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Joan Claybrook, President

MEMORANDUM

TO: Interested parties
FR: Lori Wallach and Todd Tucker, Public Citizen's Global Trade Watch
DT: September 26, 2006
RE: Peru "free trade" agreement (FTA) would impose new limits on U.S. government ability to keep Dubai Ports World from operating U.S. ports

In July, the Oman Free Trade Agreement (FTA) passed Congress more narrowly than expected after it was revealed that it included obscure terms that would limit the U.S. government's ability to ensure U.S. port security. **Now a Peru "free trade" agreement is headed to Congress with identical provisions providing firms incorporated in Peru with a new right to "acquire and operate" landside port activities *within* the United States. But, the U.S. port security threat posed by the Peru FTA is much more immediate: In June 2006, Dubai Ports World (DPW) acquired a 30-year concession to develop and operate a new terminal at Peru's Callao port**.[1] Thus, as a foreign investor incorporated and operating in Peru, DPW would have immediate standing to use the FTA's foreign investor tribunals if the Peru FTA goes into effect. If Congress passes the Peru FTA, what was a hypothetical scenario under the Oman FTA would become a reality: Dubai Ports World would have a new right to drag the United States to international tribunals to extract cash damages if DPW is denied the right to operate U.S. ports.

That Peru FTA boosters say that the pact would provide no new rights to foreign firms is ludicrous: Currently, the president or Congress can take action to halt acquisition by an enterprise of Peru or Oman of a U.S. port service firm without facing any sanction. (For instance the action Congress took in March 2006 regarding DPW.) Under the FTAs, if the U.S. government denied a firm established and operating in Peru or Oman such access to operate the landside activities of U.S. ports, the foreign company itself would be granted a new right to sue the U.S. government directly in an international tribunal and demand cash compensation for its denied FTA "investor rights."

The claim that such a case before a foreign tribunal would be blocked by an "essential security" exception is equally ridiculous. As described in detail below, the "essential security" exception is a boilerplate exception found in many trade agreements. It can only be raised as a defense – i.e. after a country has been brought before the international tribunal, this exception can be raised as an excuse for why a violation of the agreement should not result in fines being imposed. Bizarrely, USTR has claimed that this exception is "self judging," as if by merely raising this defense the case against the United States would be pre-empted or halted. First, the clause can only be raised in the context of an on-going case, which is to say there is no way to simply pre-empt a case from being filed against the United States and the U.S.

[1] The Dubai-based Dubai Ports World company acquired the Callao Peru concession through the London-based Peninsular and Oriental Steam Navigation Company (P&0), a firm controlled by DPW as of early 2006. DPW/P&O has a 70 percent stake in the Peruvian concessionaire established to run the port operations, which is called *Consorcio Terminal Internacional de Contenedores del Callao* (translated as Callao Containers International Terminal Consortium.) The remainder of the capital comes from the Peru-based Uniport S.A. company. **(***See* "Entregan concesión portuaria en Perú en medio de protestas," *Associated Press*, June 19, 2006; "Peruvian dockers in privatization strike," *Lloyd's List*, June 21, 2006; Luis Jaime Cisneros, "Perú concesiona muelle del Callao para elevar su competitividad," *Agence France Presse*, June 26, 2006; Vanessa Ochoa, "Subscriben concesión del Muelle Sur," *La República* (Peru), July 25, 2006.)

government having to spend resources trying to defend its right to do under the Peru FTA what it can now do without penalty. Second, this very issue of whether "essential security" exceptions are in fact "self judging" has been tested, including in the WTO case against the U.S. Helms-Burton Cuba law. In that case, the WTO convened a tribunal despite U.S. objections that the matter was "foreign policy and national security"-related.[2] Finally, the Peru FTA explicitly lists certain provisions that are NOT subject to the international tribunals and unfortunately, the "essential security" clause is not one of those listed provisions, reinforcing the fact that indeed the "essential security" clause provides only as much of a defense of the U.S. right to keep Peruvian (or Omani) foreign investors out of U.S. ports as an international tribunal decides it does in each specific instance.

Thus, the Peru FTA's imposition of new limits on the U.S. government's ability to exclude certain foreign firms in general and Dubai Ports World in particular from operating ports within the United States raise significant national security concerns. A vote for the Peru FTA is a vote in favor of limiting Congress' ability to ensure the security of sensitive U.S. port infrastructure.

1. <u>How the Peru FTA restricts the U.S. government's ability to deny foreign firms the right to operate U.S. ports:</u> The Peru FTA's service sector and investment chapters include provisions that create an absolute "right of establishment" for "enterprises of a Party."[3] The "right of establishment" is the right to acquire, own, and operate certain services *within* the United States. This FTA "right of establishment" requires the U.S. government to allow firms incorporated and operating in Peru to operate within the United States. The United States made specific commitments in Peru FTA Annex II to extend these new foreign ownership rights to "landside activities" of ports. This includes foreign ownership rights for the very port activities about which Congress expressed national security concerns during the Dubai Ports World debate.

For service sectors, such as U.S. landside port activities, listed as covered by the FTA's rules, the U.S. (or Peruvian) government may not limit "enterprises of a Party" (i.e. firms incorporated and operating in Peru) from owning and operating covered services according to the FTA's "Market Access" provisions. The U.S. government also may not limit the number of such services or the size of such services or require a particular form of ownership (i.e. cannot require U.S. partners.) In addition, the Peru FTA's Most Favored Nation (MFN) rule requires that if the United States allows *any* foreign port-operating firms to operate within the United States (as we do), then the United States is required to allow port firms incorporated in Peru to have the same rights and access as the firms from other foreign countries.[4]

If the Peru FTA were to go into effect, any U.S. government action to deny or limit these new ports-related FTA rights would subject the United States to challenge before UN or World Bank tribunals. These tribunals are comprised of foreign jurists empowered under the FTA to determine if a foreign port operations firm's FTA rights have been denied by U.S. government action and if so to order the U.S. government to pay our tax dollars to the foreign firm to compensate their denied FTA rights.

Generally the service sectors to which the "right to establish" for foreign companies applies in these FTAs are the same service sectors that the United States agreed to bind to the World Trade Organization's

[2] Cited in letter from Reps. Charles Rangel (D-N.Y.), Benjamin Cardin (D-Md.), Sander Levin (D-Mich.), and Xavier Becerra (D-Calif.) to USTR Susan Schwab, dated Sept. 14, 2006.

[3] Peru FTA Article 11.4.

[4] Peru FTA Article 10.4: Most-Favored-Nation Treatment: 1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory. 2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

(WTO) General Agreement on Trade in Services (GATS) in 1994. However, the Peru FTA adds to the U.S. GATS commitments and includes (as covered by the Peru FTA) landside operations of ports.

Annex II of the Peru FTA lists the broadest exceptions from the FTA – areas of policy in which a country reserves the right to establish future policies that conflict with the FTA's obligations. In the Peru FTA, while the U.S. Annex II schedule excludes many categories of maritime-related services so as to allow future policies to be established that would violate the FTA rules, there is a new note to the U.S. maritime exception that explicitly states that many "landside aspects of port activities"[5] are not covered by the exception to the FTA's service sector and investment agreements' terms.

The FTA texts defines this category as: "operation and maintenance of docks; loading and unloading of vessels directly to or from land; marine cargo handling; operation or maintenance of piers; ship cleaning; stevedoring; transfer of cargo between vessels and trucks, trains, pipelines and wharves; waterfront terminal operations;" and more. These are precisely the sorts of activities that the Congress insisted in March not be allowed to come under the operation of the Dubai Ports World company.

Thus, if implemented as signed, the U.S. commitments in the Peru FTA's investment and service sector provisions would immediately provide DPW – as a foreign investor incorporated and operating in Peru -- the right to acquire, own and operate landside port activities in U.S. ports. Thus while the port security issue with the **Oman FTA relied on the hypothetical scenario of an Oman-based DPW subsidiary, Dubai Ports World *already* has a subsidiary in Peru that would be granted the right to establish landside ports operations in the United States if Congress were to pass the Peru FTA.[6]**

The Peru FTA confers its foreign investor rights onto "enterprise[s] of a Party," which includes all firms that are "organized or constituted under the law of that Party."[7] A related clause notes that simply having a post office box does not qualify, but that an enterprise must have some actual presence. Clearly Dubai Ports World's operation of a terminal in a major Peruvian port qualifies. Indeed, probably any firm incorporated in Peru that, for instance, also has a small front office operation – including foreign-owned companies – would gain the FTA's foreign investor and service sector privileges, including the "right to establish" within the United States.

2. **The United States would be subject to challenge before an international tribunal if action was taken to deny Dubai Ports World control of U.S. landside port operations.** Under the Peru FTA, U.S. government actions to halt foreign acquisition of port service operations could be challenged in two fora. Government-to-government dispute resolution would involve the Peruvian government challenging (say, on behalf of a port company such as Dubai Ports World that is an enterprise incorporated in Peru) any U.S. government actions to restrict operation of landside activities in U.S. ports. These cases are not heard in U.S. courts, but in three-person trade tribunals without the normal due process rights guaranteed in U.S. courts. In these cases, each country in the dispute may select one "judge" from its country and then these two tribunalists choose the third "judge" – all from a list of trade experts provided by each country. Among other problems with this system, it results in "judges" with a narrow trade expertise and perspective, including non-U.S. individuals, being empowered to balance competing U.S. interests – for instance in this case balancing our national security needs and our trade commitments to decide which comes first. If a tribunal rules that U.S. policy or practice has violated the FTA's rules, the United States

[5] See e.g. Peru FTA Annex II-US-5: "landside aspects of port activities, including operation and maintenance of docks; loading and unloading of vessels directly to or from land; marine cargo handling; operation and maintenance of piers; ship cleaning; stevedoring; transfer of cargo between vessels and trucks, trains, pipelines, and wharves; waterfront terminal operations; boat cleaning; canal operation; dismantling of vessels; operation of marine railways for drydocking; marine surveyors, except cargo; marine wrecking of vessels for scrap; and ship classification societies."
[6] See footnote 1.
[7] Peru FTA Article 11.14.

must bring the law into compliance or face permanent annual trade sanctions for the amount claimed lost by the other country due to the U.S. policy or practice. In practice, the United States does not allow such sanctions – it changes its laws to comply as it has done with each of dozens of WTO rulings against U.S. law. (Only Europe has ever chosen to face long term trade sanctions. It pays over $150 million annually to keep in place a law banning imports of meat containing artificial growth hormones.)

The U.S. Trade Representative (USTR) might argue that the Government of Peru would not want to pick a fight with the United States over port services after the fireworks around the Dubai Ports World case. However, these provisions are also enforceable through a second venue over which the Peruvian government has no control. The Peru FTA includes what is called "investor-state enforcement." This is a system enumerated in the FTA's investment chapter in which the actual investor/company has the right to privately enforce its FTA rights against the United States.

Under this system, if the Peru FTA was approved, any foreign company incorporated and operating in Peru would have the right to initiate its own enforcement case against the United States at the United Nations' Commission on International Trade Law (UNCITRAL) or the World Bank's International Center for Settlement of Investment Disputes (ICSID) if the United States denied it the right to own and operate land side port facilities. In this system, UN and World Bank tribunalists are empowered to determine if a foreign investor's FTA rights have been denied, and if so to order the U.S. government to pay the foreign company for its lost future profits denied by the U.S. government action or policy. (This system exists under NAFTA and of the 11 cases decided under this system to date, NAFTA country governments have been ordered by tribunals to pay foreign investors over $35 million in disputes concerning land use, construction permits and bans on toxics.)

Under the investor-state enforcement scenario, even if the Peruvian government would not pursue a case, Dubai Ports World could use its Peruvian subsidiary to demand that the United States pay it damages of the expected future profits it would be denied if Congress or the President pressured to undermine its FTA-granted right to operate U.S. ports.

3. <u>The Peru FTA's "essential security" exception does not pre-empt or halt tribunal such challenges</u>: The Peru FTA has the standard boilerplate "essential security" exception included in most trade agreements.[8] This provision can be raised as a defense in the context of an ongoing challenge against a country's law in an international tribunal.

The "essential security" exception literally is only raised *after* a challenge has been initiated. **<u>The "essential security" exception does NOT PREVENT or HALT a Peru FTA challenge.</u>** The existence of the "essential security" clause does not in anyway preemptively foreclose the possibility of a challenge against the United States. If a foreign firm denied the right to acquire port facilities challenged the United States, the "essential security" exception is one of various defenses we could raise. However, a tribunal of foreign jurists gets to decide if our defense is acceptable based on the U.S. revealing evidence of the threat.

Not so, claimed USTR during the debate over the Oman FTA, arguing that the "essential security" exception was a self-judging standard,[9] and that trade panels could not "second guess" U.S. invocation of

[8] Peru FTA Article 22.2

[9] "All of our trade agreements include an article on 'essential security.' Under that article, nothing in an agreement can prevent us from applying measures that we consider necessary for the protection of our essential security interests. This exception is self-judging. The validity of the defense turns on what the USG considers necessary to protect our essential security, not on a tribunal's assessment of our essential security. All the commitments we undertake in a trade agreement are subject to this overarching provision." Quoted from "Free Trade Agreements and the Supply of Services at U.S. Ports," Office of the U.S. Trade Representative, June 2006.

the "essential security" exception.[10] In other words, if Congress or the executive branch were to decide to block Dubai Ports World from using its Peru FTA-granted right to take over U.S. ports, the United States would – so the Peru FTA boosters' story goes – be able to deprive an international tribunal of jurisdiction (or cause the underlying complaint to be automatically resolved in favor of the United States, thereby freeing the United States from its FTA obligations) simply by terming the action as "essential security"-related.

Yet, in fact, Article 21.2 of the Peru FTA explicitly spells out which FTA provisions that are exempted from "second guessing" (review) by trade tribunals. The Peru FTA's "essential security" exception is noticeably missing from the list of provisions not subject to review, meaning invocations of the "essential security" exception are reviewable by FTA-established trade tribunals.

Moreover, in the context of other trade pacts, such as WTO, which have the same boilerplate "essential security" exception,[11] a nation's attempt to raise the security exception as a defense has been deemed reviewable by foreign tribunals in past cases. For instance, in 1996 the European Union brought a WTO case against the U.S. trade embargo of Cuba (codified in the 1996 Helms-Burton Act).[12] While the United States argued that the matter "touches on the foreign policy and national security of the United States," the WTO ignored these objections and established a tribunal to proceed to evaluate the merits of the challenge against the U.S. law on November 20, 1996.[13] The members of the panel were then named by the WTO Director-General on February 20, 1997 over the objections of the United States.[14]

During the Oman FTA debate, when challenged with this WTO precedent, officials from the U.S. Trade Representative's Office ended up admitting that a U.S. invocation of the "essential security" exception could in fact be second guessed and reviewed.[15] The USTR official then switched arguments, noting that "all" the WTO could do is determine that the United States should pay damage to Europe to compensate for keeping our WTO-illegal law in place, but that the U.S. government did "not believe anything the

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[10] Statement of USTR General Counsel Jim Mendenhall, quoted in letter from Reps. Charles Rangel (D-N.Y.), Benjamin Cardin (D-Md.), Sander Levin (D-Mich.), and Xavier Becerra (D-Calif.) to USTR Susan Schwab, dated Sept. 14, 2006.

[11] See, Article XXI of the General Agreement on Tariffs and Trade (a trade pact established in 1947 and administered by the World Trade Organization since 1995.)

[12] *See* John A. Spanogle, Jr., "Can Helms-Burton be Challenged under WTO?" *Stetson Law Review* 27 1997-1998, at 1318.

[13] Communication by the DSB Chairman, Constitution of the Panel Established at the Request of the European Communities, "United States – the Cuban Liberty and Democratic Solidarity Act," WT/DS38/3. (Even in pre-WTO cases, such as Nicaragua's 1985 GATT challenge of the Reagan administration's trade embargo of the country's Sandinista administration, it is clear that international legal opinion believes that essential security claims are reviewable. Because the GATT in 1985 operated under pre-WTO rules that allowed any single country to veto over the convening of a panel, the United States was able to handily block a GATT review of the U.S. embargo of the Sandinista administration. But Japan and other key GATT member countries spoke publicly that they believed that trade tribunals should be able to review any essential security claim. *See* Hannes L. Schloemann and Stefan Ohlhoff, "'Constitutionalization' and Dispute Settlement in the WTO: National Security as an Issue of Competence," *American Journal of International Law*, April 1999, 93:2, at 434, note 61.)

[14] Communication by the DSB Chairman, Constitution of the Panel Established at the Request of the European Communities, "United States – the Cuban Liberty and Democratic Solidarity Act," WT/DS38/3; "U.S. Says It Will Not Participate in WTO Panel on Helms-Burton," *Inside U.S. Trade*, Feb. 21, 1997.

[15] Statement of USTR General Counsel Jim Mendenhall, quoted in letter from Reps. Charles Rangel (D-N.Y.), Benjamin Cardin (D-Md.), Sander Levin (D-Mich.), and Xavier Becerra (D-Calif.) to USTR Susan Schwab, dated Sept. 14, 2006. Meanwhile two bizarre, highly political memos from the Congressional Research Service that purport to discuss these issues do not merit response. In 10 pages of memorandum, the CRS author used some form of the hedge phrase "appear to" in no less than 23 instances, systematically without any legal arguments backing up the bizarrely stated political conclusions. Example: the FTA "does *not appear* [to grant] any type of new business opportunity to Oman or Omani based companies" [italics added]. *See* Todd B. Tatelman, "Legal Issues Related to the Proposed Oman Free Trade Agreement and Port Security," Congressional Research Service Memorandum, July 18, 2006; Todd B. Tatelman, "National Security Issues and the Proposed U.S.-Oman Free Trade Agreement," Congressional Research Service Memorandum, July 19, 2006. Quote taken from July 18 memo, page 1.

WTO says or does can force the U.S. to change its laws."[16] In making that statement, the USTR personnel effectively reinforced the concerns raised about the FTA ports provisions. **The real issue at hand is whether the U.S. government or an international tribunal decides what is in the "essential security" interest of the United States. Given USTR admits that "essential security" claims are reviewable by trade tribunals, a vote for the Peru FTA is a vote to subject the U.S. government's currently unencumbered ability to decide what foreign firms should be allowed to operate in U.S. ports to second guessing by international tribunals empowered to impose trade sanctions if certain firms rights are denied, such as those of DPW which as an enterprise of Peru would have rights to acquire U.S. landside port operations.**

Having established that a tribunal would indeed be empowered under the Peru FTA to review what was considered in the "essential security" interest of the United States, it is worth considering what sort of case the United States could make in the context of Dubai Ports World, an enterprise of Peru.

Peru FTA Article10-4 requires the United States provide foreign investors from Peru the same treatment as we provide port service investors operating in the United States from *any* other country. This Most Favored Nation rule means that because the United States allows many other foreign port firms to operate here, we cannot claim simply that ANY foreign firms in our ports is a security threat and thus we must show a *specific threat* to convince the foreign tribunal we qualify for the "essential security" exception. Thus, the best case scenario under the "essential security" exception is that the United States would spend significant money and reveal national security secrets trying to convince a foreign tribunal that we are justified in violating our Peru FTA obligations and keeping out a foreign firm because we satisfy the requirements of that defense.

However, if, such as in the case of Dubai Ports World in spring 2006, a Committee on Foreign Investments in the United States (CFIUS) review had been completed without a finding of a security threat, there is no doubt that an FTA panel would not permit use of the FTA's "essential security" exception to excuse consequent U.S. government action that interfered with the FTA investor right to establish U.S. port operations. However, the converse is not necessarily true. If a CFIUS review did determine that an acquisition was not in the security interest of the United States, this would not automatically shut down an FTA claim.

First, because the investor initiates these claims and the FTA requires that a government respond within a set amount of time in certain ways, at a minimum even with a CFIUS review to defend its action, the United States would be forced to engage in the process and respond in a UN or World Bank tribunal to a suit and then raise the "essential security" defense. One recent NAFTA investor-state case that was dismissed cost the United States over $3 million in legal fees to get dismissed. Thus, if Congress approves the Peru FTA which includes terms that could conflict with action to block an acquisition recommended by CFIUS or action not recommended by CFIUS (i.e. the DPW case), at a minimum Congress would be exposing us to expensive litigation in UN and World Bank arbitral proceedings to get the case dismissed.

Further, even if there was a CFIUS finding of a national security threat regarding a specific acquisition of an enterprise of Peru, the United States would be required to reveal sensitive information to an international tribunal to prove the merits of its "essential security" exception claim. This is the case because the United States allows foreign companies from *other* countries to establish such operations. This would be deemed discriminatory policy – in technical terms it is a Most Favored Nation violation and the FTA's Investment chapter explicitly provides MFN for a Peruvian enterprise relative to the foreign investors of ANY country allowed to operate in the United States. Thus, to be blunt, by allowing,

[16] Administration official quoted in David E. Sanger, "U.S. Won't Offer Trade Testimony on Cuba Embargo," *New York Times*, Feb. 21, 1997.

for instance, Singaporean port operators in the United States despite known **Al Qaeda** cells in Singapore, the United States makes it very hard for an FTA panel to allow it to use the "essential security" exception absent clear evidence of a direct threat.

Instead of – best case scenario – having to spend millions on a defense at the international tribunal and expose U.S. intelligence information to FTA tribunalists to obtain an "essential security" exception excuse to violate the FTA, why wouldn't Congress insist that the provisions limiting Congress' national security related authority are just snipped out?

4. <u>The Peru FTA does not circumvent Exon-Florio or CFIUS, but rather would subject U.S. government actions to block an acquisition to challenge</u>: Boosters of the Peru FTA (PUFTA) have tried to confuse the issue by declaring importantly that the PUFTA does not "circumvent" the Exon-Florio Amendment or prevent continuing CFIUS reviews of foreign investments. No one has ever claimed such a thing. The problem arises if the government *<u>takes action</u>* to halt, limit or undermine an acquisition by a foreign firm that is "an enterprise of" Peru. It is the action – not the existence of Exon-Florio or CFIUS – that is subject to challenge.

Further, a bizarre set of Congressional Research Service (CRS) memos[17] creates another straw-man and knocks it down, suggesting that those concerned with the FTA threat to port security claim that the FTAs provide a CFIUS "pre-clearance."[18] No one has claimed any such thing. However, a perverse outcome of OFTA is that i*f* CFIUS cleared an investment, as it did with Dubai Ports World, and *then* Congress intervened to halt an acquisition, the U.S. Congress, president and public likely would see our own CFIUS report (finding no evidence of a security threat) being used AGAINST the United States before a World Bank or UN tribunal as evidence that our PUFTA violation cannot be justified by use of the "essential security" exception!

Conclusion

It is politically suicidal to vote for a trade deal that is KNOWN to limit homeland security authority with the HOPE that a foreign tribunal deigns to permit the U.S. government to justify its trade pact violation with a security exception so that we can keep out foreign investors who threaten our security without having to pay millions of tax payers dollars in damages to exercise a right we now have free and clear.

Certainly few in Congress would knowingly vote for any "free trade" agreement that would impose restrictions on future congressional activities regarding national security and U.S. ports.

Thus, it is rather startling that as members of Congress have raised concern about this issue, the main response back from the office of the U.S. Trade Representative is that these provisions were also in CAFTA and the Bahrain Free Trade Agreement. That Congress did not *catch* that USTR changed the coverage of the FTA by changing a few sentences buried in an Annex (for instance the Singapore FTA does NOT provide such rights nor does NAFTA nor the WTO) is hardly a counter-argument for why providing foreign ownership rights over U.S. ports is good policy!

[17] Todd B. Tatelman, "Legal Issues Related to the Proposed Oman Free Trade Agreement and Port Security," Congressional Research Service Memorandum, July 18, 2006; Todd B. Tatelman, "National Security Issues and the Proposed U.S.-Oman Free Trade Agreement," Congressional Research Service Memorandum, July 19, 2006.
[18] Todd B. Tatelman, "Legal Issues Related to the Proposed Oman Free Trade Agreement and Port Security," Congressional Research Service Memorandum, July 18, 2006, at 2.