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RE: Public Interest Analysis of Leaked Trans-Pacific Partnership (TPP) Investment Text

After more than two years of negotiations under conditions of extreme secrecy, on June 12, 2012, a leaked copy of the investment chapter for the Trans-Pacific Partnership (TPP) trade agreement was posted at <http://tinyurl.com/tppinvestment>. Public Citizen has verified that the text is authentic.

The leaked text provides stark warnings about the dangers of “trade” negotiations occurring without press, public or policymaker oversight. It reveals that negotiators already have agreed to many radical terms granting expansive new rights and privileges for foreign investors and their private corporate enforcement through extra-judicial “investor-state” tribunals.

Although TPP has been branded as a “trade” agreement, the leaked text shows that TPP would limit how signatory countries may regulate foreign firms operating within their boundaries, with requirements to provide them greater rights than domestic firms. The leaked text reveals a two-track legal system, with foreign firms empowered to skirt domestic courts and laws to directly sue TPP governments in foreign tribunals. There they can demand compensation for domestic financial, health, environmental, land use laws and other laws they claim undermine their new TPP privileges.

The leak also reveals that all countries involved in TPP talks - except Australia - have agreed to submit to the jurisdiction of such foreign tribunals, which would be empowered to order payment of unlimited government Treasury funds to foreign investors over TPP claims. As revealed in Section B of the leaked text, these tribunals would not meet standards of transparency, consistency or due process common to TPP countries' domestic legal systems or provide fair, independent or balanced venues for resolving disputes between sovereign nations and private investors. For instance, in a manner that would be unethical for judges, the tribunals would be staffed by private sector lawyers that rotate between acting as “judges” and as advocates for the investors suing the governments.

U.S. negotiators are alone in seeking to expand this extra-judicial enforcement system to also allow the use of foreign tribunals to enforce contracts foreign investors may have with a government for government procurement or to operate utilities contracts and even for concessions related to natural resources on federal lands. (Text that is not yet agreed in the leaked text appears in square brackets and Public Citizen has seen a version of the text that lists which countries support various proposals.)

While 600 official U.S. corporate advisors have access to TPP texts and have a special role in advising U.S. negotiators, for the public, press and policymakers, this leak provides the first access to one of the proposed agreement's most controversial chapters. In May, Sen. Ron Wyden, the Chair of the Senate Finance Subcommittee on Trade – *the U.S. congressional committee with jurisdiction over TPP* – submitted legislation requiring that access be provided to members of Congress and their staff after he and his staff were denied access to even the U.S. TPP text proposals submitted during negotiations.

The TPP may well be the last trade agreement that the U.S. negotiates. This is because the TPP, if completed, would have a new feature: it would be open for any other country to later join. TPP offered an opportunity to develop a new trade agreement model that could deliver the benefits of expanded trade without undermining signatory nations' domestic public interest policies or establishing special privileges for foreign corporations. President Obama campaigned on fixing these investment rules to protect the public interest.¹ Unfortunately, Public Citizen's analysis of this text shows that the U.S. positions do not reflect the changes that candidate Obama pledged to remedy this regime's threats.

Indeed, the leaked text shows that TPP would expand on the extreme investor privileges found in the North American Free Trade Agreement (NAFTA) and subsequent NAFTA-style deals. These investor privileges have come under attack for threatening public health, the environment, democratic policymaking, and for favoring foreign firms over domestic firms. Over \$350 million has been paid to investors by governments under the investor-state provisions in NAFTA alone investor over toxic waste dump permits, logging rules, bans of toxic substances and more.² Currently, there are over \$13 billion in pending corporate "investor-state" trade pact attacks on domestic environmental, public health and transportation policy. And, mere threats of such cases have repeatedly resulted in countries dropping important public interest initiatives, exposing their populations to harm that could have been avoided. Yet the leaked text shows that while TPP countries have agreed to impose binding obligations on themselves to provide foreign investors an array of extraordinary new privileges, the TPP countries have not agreed to health, labor or environmental obligations to be required of investors.

The goal of such international investment rules was ostensibly to provide a means for foreign investors to obtain compensation if a government expropriated their plant or land and the domestic court system did not provide for compensation. Over time, both the rules and their interpretation have been dramatically expanded – a problem that the leaked text shows that the TPP would exacerbate.

Rather than being an option of last resort, corporations' use of the investor-state regime is increasing exponentially. Investment treaties with such enforcement mechanisms have existed since the 1950s. Yet, by 1999, only 69 cases had ever been filed at the International Centre for the Settlement of Investment Disputes (ICSID) - the World Bank body listed as a venue for investor cases in the leaked text. Now ICSID's cumulative case load is over 385 - an increase of 460 percent over the last 13 years. And ICSID is only one venue for such cases. Over \$719 million has been paid out under U.S. Free Trade Agreements (FTAs) and Bilateral Investment Treaties (BITs) alone - 70 percent which are from challenges to natural resource and environmental policies, not traditional expropriations. Tobacco firms are using the regime to challenge tobacco control policies, including a case by Phillip Morris against Australia. Absent substantial changes to the leaked text, TPP would greatly increase the number of investor-state attacks on public interest policies and would expose governments to massive new financial liabilities.

Trade officials from the U.S. and eight Pacific Rim nations – Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore and Vietnam – are in intensive, closed-door negotiations to finish the TPP *this year*. This initial analysis explores the major problems with the alarming draft TPP investment chapter, and what has changed and what is the same relative to past U.S. trade deals.

¹ See e.g. <http://www.citizenstrade.org/ctc/activist-resources/president-barack-obama-on-trade-issues/>

² See <http://www.citizen.org/documents/investor-state-chart1.pdf>

The TPP text replicates the worst aspects of the old U.S. trade pact investment model:

There are many provisions in the leaked TPP investment chapter text that replicate (identically or almost so) the damaging NAFTA investment chapter model. These provisions are so extreme that many people unfamiliar with them tend to dismiss description of them or their implications. Thus, we provide a guided tour of the text so readers can review the provisions themselves. Among the rights granted to foreign investors that are showing a repeat performance:

- **A right to challenge capital controls and other macro-prudential financial regulations that promote financial stability** (Article 12.11). Like past U.S. FTAs, the leaked TPP text requires that governments “shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory.” This forbids countries from using capital controls or financial transaction taxes, even as the International Monetary Fund has reversed its opposition to the use of capital controls following the global financial crisis. U.S. Representatives Barney Frank (D-Mass.) and Sander Levin (D-Mich.) – respectively, the ranking members on the House Financial Services and Ways & Means Committees – demanded that the Obama administration ensure that countries maintain the ability to use such financial stability tools in a May 2012 letter to the Obama administration, which noted that they could not support a TPP unless this issue was addressed. A February 2012 letter signed by over one hundred prominent economists, including Jagdish Bhagwati of Columbia University and former IMF officials Olivier Jeanne of Johns Hopkins University and Arvind Subramanian of the Peterson Institute for International Economics, demanded that such provisions be excluded from TPP. This followed on a January 2011 letter to the Obama administration signed by over 250 economists, including Nobel laureate Joseph Stiglitz, Harvard economics professors Ricardo Hausmann and Dani Rodrik, and José Antonio Ocampo (a former executive secretary of the UN Economic Commission on Latin America and the Caribbean and Colombian government economics minister), noting that past U.S. FTAs and BITS “strictly limit the ability of our trading partners to deploy capital controls.” Yet the TPP leaked text shows that the U.S. has not budged on the past template, while several other nations have proposed provisions that could safeguard policy space for financial stability measures.
- **An overreaching definition of “investment” that goes far beyond “real property” as defined under domestic law would expose wide swaths of common domestic policy to attack under TPP.** The definition of “investment” in the leaked text would allow attacks on a vast array of non-discriminatory domestic policies before foreign tribunals. This includes health and land use policies, government procurement decisions, regulatory permits, intellectual property rights, regulation of financial instruments such as derivatives, contracts to operate utilities and more (Article 12.2). The new rights and protections would extend to investments already existing before TPP would go into legal effect.
- **Overreaching definition of “investor” and lack of robust “denial of benefits” provisions allow firms from non-TPP countries to exploit the extraordinary privileges TPP would establish for foreign investors and the private investor-state enforcement regime.** The text also includes an overreaching definition of “investor” as a person or legal entity that makes an investment as defined in the pact (Article 12.2). This includes firms from non-TPP countries that have incorporated in a TPP signatory country. Thus, for instance, one of the many Chinese state-owned corporations in Vietnam could sue the U.S. government in a foreign tribunal to demand compensation under this text. Additionally, the leaked text fails to require in the definition of “investor” that a person or entity have actual business activities or make a significant commitment

of capital in the host country. This has proved to be a serious problem in past pacts, with firms that have made no real investment in a country dragging governments through costly foreign tribunal proceedings. Past trade deals include terms whereby an investor that is not native to a nation in the pact can be denied the benefits of the deal. The ostensible goal is to discourage “free riding” and “treaty shopping” by multinational firms. The thresholds to counter abusive nationality planning are whether an investor has “substantial business activities” in the claimed home nation, and whether it is owned or controlled by investors outside of the trade pact signatory countries. However, such “denial of benefits” terms are not particularly robust, since even having a staff person or two and a minor paper trail in the claimed home country can pass the “substantial business activities” threshold. These low thresholds are replicated in the TPP text, allowing Chinese or German investors (for instance) to channel investments through TPP nations in order to obtain the radical TPP foreign investor protections and access to the private enforcement regime.

- **Procedural rights that are not available to domestic investors to sue governments outside of national court systems, unconstrained by the rights and obligations of countries’ constitutions, laws and domestic court procedures** (Section B). There is simply no reason for foreign investors to pursue claims against a nation outside of that nation’s judicial system, unless it is in an attempt to obtain greater rights than those provided under national law. Moreover, many of the TPP partners have strong domestic legal systems. For example, TPP partners New Zealand, Australia and Singapore are all ranked by the World Bank as performing at least as well as the United States with regard to control of corruption and adherence to rule of law. Yet in a manner that would enrage right and left alike, the private “investor-state” enforcement system included in the leaked TPP text would empower foreign investors and corporations to skirt domestic courts and laws and sue governments in foreign tribunals to demand cash compensation from domestic Treasuries over domestic policies that they claim undermine their new investor rights and expected future profits. This establishes an alarming two-track system of justice that privileges foreign corporations in myriad ways relative to governments or domestic businesses. It also exposes signatory countries to vast liabilities, as foreign firms use foreign tribunals to raid public treasuries. The explosion in investor-state attacks has produced rising concerns. A letter signed by former judges, law professors and other prominent lawyers from TPP nations warns: “the foreign investor protections included in some recent Free Trade Agreements (FTA) and Bilateral Investment Treaties (BIT) and their enforcement through Investor-State arbitration should not be replicated in the TPP. We base this conclusion on concerns about how the expansion of this regime threatens to undermine the justice systems in our various countries and fundamentally shift the balance of power between investors, states and other affected parties in a manner that undermines fair resolution of legal disputes.”³
- **The foreign tribunals would be staffed by private sector lawyers who rotate between acting as “judges” and representing corporations suing governments, posing major conflicts of interest.** The leaked text includes provisions that submit signatory countries to the jurisdiction of both World Bank and United Nations investor arbitral tribunals staffed by private sector attorneys. The international tribunals that currently rule over investor-state claims lack public accountability, standard judicial ethics rules and appeals processes. In this system, private sector lawyers rotate between roles as “judges” in disputes brought by investors against governments and as advocates for investors against governments in a manner that would be unethical for judges. The corporation

³ See <http://tpplegal.wordpress.com/>

initiating a case chooses the venue and selects one of the “judges” from a roster. The defending country chooses another and those two select the third (Article 12.21).

- **Foreign tribunals empowered to order governments to pay unlimited cash compensation out of national treasuries.** Even when governments win these cases, they waste scarce budgetary resources defending national policies against these corporate attacks, as taxpayer funds must be used to pay large hourly fees for the tribunals and legal costs (Article 12.28).
- **Investors can demand compensation if new policies that apply to domestic and foreign firms alike undermine foreign investors’ “expectations” of how they should be treated.** This includes a right to claim damages for government actions (such as new environmental laws) that reduce investors’ expected future profits (Article 12.12 on indirect expropriation) or that go against the expected level of regulatory scrutiny that an investor might have had when dealing with a previous government (Article 12.6 on minimum standard of treatment, or MST). After a series of alarming NAFTA investor-state rulings based on language replicated in the leaked TPP text, an annex was added to recent U.S. FTAs with language aimed at defining what sorts of government action should be considered an “indirect expropriation.” This annex, which has been criticized as insufficient given it would still allow challenges based on mere changes to governments’ regulatory policy, included a useful provision: “For greater certainty, whether an investor’s investment-backed expectations are reasonable depends in part on the nature and extent of governmental regulation in the relevant sector. For example, an investor’s expectations that regulations will not change are less likely to be reasonable in a heavily regulated sector than in a less heavily regulated sector.”⁴ This is omitted in the leaked TPP investment text. However, even if this clause were included, investor-state tribunals would maintain enormous discretion under the investor protections included in the leaked text to order a government to pay a foreign investor merely because the government improved a regulatory policy of general application. Indeed, the inclusion of the NAFTA language on guaranteed minimum standard of treatment for foreign investors and the rights for compensation of indirect expropriation directly contradicts the assurances TPP governments have given to legislators and public interest advocates that the pact would safeguard regulatory sovereignty. In fact, inclusion of these terms in a TPP would provide abundant opportunities for investor challenges of laws applying to both domestic and foreign firms and enormous discretion for investor-state tribunals to order governments to compensation foreign investors for challenges of such policies.
- **Right to claim compensation for indirect expropriation allows foreign investors to demand government payments for regulatory costs all firms operating in a country must meet.** In the past under domestic and international law, governments’ obligation to compensate for expropriation applied to the physical taking of real property, for example when a government expropriated a house to make way for a highway. The leaked TPP text would provide investors with a right to demand compensation for “indirect” expropriation (Article 12.12), which can be and has been interpreted to mean regulations and other government actions that merely *reduce* the value of a foreign investment. Under the U.S. Constitution, compensation for “regulatory takings” has generally been held to apply only to regulations affecting *real* property. For example, the U.S. Supreme Court has indicated that personal property is unlikely to be the basis for a successful

⁴ See e.g. U.S.-Korea Free Trade Agreement Annex 11-B

http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file587_12710.pdf

regulatory takings claim given that “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 regulation might even render his property economically worthless.”⁵ Moreover, the indirect expropriation provision in investment agreements has been interpreted to require compensation based on the impact of the government measure on the value of an investment, regardless of whether there has actually been some appropriation of an asset by a government. This interpretation of indirect expropriation cannot be justified as reflecting the general practice of states, given that the dominant practice of nations is to provide for compensation only when the government has actually acquired an asset, not when the value of an asset has been adversely affected by regulatory measures. (For analysis of changes proposed for TPP relative to past pacts on expropriation, see the next section of this memo).

- **The provision used in most successful investor compensation demands would be extended.** The most successful (and controversial) basis for investors’ challenges of government policies in past agreements is alleged violations of the guaranteed minimum standard of treatment for investors or the closely linked “fair and equitable treatment” (FET) provision (Article 12.6). These terms often have been given very broad interpretations by tribunals. Of the 22 known “wins” by investors under U.S. trade and investment agreements, nearly 75 percent (16) have found FET violations. (In contrast, only six have found national treatment violations, three have found expropriation violations, and three have found performance requirement violations. Some cases found violations of multiple rules.) While some of the FET violations involved “denials of justice” as that term has long been understood under customary international law, some tribunals have found FET violations for government regulatory actions that simply contradicted what investors’ argued were their “reasonable expectations.” For instance, in the *Occidental v. Ecuador* case under the U.S.-Ecuador BIT, a tribunal ruled that the reasonable expectations requirement means that “there is certainly an obligation not to alter the legal and business environment in which the investment has been made.” The TPP includes nothing to forestall these extreme interpretations. Instead, the leaked text includes an annex contained in recent U.S. FTAs that states that the minimum standard of treatment provision is intended to reflect the relevant standard under customary international law, which is created through the “general and consistent practice of states followed by them from a sense of legal obligation.” This circular language does not fix the problem. Past investor-state tribunals have not based interpretations of the “minimum standard of treatment” on the *actual* practice of nations, but rather have simply cited characterizations of these standards by other tribunals, using essentially a common law methodology to create “evolving” standards of escalating investor protection. The TPP fails to remedy this severe flaw, leaving uncertainty and unpredictability that invites investors to launch investor-state attacks.
- **Domestic policies that apply equally to domestic and foreign firms can violate investors’ TPP rights.** The TPP text would allow investors to claim that government actions (such as new environmental laws) violate “national treatment” or “most favored nation” rules, even when the laws are facially neutral and lawmakers did not intend to harm foreign investors – if, because of a foreign investors’ own business model, the foreign firm might end up experiencing a slightly higher burden in complying with the law (Article 12.4 and 12.5).

⁵ *Lucas v. South Carolina Coastal Comm’n*, 505 U.S. 1003, 1027-28 (1992).

- **No general exception to safeguard environmental, health, labor and consumer protection policies.** Some trade agreements (although not U.S. bilateral deals) allow deviations from the substantive obligations of the agreement if a country is pursuing environmental, labor or consumer protection policies. The leaked TPP text reveals that such a safeguard is not included. Instead, the leaked TPP text includes the standard annex on expropriation, noted above, that has been included in recent past U.S. pacts. It includes language that explicitly allows for some circumstances when “non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, the environment, and real estate price stabilization (through, for example, measures to improve the housing conditions for low-income households)” can constitute indirect expropriations.”⁶ As described below, other countries have proposed alternative language for such an annex.

What’s new, different or worse relative to the NAFTA model:

In addition to replicating word-for-word terms that have led to a series of extrajudicial attacks on public interest laws in the past, the leaked TPP investment text reveals that:

- **U.S. negotiators in particular are pushing especially extreme rules.** For example, U.S. negotiators alone are pushing for foreign investors to have greater rights than domestic investors with respect to disputes relating to procurement contracts with the signatory governments, contracts for natural resource concessions on land controlled by the national government and contracts to operate utilities (See Articles 12.2 and 12.18(1)(a)(i)(B-C)). The U.S. alone seeks to allow disputes over such matters between foreign firms and governments to be resolved in investor-state tribunals rather than requiring foreign firms to use the same domestic laws and courts to which domestic firms would bring such disputes. All countries except the United States want initiation of a case under the extraordinary investor-state system to be possible only six months after formal notice of request for consultations on the dispute. The U.S. seeks a start date for such challenges to be six months after the *government action* giving rise to the claim (Article 12.18.1), inviting a swarm of rapid investor challenges.
- **Australia alone has indicated that it will not be subjected to the jurisdiction of controversial foreign investor tribunals** where investors are allowed to sue governments outside of their domestic court systems to demand payment of damages over domestic policies that undermine investors’ expected future profits or changes to regulatory policies of general application (See footnote 20). No other country has listed an objection to being subject to the private investor-state corporate enforcement regime. This would impose new obligations for New Zealand, Malaysia, Brunei and Vietnam – the countries involved in TPP negotiations that do not now have U.S. FTAs.
- **Several countries have proposed new exceptions to safeguard countries’ ability to regulate speculative financial transactions and more,** but the United States has not supported these proposals. Several countries are proposing a defense measure that would partially exempt social security systems from investor challenges under the free transfers obligations. (See Articles 12.5, 12.11.4(f), and XX.3 (on final pages), Article 12.5 and Annex 12-I)

⁶ See e.g. U.S.-Korea Free Trade Agreement Annex 11-B

http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file587_12710.pdf

- **A clarification included in past U.S. FTAs designed to limit investors' claims that mere changes to a government policy constitute an indirect expropriation that must be compensated is omitted.** Most U.S. FTAs include an annex clarifying that whether a so-called "indirect expropriation" has occurred for which an investor can obtain compensation depends on the character and economic impact of the government action, and whether the action interferes with investors' expectations. As noted above, the Korea FTA had included an important clarification in a footnote that an "investor's expectations that regulations will not change are less likely to be reasonable in a heavily regulated sector than in a less heavily regulated sector." This is omitted.
- **Several countries have sought provisions to ensure that disputes related to sovereign debt and sovereign debt restructuring are not subject to the full range of investment chapter disciplines** (See Article 12.2(Definition of Investment at c), footnote 2 and Annex 12-K).
- **The U.S. has not agreed to federalism protections proposed by other countries and included in past U.S. FTAs.** Among the obligations in the leaked TPP text and in past U.S. FTAs is "National Treatment," which requires that foreign investors are treated the same as domestic investors. Past U.S. FTAs have specified that, with respect to sub-federal laws, equal treatment for foreign firms means that they must be treated as favorably as the subfederal entity would treat a domestic firm. That is to say that a state or provincial law would not be in violation of the National Treatment standard simply because it provides less favorable treatment than, for instance, another state or province's laws or the national law. While some TPP countries have supported inclusion of this provision in TPP, the U.S. has not done so. (See Article 12.4.3).
- **Some parties have proposed that the extraordinary investor-state enforcement system can only be triggered if an investor can show that a government action "causes loss or damage to an investor or its investment," but this has not been supported by the United States or several other countries** (Article 12.17.1). Whether this language would successfully foreclose frivolous investor claims, for instance claims aimed at pressuring a government to eliminate a policy that cannot be shown to actually cause economics damage to an investor, is an open question. However, the underlying problem that the language seems designed to address is very real. The standards an investor must meet in Section B (which describes the investor-state enforcement system) to initiate a demand for compensation are minimal. Given the tribunals' private sector lawyers bill by the hour at high rates and the government and the investor generally must split these costs regardless of the outcome of a case, the mere filing of a case and the related prospect of having to pay the tribunal costs has a chilling effect on government actions.
- **Several TPP countries are pushing for various novel "exhaustion" requirements to require investors to pursue mediation or domestic administrative review before launching an investor-state case (Article 12.17). The U.S. is not supporting the stronger versions of these so-called exhaustion requirements, which is a fundamental principle of international law. It is also U.S. policy with regard to most claims by U.S. citizens against foreign governments.**
- **Some TPP parties are pushing for a wholly different annex to limit expropriation claims (Annex 12-D) to replace the standard U.S. expropriation annex.** This alternative annex is an improvement, but still problematic. It says that an indirect expropriation only occurs when the state's deprivation of the investor's property is either severe or for an indefinite period; and ... disproportionate to the public purpose, and is especially likely when the measure is discriminatory or breaches a state's prior binding commitment to the investor, including in a contract or license.

However, one country is proposing stronger language that would state simply that “non-discriminatory regulatory actions ... that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety and the environment do not constitute indirect expropriation.” The U.S. does not appear to be supporting the much clearer and categorical protection for the public interest.

- **Weak environmental language:** The TPP includes the self-cancelling “Investment and Environment” language of past U.S. FTAs that states that “Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure *otherwise consistent with this Chapter* that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental” concerns. However, as the italicized portion makes clear, this is only a defense against government actions that do not violate the chapter’s substantive obligations, so it’s not much of a defense. One country, however, is proposing an additional paragraph to this text that reads: “The Parties recognise that it is inappropriate to encourage investment by relaxing its health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion, or retention in its territory of an investment of an investor.” It appears that the U.S. is not supporting this positive (albeit hortatory) language. (See Article 12.15)
- **Who is an investor?** Like past FTAs, the definition of “investor of a Party” is limited to those investors that have made or are “attempting to make” an investment. Unlike past FTAs, the “attempts to make” threshold is defined as when “that investor has taken concrete actions or actions to make an investment, such as channeling resources or capital in order to set up a business, or applying for permits or licenses.” This truly is the bare minimum of what should constitute a protected investor, and it is shocking that an investor that didn’t meet that threshold might have been protected under past FTAs.
- **Some TPP parties are proposing a new article that makes a hortatory reference to encouraging corporate social responsibility.** The U.S. is apparently not supporting even this hortatory language. (Article 12.15 *bis*)