Behind the spin: the real story on foreign investment and ISDS in the TPPA-11

The Prime Minister and Trade Minister in New Zealand's new Labour-led government have made a number of claims regarding the revised Trans-Pacific Partnership Agreement among the eleven non-US parties, especially relating to investment.

This memorandum explains why those claims are either wrong or partly true, often with significant omissions. It addresses only the investment issues. A separate memorandum is being prepared on the process matters arising from the TPPA-11, and a further memorandum on Treaty of Waitangi issues. Expert reports on a variety of other aspects of the original TPPA-12 can be accessed on www.tpplegal.wordpress.com.

It is important to have the full story now. The Trade Minister has promised to hold a public consultation on the revised deal (renamed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership) before it is signed. That could require a rapid consultation, as Japan has suggested it wants to host the signing in February 2018.

The government has already released statements and a video from the Prime Minister promoting its claims about the agreement. People need to have more accurate information and analysis to assess Labour's claims and participate effectively in the promised consultation.

New Zealand First has consistently and resolutely opposed ISDS, including by promoting a Bill that would bar ISDS from all trade agreements including the TPPA. New Zealand First's supporters need to know the full story so they can hold their party to account.

This memorandum is based on the text of the TPPA-12. The text of the revised agreement is not available, and apparently will not be available until four outstanding matters have been concluded. It's not clear if it will be released before the consultation process begins. Again, that matters. The Trade Minister has said the text remains unchanged from the TPPA-12. That is largely true. The advances he points to involve either the suspension of certain provisions, the adoption of side-letters with individual TPPA-11 governments, or domestic legislation that does not require any changes to the original text.

. After the TPPA-11 ministers met in Vietnam on 9-10 November 2017 they released a statement. It had two annexes. Annex II lists the provisions in the old TPPA that will be suspended, pending any re-entry by the US in the future. These provisions have not been removed from the text; they will only be suspended and can be re-activated.

But there are some important changes to the original text, the details of which remain secret. Another annex to the ministers' declaration (Annex I) lists a number of important new provisions that will replace or add to the old text. The details of these new provisions remain secret.

These new provisions are important. They will explain how the items that have been suspended from the old TPPA-12 will be reactivated if the US seeks to re-join. There are mixed messages: some say the suspended items would automatically become live if the US re-joined, and others say the US would have to 'negotiate' re-entry, allowing some suspended items to remain so. Realistically, the US would only re-enter on terms it could sell to the Congress. Annex I also lists a new provision for future review of the TPPA-11, but there is no indication of the nature and process for that review, when it would occur, and what it might consider. The Prime Minister says it would be after 3 years and could allow the removal of the investor-state dispute settlement (ISDS) provisions. But if the parties could not agree to do that now, the idea they might agree 3 years later is hardly convincing.

A short background to the investment chapter and ISDS

The special rules for foreign investors in the investment chapter and their right to enforce them against governments in ad hoc international tribunals have finally been recognised as a major concern for New Zealand. The investment chapter in the TPPA gives foreign investors from those countries special protections, including the right to be treated like locals (eg the same incentives and no 'Buy Kiwi made' rules), not to be subject to discriminatory rules (eg. not engage in certain activities), not to have the value or profitability of their investment significantly undermined contrary to their expectations when they invested (eg. a major change in regulations), and not have their investment expropriated directly (eg nationalised) or indirectly, by new regulations (eg. zoning restrictions that prevent their activities). These protections are not available to New Zealand investors. There are no corresponding obligations on the investors towards New Zealand.

These rules can be enforced directly by the investor against the New Zealand government, not in our domestic courts but in ad hoc offshore tribunals. There are many concerns about these tribunals: the arbitrators are not proper judges, but are appointed for individual cases; the arbitrators' firms often act for investors, and their rulings in one case may encourage investors to appoint them to future disputes (the TPPA promised conflict of interest rules, but they have not been drafted); there is no system of precedent as in the domestic courts; there is no appeal; they may or may not accept a 3rd party or *amicus* submission; the legal documents may be withheld for confidentiality reasons; the tribunal can award monetary compensation for lost future profits and compound interest, which governments are legally obliged to pay; there is no guarantee governments will recover all their costs even if they win. Often investors threaten or bring an investment dispute to get the government to back off a proposed policy, law or decision (known as the chilling effect).

New Zealand has had relatively limited exposure through its existing agreements prior to TPPA, although the free trade agreement (FTA) with China has the full ISDS process. It is often claimed that New Zealand has never been sued using ISDS, so there is nothing to worry about. Australia said that as well before Philip Morris sued them over plain packaging tobacco. This year four countries have been sued for the first time in ISDS disputes.

The Labour-led government has now accepted that ISDS is, to use the Prime Minister's words, 'a dog'. It has announced there will be no ISDS in future agreements, which presumably includes those under negotiation now, such as the Regional Comprehensive Economic Partnership (with China, India, Japan, South Korea and ASEAN). New Zealand First has long opposed ISDS, and promoted a member's bill that would have prevented it being included in New Zealand's future agreements. That never got to select committee.

The government's new policy brings New Zealand into line with many countries that are refusing to accept ISDS in such agreements. Others have gone further and developed alternatives to ISDS (https://tpplegal.files.wordpress.com/2017/11/investment-precedents.pdf). Some countries require disputes to be resolved in their domestic courts or through mediation, and strike a better balance between foreign and domestic investors, and social and commercial interests. They also more effectively protect the state's sovereignty. By keeping ISDS unchanged in the TPPA-11 the new government has squandered an opportunity to make the agreement genuinely more progressive.

Claim 1: The TPPA-11 is not perfect but it's a lot better than it was.

It is no different from the old TPPA for almost all the investment rules, and the ISDS process is unchanged.

Claim 2: Government is confident it has full ability to regulate for the environment, for health and safety, for labour laws and the public interest

This is a serious overstatement. In fact, there were fewer protections for environment, health and other public interests in the TPPA-12 than in New Zealand's other agreements with ISDS, because the US refused to allow them. The TPPA-11 hasn't taken the chance to strengthen those protections at all. Instead, it has kept the restrictive US wording intact.

In most FTAs, there is a general exception that allows governments to take action for health, environment, public order and public morals, and that applies to the whole agreement, including the investment chapter. It provides weak protection anyway, because it has many conditions that are so hard to meet that the exception has provided a full defence in only 2 of 46 of the WTO disputes where it has been relied on. Yet even that weak general exception doesn't apply to the investment chapter in the TPPA.

Instead, there is a circular provision (Art 9.16) that allows governments to take action for health, environment and 'other regulatory objectives', but only where that action is allowed by the chapter. So it adds nothing. Another provision simply recognises that it's good to ask companies to voluntarily adopt international standards on corporate social responsibility (Art 9.17). There is no obligation or compulsion on the government or the investor to do anything.

That means there are no explicit protections for environment, labour or health for most of the rules that investors use to sue governments. There is one exception. The annex on the rule against expropriation of an investment says actions taken for legitimate public purposes wouldn't amount to an indirect form of expropriation (eg a change to zoning that makes the investor activity impossible or unprofitable). But that is subject to two restrictions: the action in question must treat foreign investors the same as New Zealanders, so no special rules for foreign firms; and actions for public purposes could still be considered an indirect expropriation 'in rare circumstances'. The investment tribunal would decide what amounts to 'rare circumstances'.

Claim 3: The government has got full ability to regulate for taxation

Many taxation measures are still subject to ISDS. The TPPA-11 appears to have suspended the ability to bring ISDS disputes for financial services and investments, including sovereign debt. However, the bullet point in the Annex to the ministers' statement is unclear; it only refers to one of the rules investors might rely on to bring an ISDS claim over financial services or financial investments, which would mean ISDS could still apply for other rules, such as non-discrimination or restrictions on potentially toxic 'new financial services and products'.

ISDS would also still apply to new taxes on non-financial activities or decisions regarding the tax liability of foreign investors, such as online traders, companies seeking to minimise their tax exposure through transfer pricing, windfall taxes on water bottling companies, or legal firms helping to structure investments to use tax havens. The TPPA has very complex exceptions for tax measures that become matters for long and costly legal argument before ISDS tribunals.

Claim 4: The government has further narrowed the effect of ISDS clauses with the total effect that more than 80% of the foreign direct investment coming into New Zealand is no longer covered by ISDS clauses.

This statement by the Trade Minister in the House refers to a side-letter between Australia and NZ not to allow their investors to use ISDS against the other country. This is not new. There is no state-state or investor-state enforcement in the investment protocol to the CER agreement. Previous agreements that include third countries, such as the Australia-NZ-ASEAN FTA have a similar side letter. The same side letter was in the original TPPA-12. The Trade Minister says other TPPA-11 countries might also sign a side letter, but won't say which ones or whether they have agreed.

The reasoning that the side-letter with Australia will minimise the risk to NZ is seriously flawed. Investors are notorious for holding their investments through subsidiaries in countries of convenience where they can take advantage of ISDS. Sometimes they get away with it. Sometimes they don't – but by the time an investment tribunal rules against them, they have used the threat of a case to get the government of the country they are suing, and others who are thinking of adopting similar policies, to back off, and the government will have paid out a lot of money to defend the case. That's what happened when Philip Morris Asia used a Hong Kong investment agreement to sue Australia over its plain packaging law. Australia eventually won, but the costs award has been kept secret. Meanwhile New Zealand and other countries put similar legislation on hold.

The 'denial of benefits' rule (Art 9.15) in the TPPA would make that more difficult, but it is far from perfect and won't deter a determined investor from trying it on.

Claim 5: A dispute over an investment contract between NZ and a company from a TPPA-11 country must be litigated in the New Zealand courts rather than through an ISDS panel.

The government has made a big song and dance about this. Their claim is partly true, but the provision that has been suspended is a side issue. The main rules in the TPPA that protect foreign investors in relation to these contracts, and application of the ISDS process itself, remain untouched.

In the TPPA-12 there were two ways foreign investors could use ISDS against the government over contract disputes that involve natural resources or infrastructure, such as the Waterview tunnel.

Such contracts are included in the definition of 'investment' and subject to the rules in the investment chapter. If the government takes some action in relation to a contract that the investor says breaches the rules non-discrimination, 'fair and equitable treatment' or indirect expropriation, an investor can bring a dispute. Lots of ISDS cases involve such disputes, for example when the government takes action over privatised water or PPP contracts. This is the much more commonly used and has the greatest legal risk. It remains untouched in the TPPA-11.

*A second way allows the investor to enforce the contract itself using ISDS without claiming a breach of the TPPA's investment rules. Under the TPPA-12 it could only do that if the contract did not specify the legal forum in which the contract would have to be enforced. This is the rule that has been suspended. And again, the provision has only been **suspended**, not removed.*

Claim 6: The Treaty of Waitangi exception protects the rights of a New Zealand Government to do anything in the name of the Treaty. … It is not subject to investor-state dispute settlement

The Trade Minister describes the exception as 'a good Treaty clause, which the Waitangi Tribunal has been happy enough with'. Labour actually drafted the exception for the Singapore NZ FTA back in 2000 and it has just been rolled over ever since then. It is true that the Waitangi Tribunal's report on the claim that the TPPA would breach the Crown's obligations under the Treaty, said in relation to the matters it considered under urgency that the Treaty of Waitangi exception provided 'reasonable protection for Maori interests', not 'perfection'.

But there are several problems with the exception that emerged during the Tribunal hearing. First, it applies only to treatment that is more favourable to Maori than to others, and that does not involve arbitrary or unreasonable discrimination. The government decides whether something is a Treaty obligation. But whether a measure meets those other requirements would be decided by an ISDS tribunal.

The exception clearly does not apply to non-discriminatory regulations or decisions of the Crown that are adopted in fulfilment of Treaty obligations. For example, restrictions on offshore mining, revoking rights to capture and export bottled water, new restrictions to protect rongoa or other taonga that don't confer a special benefit on Maori.

Further, the exception does not refer to ISDS (which was subject to the state's consent in the Singapore FTA). It expressly limits the scope of state-state disputes where a Treaty of Waitangi measure is being challenged. But it says nothing about ISDS. The Tribunal expressed concern about the ambiguity (pp.39-41), especially as the ISDS tribunal itself would decide whether it has the power to hear a claim.

The Tribunal expressed particular concerns about the potential for threats of an investment dispute to have a 'chilling effect' on the willingness of the Crown to take certain actions to meet its Treaty obligations:

> "The Crown however goes further and says that nothing in the TPPA will prevent the Crown from meeting its Treaty obligations to Māori. We have some reservations about this. There are two reasons for this. The first is a concern that the Treaty exception clause as presently structured may not encompass the full extent of the Treaty relationship. We agree with [Associate Professor] Kāwharu that not all Crown actions or policies that may be necessary to protect Māori Treaty interests consist of measures that accord more favourable treatment to Māori. … The way the phrase 'more favourable treatment' is used gives rise to some uncertainty as to how the exception will be interpreted and applied. (pp.49-50)
>
> Our second reservation arises from uncertainty about the extent to which ISDS may have a chilling effect on the Crown's willingness or ability to meet particular Treaty obligations in the future or to adopt or pursue otherwise Treaty-consistent measures. (p.50)
>
> The protections and rights given to foreign investors under the TPPA are extensive. The rights foreign investors have to bring claims against the New Zealand Government in our view raise a serious question about the extent to which those claims, or the threat or apprehension of them, may have a chilling effect on the Crown's willingness or ability

to meet its Treaty obligations or to adopt otherwise Treaty-consistent measure. This issue and the appropriate text for a Treaty exception clause for future free trade agreements are matters about which there should, in our view, be further dialogue between Māori and the Crown. (p.x)

The National government ignored the call for further dialogue to review the exception, and tabled the same text in other agreements. The Labour government appears to be following the same line.

Claim 7: ISDS no longer applies to investor screening.

This is a tricky one because the wording of the original TPPA is ambiguous. It would have allowed an investor to use the ISDS mechanism to challenge a government's decision on an 'investment authorisation', without having to claim a breach of one of the rules in the investment chapter (as with investment contracts, per Claim 5). In New Zealand's case an investment authorisation involves the decisions by ministers to grant consent under the Overseas Investment Act 2005.

New Zealand (and Australia, Canada and Mexico) already had an Annex (9-H) in the TPPA-12 that said a decision under the Act to grant or decline consent could not be subject to the Agreement's state-state or investor-state dispute process. That means New Zealand's investment decisions were already excluded from ISDS. The suspension of this provision in the TPPA-11 therefore doesn't add anything new. While Annex 9-H does not refer to the conditions of a consent, just the consent itself, it probably includes both. It is arguable whether the investor can still bring an ISDS case alleging the government breached one of the rules in the agreement (eg. discrimination or unfair process) when it was considering an investment application.

However, Annex 9-H only protects decisions on a specific investment, not broader changes to the criteria the Act requires foreign investors to meet. It would also not apply to other kinds of decisions, for example refusing an investor a resource consent for a mine.

Claim 8: The government has the right to ban foreign purchases of residential housing.

This is the issue the government has made the most of in when claiming that the TPPA-11 meets its pre-election conditions. The answer is quite complicated.

It is true that Labour can restrict foreign purchases of residential housing under the TPPA. But it didn't need to change the TPPA text to achieve that. However, it can only make that change during a very short window before the agreement enters into force. If the TPPA-11 enters into force before it has made those changes to the overseas investment law, it would not be able to introduce further and different restrictions of foreign investment in land (or anything else) in the future.

There is no doubt the National government tried to box Labour in over this issue. Labour made it clear in Opposition that it wanted to ban non-resident purchases of residential property. National could have explicitly excluded residential property from New Zealand's investment obligations, at least for some of the rules, and it chose not to do so. Labour was apparently told by National and MFAT that the TPPA-12 wouldn't allow it to introduce such a ban. It is possible that Labour was being deliberately misled by not being told about the 'window'. Alternatively, National and MFAT may have believed the TPPA-12 would have *come into force before Labour ever became the government, and that would have closed the window on introducing any change to New Zealand's overseas investment law.*

The following provides more detail about what can and can't be done in the future to regulate foreign ownership, especially of land.

New Zealand is allowed to keep the existing overseas investment law that requires foreign investors from TPPA-11 countries to gain approval for certain kinds of investment. But this leeway only applies to the categories of investment that are subject to approval at the time the TPPA-11 enters into force. Those categories are: buying 25% of shares, a business or assets valued over $200 million ($100 million for investments made by "government sources" of other TPPA-11 countries); buying an interest in commercial fishing quotas; or acquisition or control of ***certain categories of land that are regarded as sensitive or that require specific approval under the overseas investment law****. If the law doesn't require approval of a particular category of land at the time the TPPA-11 comes into force, the strict reading of this entry means the government can't add a new category of land that requires approval (there is a schedule of 'sensitive land' under the Act).*

The only right that New Zealand governments retain is to change the ***criteria*** *that apply to those specific categories of land, fish quotas, and shares, businesses and assets. The categories that can be subject to foreign investment vetting are frozen as at the time the TPPA-11 comes into force. The government couldn't require other categories of strategic assets to gain foreign investment approval, such as media, carbon credits, PPP contracts or repositories of New Zealanders' data (unless they were over the $200 million threshold).*

There is another problem. Labour is talks of ***banning*** *foreign purchases of residential property. The window allows it to require foreign investors to seek approval from the Overseas Investment Office for this category of purchase, and it can impose tight criteria that are hard to satisfy. But it must deal with those applications in good faith. It cannot pre-judge all applications and say none of them can be allowed to succeed, ie a ban.*

But there is a further conundrum. The Annex 9-H referred to in regard to Claim 7 would prevent a state or investor bringing a dispute to challenge a decision over purchase of land. The problem facing Labour would seem to be the good faith obligation to comply with the obligations agreed to under the TPPA-11, even though it couldn't be sued if it failed to do so.

In addition, these protections for the foreign investment regime apply only to some of the rules in the investment chapter. They don't apply to the rules that foreign investors use most often to challenge government regulation of their investments. That raises a further tricky question – would the Annex 9-H referred to above prevent such a claim. It is legally arguable either way, which would make it a matter for an investment tribunal to consider.

Those arguments relate to the TPPA. The wording of New Zealand's other agreements is different in small but significant ways. Labour was initially advised there would be a problem with the South Korea and Taiwan FTAs, which would flow on to the China agreement because China's investors are entitled to the best treatment New Zealand gives investors in later FTAs, such as those with South Korea or Taiwan. That problem arose because Labour didn't prevent China from enjoying the benefits of those future FTAs (contrary to the Trade Minister's claim in Parliamentary that the China agreement is so well drafted that it always protected the right of a future government to ban buyers of NZ homes).

Labour now says the advice it was given about the South Korea and Taiwan agreements was wrong. Actually, the legal position is ambiguous: it might allow the government to add to the categories of land that require approval, or it might be limited to changing the criteria for categories that existed when those FTAs came into force. Labour has chosen the interpretation that allows it to introduce the 'ban'. It's not wrong, but it could be challenged.

The government has a bigger legal problem with the Singapore FTA (which the Minister described in Parliament as a 'slight complication'), because that only allows a change in the rules for non-urban land over 5 hectares, or urban land if it is worth over $10 million. It is not clear whether the new government has reached any side-agreement with Singapore on this in the TPPA-11 or will make the changes and take the legal risk that an investor from Singapore sues. That could include an investor from a third country, such as the US or China, that operates its investment in New Zealand through a Singapore subsidiary. Where an investor's home country is a party to both the TPPA-11 and an earlier FTA, the investor can choose whichever is better for its interests. The good news for Labour is that the Singapore FTA (unlike the others) allows the government to block an investment dispute on a case by case basis, so the legal risk can be neutralised.

Claim 8: The model of Pharmac has been protected

According to the government, National protected the Pharmac model, but the TPPA-11 improves on that by suspending provisions that would have increased medicine costs by tens of millions of dollars a year. That shows how narrow Labour and National's idea of 'protecting the Pharmac model' was, as now-suspended provisions could have crippled the health budget and Pharmac's ability to function. Yet they have only been suspended, not removed from the TPPA-11.

Of importance for this memo on investment is that Pharmac's decisions are still open to challenge under ISDS. The definition of an investment includes a patent or license, as well as a business (including a pharmaceutical company or private hospital). There is nothing to stop a pharmaceutical company from bringing an investment dispute against New Zealand for a decision by Pharmac, or to challenge other regulations or even court decisions that have a substantial negative impact on their investments. There are known to have been at least three recent ISDS claims of this kind: one challenged a Canadian court decision that applied Canada's domestic legal doctrines, another is seeking to overturn a decision of Ecuador's Constitutional Court over Viagra, and a third is by Novartis to get Colombia to back off compulsory licensing of a patented medicine.

Australia tried to exclude the Australian Pharmaceutical Benefits Scheme from ISDS in the TPPA-12, but the US refused. It has done so in its revised FTA with Singapore, mirroring the exclusion of tobacco control measures from ISDS in the TPPA. Australia and New Zealand have not insisted on a similar exclusion from the TPPA-11.

Claim 9: The investment chapter is now similar to other agreements New Zealand has signed

This is half true. The investment chapter now looks much more like NZ's existing agreements. But they are far from fine - those agreements also contain the ISDS provisions that Jacinda Ardern called 'a dog'.

The TPPA-11 is worse than New Zealand's previous agreements in a number of other ways. For example, the Chile-Singapore-Brunei-New Zealand agreement (the P4) that was supposedly the precursor to the TPPA-12 had minimal investment rules and no ISDS. The Singapore NZ FTA allows the government to block a Singaporean investor from bringing a dispute on a case-by-case basis; the TPPA-11 doesn't allow New Zealand to say no. As noted above, the US insisted that the general exception doesn't apply to the investment chapter (which it does in NZ's other agreements), and that hasn't changed.

Claim 10: The TPPA-11 provides for a 3-year review, at which time all the parties could agree that ISDS is a 'dog' and should be removed.

There is no such review provision in the TPPA-12. The statement of the TPPA-11 ministers had an Annex setting out the changes to the TPPA-11. It refers to a new Article 6: Review of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (the new branding for the TPPA-11). But that's it. There is no indication of what parts of the agreement this review covers, when it will occur, whether it would only look to further liberalise the existing agreement (as is common with review provisions), what the process would be, whether there must be consensus, etc. The only clue we have is that PM Ardern said it would be after 3 years (presumably 3 years after the TPPA-11 comes into force) and that it could result in agreement to remove ISDS.

It is impossible to assess her statement about the nature and content of the review without more detail about the new text. But it rather defies logic to expect they might agree by consensus to remove ISDS in a 3-year review, when they were unable to reach that consensus now.

Ironically, one factor that might see that happen would be the re-engagement of the US with the TPPA. The US has reportedly proposed that ISDS should be optional for governments in the current revision of the North American Free Trade Agreement (NAFTA). That raises a further irony - the rationale for keeping the TPPA-12 text intact was in case the US sought to re-join!

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