (2002)

[7] The Supreme Court's reference to that factor in *Penn Central* as reflects a clear limitation on takings claims under U.S. law that is not evident in an unexplained reference to the "character of government action." See also Lingle v. Chevron (USSC May 23, 2005). In *Penn Central*, the Court explained that a "'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government, . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the public good." The Supreme Court thus referred to the character of government action to distinguish between a permanent invasion of land, which is more likely to give rise to a right to compensation, and normal regulatory action, for which compensation is only required in extreme circumstances that are equivalent to a permanent, compelled, physical occupation. Without a clear explanation of how the character of government action affects the analysis of a takings

language concerning the analysis of an investor's expectations is too vague, leaves too much to the discretion of the arbitrators, and does not indicate the deference to governmental regulatory authority that is found in U.S. jurisprudence.[8] Property rights are not defined in the agreement, nor is there any reference to the fact that under Supreme Court cases takings claims must be based upon compensable property interests, which are defined by background principles of property and nuisance law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992). Furthermore, the agreement fails to include the fundamental distinction between land and "personal property."[9]

While the "rare circumstances" language in the agreements provides some direction for arbitral panels, it fails to adequately convey the degree to which it is unlikely that a regulatory action would be considered an expropriation under U.S. law. It would take an extreme circumstance for any of the thousands of our country's laws and regulations to be found to constitute an expropriation. It would be more accurate to state that regulatory actions designed to protect health, environment, or the public welfare do not constitute an expropriation, except in instances equivalent to a permanent, compelled, physical occupation.[10]

Minimum Standard of Treatment. In regard to minimum, or general, treatment, we are deeply concerned that the term "fair and equitable treatment" has been included as an essential element of the standard. "Fair and equitable treatment" opens the door to outcomes in investment cases that go far beyond U.S. law. While we welcome the clarification that "fair and equitable" includes procedural due process, inclusion of one principle in a standard does not eliminate the significant potential of a broader, unbounded interpretation of the standard. The terms "fair" and "equitable", after all, are inherently subjective and incapable of precise definition.

- There is no right corresponding to "fair and equitable treatment" under U.S. law. The closest thing in U.S. law is the Administrative Procedure Act (APA), which allows a court to review federal regulations to determine whether they are "arbitrary or capricious." First and foremost, the APA does not apply to many governmental actions (e.g., legislation, court decisions, actions by state, local and tribal

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claim, a tribunal applying this factor would be free to interpret it so as to afford foreign investors far greater rights than the U.S. Constitution provides.

[8] The expropriation annex does not include critical limitations stating that an investor's expectations are a necessary, but not sufficient, condition for liability, that an investor's expectations must be evaluated as of the time of the investment or that an investor must expect that health, safety, and environmental regulations often change and become more strict over time. For example, it fails to include the *Concrete Pipe* Court's reiteration of the principle that those who do business in an already regulated field "cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end." *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 508 U.S. 602, 645 (1993).

[9] "In the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulations might even render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale)." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1028 (1992).

[10] As the Supreme Court unanimously stated in the *Riverside Bayview* case, land-use regulations may constitute a taking in "extreme circumstances." *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985).

governments, and exercises of prosecutorial discretion) that are covered under investment agreements. The Korea agreement thus constitutes a substantial enlargement of foreign investors' rights. Secondly, the APA does not provide for monetary damages (as these investment provisions would allow); only injunctive relief is allowed.

Foreign investors already have the same rights as U.S. investors under the APA to seek injunctive relief. Enshrining this equal access in a trade agreement is one thing, but also granting foreign investors the right to a different legal standard and to be paid the costs of complying with a requirement that may violate the APA but does not constitute a compensable taking under the Constitution as interpreted by the Supreme Court would clearly violate the Congress' "no greater substantive rights" mandate. In other words, giving foreign investors the right to monetary damages under investment rules, where an identically situated U.S. investor would be limited to injunctive relief, would violate the "no greater substantive rights" mandate. Finally, U.S. courts are bound by deference doctrines in applying the APA; there is no equivalent doctrine in the Korea agreement or other international law, to our knowledge.

- In addition, the "fair and equitable" language, if viewed as an independent standard, is extremely dangerous to good governance. It would invite an arbitral tribunal to apply its own view of what is "fair" or "equitable" unbounded by any limits in U.S. law. Those terms have no definable meaning, and they are inherently subjective. Indeed, we wonder how they can have any principled meaning when applied to countries with such different histories, cultures, and value systems as are involved in free trade agreements. The kind of second-guessing of governmental action—e.g., legislation, prosecutorial discretion, police action, court decisions, regulatory actions, zoning decisions, etc., at all levels of government—invited by this type of standard is antithetical to democracy.

Dispute Settlement. We also object to the references to the UNCITRAL rules in Article 10.15. These rules are inconsistent with transparency and public participation, both of which are essential because of, inter alia, the fundamental issues of public policy that are the subject of investor-state disputes. There is no reason to include any other dispute settlement possibilities than the International Centre for Settlement of Investment Disputes (ICSID) and the ICSID Additional Facility, which are considerably more transparent and participatory, and there is no reason to give a private investor a choice of rules in any event.

Attachment 5

Submitted by Frances B. Smith

April 25, 2007

As a member of the USTR's Trade and Environment Policy Advisory Committee (TEPAC), the Competitive Enterprise Institute (CEI) takes seriously its responsibilities to the USTR, the President, and Congress to provide our views on "whether and to what extent the Agreement promotes the economic interests of the United States and achieves the applicable overall and principal negotiating objectives set forth in the Trade Act of 2002." Since TEPAC's responsibility is to focus on trade and environmental issues, the committee has a primary responsibility to ascertain whether the environmental provisions of the Trade Act are met.

The U.S-Korea Free Trade Agreement is likely to advance the economic interests of the U.S. in opening up markets in a broad range of consumer and industrial products, as well as agriculture goods. The agreement is not likely to have negative environmental effects in either country since there already is vigorous trade between the countries.

These comments, dissenting from the majority report, are intended to address certain issues that have not been dealt with in the majority report and to clarify CEI's differing viewpoint on several concerns.

As CEI has noted in reports on other FTAs, our dissent from the TEPAC majority report stems from the Agreement's excessive reliance on mandates as a direct means to advance various environmental objectives. As noted in passing in the majority report, trade can create wealth, and, in that sense, the most effective means of advancing environmental objectives around the world is to move toward free trade. Trade agreements should focus on this positive impact, not seek to use trade policy as a tool to force changes that might – or might not – actually advance some environmental objective. Environmental goals should be pursued directly – not via restrictions to trade expansion.

In its comments, the Competitive Enterprise Institute would like to focus initial attention on a broader issues: the importance of the Free Trade Agreement with the Republic of Korea, not only one of the major trading partners of the U.S. but also a country that is strategically important as a democratic country in Asia with long-standing ties to the U.S. South Korea is now the United States' seventh-largest trading partner and is the 11th-largest economy in the world, according to the U.S. State Department. The FTA would help strengthen this vital strategic and economic relationship.

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Thus, CEI was concerned that the Environment Chapter carries the bracketed note: "Placeholder subject to further discussions based on further consultations with U.S. Congress."

CEI would urge Congress to review the trade agreement in light of its exceeding the environmental mandates of the Trade Act of 2002, but also look beyond that to Korea's importance as a friend of the U.S. Just this week the European Union announced that it would begin talks on free-trade pacts with India, South Korea and the 10-nation ASEAN group.

Korea negotiated the agreement with the U.S. in good faith and under current laws and mandates. If Congress, however, changes this good-faith agreement, with new requirements and mandates in the chapter on the environment, such actions could do great damage to U.S.-Korea relationships at the same time that other countries are courting Korea. This could harm the U.S. not only economically but also strategically.

Specific comments: CEI disagrees with the majority view in several areas, as outlined below:

--Public participation provisions

CEI is a strong proponent of public participation and the ability of a populace to express their views freely. CEI also strongly believes that individual countries –because of their culture – may have approaches to encouraging public participation that differ markedly from those in the U.S. One can debate which countries are "better" than others in promoting public participation. In Switzerland, national referenda are sometimes used to decide important issues. In France, sometimes a national *Congrès* is assembled on a particular issue (e.g., agricultural biotechnology). Those types of "public participation" may not work well in the U.S. – or indeed in many other countries.

CEI thus dissents from the majority report, which promotes a public participation model based on what is done in the U.S. CEI would point to the somewhat condescending nature of offering that model. Korea, for example, has a 98 percent literacy rate – slightly lower than the U.S. but higher than that of Spain and Israel, according to the UN Development Programme Report 2004. Korea also has a very high level of high school attendance – 95 percent. An educated populace in a democratic society provides numerous avenues for public participation without the need for the U.S. to tell them how to do it.

--Investment—Expropriation

Increasingly, TEPAC members have focused on investment provisions in trade agreements because of their relationship to environmental regulation. In the comments below, CEI takes issue with the TEPAC majority view on the Investment Chapter, particularly in relation to Annex B, Expropriation.

In dissenting from the TEPAC majority report on the investment provisions in the U.S. – CEI would first like to address a broader issue. We would point out that concerns about

investments are better dealt with in a separate investment agreement--if countries wish to do so--but should not necessarily be part of a bilateral trade agreement. Already, important but separate issues are being included in trade agreements (environment, labor, intellectual property, investment, etc.). Those issues would be better advanced by dealing with them in other fora dedicated to those issues. Using trade as a "big stick" to force agreement on those separate issues undermines the importance of trade in advancing economic growth, which can enable countries to address those issues directly and with greater vigor.

Investment rules and challenges to domestic regulations should be considered, as far as possible, in the domestic legal systems of those countries. Countries that fail to adequately address the concerns of investors will likely face economic consequences in lower levels of foreign investments. While closer cooperation and facilitation between the Parties might help to bridge different concepts of investment and its protection, enforcement outside of the domestic legal system can pose significant problems and concerns relating to public acceptance, the rule of law, and national sovereignty.

CEI dissents from the majority report in its view of the Investment Chapter and its relevant Annexes and Letters.

It is clear from the text of the chapter, the definitions, and the footnotes just what an "investment" is and what it is not, as well as what an "intangible . . .property right" is and is not (see footnote 14 in the chapter, which clarifies the definition by stating: "For greater certainty, market share, market access, expected gains, and opportunities for profit-making are not, by themselves, investments."

In addition, the Confirming Letter further clarifies "tangible or intangible property right" as noted in Annex B: The Letter states: "For purposes of this Agreement, the term "tangible or intangible property right" in paragraph 1 of Annex B includes rights under contract and all other property rights in an investment, as that term is defined in Article X.28 (Investment – Definitions)."

CEI disagrees with the majority view of the expropriation provisions, as our view is that the text of Annex B clarifies, according to U.S. law, the criteria for indirect appropriation of an intangible property right.

The State Department's Model BIT, in stating the criteria of what constitutes an indirect expropriation, notes under 4 (b) of Annex B "the character of the government action." CEI would offer that the additional language in Annex B clarifies what that term can mean. The effort to clarify the meaning is a positive one and one that is consistent with U.S. legal principles and practices.

Under these investment rules, U.S. investors would have the same rights as Korean investors. Thus, from a review of the text, CEI disagrees with the majority's contention that foreign investors receive greater rights than U.S. investors have in the U.S.

For these reasons, CEI would offer that the investment provisions are consistent with the Trade Act of 2002 and the Congressional concern about ensuring that foreign investors in the U.S. receive no more protection against expropriation than U.S. laws allow.

--Sanitary and phytosanitary standards.
CEI is pleased that the agreement includes a strong recognition of the responsibilities of countries in adhering to the World Trade Organization's Sanitary and Phytosanitary Agreement, which requires scientific risk assessment. CEI also commends the agreement for establishing a joint Korea-US committee on SPS issues, as such issues in the past have given rise to disagreements between these countries. Greater understanding of each other's regulatory structure in addressing risk assessment relating to human, animal, and plant health could help to alleviate misunderstandings early on.

CEI, however, does not share the TEPAC majority's reading of paragraph 3 (a): "recognize that scientific risk analysis shall be conducted and evaluated by the relevant regulatory agencies of each Party." It seems clear that this provision was inserted to ensure that each country would undertake scientific risk assessment on matters affecting trade within their own domestic regulatory structures. Such a provision is critical in ensuring that negative claims about a country's products are not arbitrary.

Thus, CEI would argue that neither the sovereignty of the U.S. nor of Korea is threatened by this provision.

--Environmental Cooperation Agreement; dedicated funding source
CEI dissents from the majority endorsement of including the ECA in the text of the Agreement and establishing a dedicated funding source for environmental cooperation between the two countries.

CEI would offer that an ECA is subject to change as priorities shift. Thus, inclusion in the text could be problematic in making such changes.

CEI would also note that Korea has a GDP of $897.4 billion and is the 11th largest economy in the world. A dedicated funding source for cooperative activities for environmental improvements and monitoring would mean that other more urgent U.S. budget priorities may receive short shrift. For example, since Korea represents a very attractive trading partner for many U.S. producers, there may be a stronger push for aiding Korea in the environmental area than, say, Morocco or Peru.

In conclusion, CEI appreciates the opportunity to express its views on this important trade agreement.

Sincerely,

Frances B. Smith
Competitive Enterprise Institute

Attachment 6

Separate Statement of TEPAC Member
Rhoda H. Karpatkin, Consumers Union of U.S., Inc.
joined by
William A. Butler, Audubon Naturalist Society
Durwood Zaelke, Center for Governance and Sustainable Development
Daniel B. Magraw, Center for International Environmental Law

April 25, 2007

We believe that lowering trade barriers can provide benefits to consumers. Trade agreements should promote sustainable economic development, and encourage the protection of public health, consumer and worker rights, product safety and the environment. We believe this was the purpose of the Negotiating Objectives contained in the Trade Promotion Authority Act of 2000. The Korea – U.S. Free Trade Agreement (KORUS), while it contains some benefits, is flawed in so many significant ways that it fails to achieve those ends.

My comments are directed specifically to the provision of Chapter XX on Intellectual Property and the as yet unnumbered Chapter on Pharmaceutical Products and Medical Devices. These contain anti-consumer measures that delay the availability to consumers of generic substitutes, provisions that have been included in all of the recent bilateral and regional Free Trade Agreements (FTAs) and Trade Promotion Agreements (TPAs). They also take aim at national formularies that serve the purpose of reducing the cost of pharmaceuticals and medical devices to consumers who participate in national health care systems.

Intellectual Property Protections for Pharmaceuticals.

Section 2102(4)(b)(C) of the Trade Act of 2002 establishes the objective that trade agreements respect the Declaration on the TRIPS Agreement and Public Health, adopted by the World Trade Organization at the Fourth Ministerial Conference at Doha, Qatar on November 14, 2001.

The Doha Declaration specified in this objective on the TRIPS Agreement and Public Health calls on WTO members to implement the TRIPS "in a manner supportive of public health and, in particular, to promote access to medicines for all."

Some recent FTAs and TPAs with developing nations contain measures or side letters citing the parties' recognition of the Doha Declaration. I find no such recognition of the Declaration in this proposed Agreement, although consumers in Korea and, as the Congress well knows, the U.S., share significant concerns about affordable access to pharmaceuticals. The issue of affordable access to medicines also concerns Congress. The relevant provisions of this proposed Agreement would *reduce* access. While consumers recognize the tension between innovation incentives and price inherent in the patents system, there are numerous pathways to reconcile those tensions so as to reward

innovation *and* to secure for consumers the benefits of affordable prices. This Agreement will make medicines less affordable for consumers.

While the provisions in Article XX are written in complex language, they greatly expand patent rights provided in the WTO TRIPS Agreement. They add roadblocks to bringing generic drugs to market and, hence, decrease the affordability of medicines for consumers. Affordability, in practical terms, equates to the availability of generics and to compulsory licensing in some cases.

As we read this Agreement, the data exclusivity provisions require special, monopolistic protections for the patent holder's pharmaceutical regulatory safety and efficacy data. This data is costly to produce; for this reason, generic manufacturers generally do not repeat the underlying tests, but need only show that their products are chemically equivalent and bioequivalent and rely on the drug approval agency's prior approval of the patented drug. This gets the generic drug to market as quickly as possible, a benefit to consumers.

As a result of these new, monopolistic protections, the introduction of generic drugs will be delayed and limited, extending the *de facto* life of pharmaceuticals patents -- by three to five years or more beyond the TRIPS-imposed 20-year patent term requirement -- by holding back the market introduction of a generic drug by "at least five years" from the date of its approval. (Article XX.10.1(a) and (b)).

The Agreement also prevents generic manufacturers from exporting generic equivalents of medicines under patent for use as medicine in other countries (including countries not Parties to the Agreement) during the term of the patent, *even if* the patent holder does not make the product available in those countries.

The costs of generating original clinical data to prove safety and efficacy are beyond the means of most companies that manufacture only generics. And, in any event, if a manufacturer wanted to market a generic based on its own testing, it could not do so during the patent term under the provisions of Chapter XX.8 of this proposed Agreement. Further, while it appears that a generic could be marketed immediately upon the expiration of the patent term if it were approved at least five years preceding that date, there is little incentive for generic manufacturers to undertake the effort and expense of obtaining such approval so early, as it would not be known at that time whether the drug entity would remain the drug of choice past the expiration date. Proprietary manufacturers often generate new "replacement" products timed to come to market close to the expiration date of their expiring product. Thus, patent holders that received "TRIPS plus", draconian powers under the Australia FTA and the CAFTA to delay and prevent the marketing of generic medicines, will also benefit from those powers under the proposed Korea FTA.

The unnumbered Chapter that addresses formularies for national health care systems is likely to have similar effects on affordable access to medicines and medical devices. Section 2, deceptively entitled "Access to Innovation," would require the governments to

set formulary prices and reimbursement levels on "competitive market-derived prices," or alternatively to set prices by a system that 'recognizes the value of patented products and services' and permits manufacturers to apply for increased reimbursement over that provided for "comparator" prices. The system would be overseen by an independent body that includes government health and trade officials, but there is no provision for representatives of consumers. It is not clear that Paragraph 3 regarding transparency of the formulary system applies to the workings of this independent body. Neither is there any specified role for the manufacturers of the "comparator" products, i.e. manufacturers of competition-inducing generic medicines. Hence, the system may well be tilted toward enabling patent holders to prevent the national formulary from effectively negotiating the prices most favorable to consumers.

These provisions could impede the efforts of the Congress in the future to use the widely accepted formulary system to address the affordability of medicines to the consumer. Congress should not allow trade agreements to restrict its ability to address the affordability of medicines in the United States.

This agreement, and others negotiated under this Administration will create upward pressure on the price of medicines globally. While it has been suggested that the result will lower the price of medicines in the United States – that is unrealistic. It is generally agreed that U.S. consumers pay a disproportionately high share of the costs of pharmaceuticals innovation. But there is simply no mechanism to translate increased prices for Koreans and citizens of other foreign countries into lower prices for U.S. consumers. Given the stranglehold monopolist and oligopolist drug companies now have on the market in this country, and the power they have demonstrated in Washington on the issue of prices, it is naïve to believe that they would voluntarily lower the prices they can now obtain from U.S. consumers.

The Congress has been grappling with the affordability of pharmaceuticals for U,S. consumers. It needs maximum flexibility to deal with this complex issue. These FTA provisions in a succession of trade agreements may well have a preemptive effect, intruding on the prerogatives of the Congress to define national policy and how to implement it.

We urge that, for these reasons, this Agreement should not be approved by the Congress.