Legal Times

WEEK OF March 8, 2004 • VOL. XXVII, NO. 10

Who Will Decide for Us?

Our trade agreements are undermining the principle of an independent federal judiciary.

BY JOHN D. ECHEVERRIA

The future direction of the judicial branch arouses fierce debate. The president and Congress are battling over their relative roles in determining the composition of the federal bench. Increasingly partisan state judicial elections spawn calls for electoral reform. In the midst of these discussions, however, the potentially most dramatic transformation of the judicial branch has gone virtually unnoticed: the establishment of special litigation processes applicable only to foreign investors.

These so-called investor-state litigation processes are an increasingly common feature of U.S. trade agreements, including the North American Free Trade Agreement and many other recently adopted and pending compacts. Because they could fundamentally change the judicial function within the U.S. system of government, they are almost certainly unconstitutional. It's time to address this latest threat to judicial independence.

GROWING PROCESS

Under the litigation procedure provided for in most modern trade agreements, foreign investors can sue the U.S. government for monetary relief based on any government action (federal, state, or local) that they believe is illegal or discriminates against foreign businesses under international legal standards, and that reduces the value of their U.S. investments. Likewise, U.S. investors in other countries that are party to such agreements can sue those national governments. Cases are heard by three-member arbitration panels, largely made up of international commercial lawyers.

While relatively unfamiliar to most U.S. lawyers, this process dates back several decades to a number of bilateral investment treaties that the United States signed with lesser-developed countries. While the process runs both ways, for years it generated litigation only against the other countries, because they had so few citizens with significant investments in the United States.

All that changed with NAFTA, a 1994 trade agreement among the United States, Canada, and Mexico. Because Canadians and Mexicans do have substantial investments here, a number of claims have been filed against this country, based on everything from state drinking-water protections to "Buy America" provisions in federal procurement rules. Most surprising, NAFTA panels have even ruled that judgments of state courts (and, by inference, federal courts) are subject to challenge.

So far, no claim against this country has succeeded. But most observers think it's only a matter of time. The risk continues to increase as U.S. trade negotiators work to create a worldwide network of agreements including this investor-state process.

Congress has given remarkably little attention to the implications of this rapidly evolving international system. Abner Mikva, former chief judge of the D.C. Circuit, former congressman, and a current panel member, has declared, "None of the people who voted for NAFTA in Congress had any clue there was an arbitration clause of this magnitude."

Moreover, the investor-state process has, at most, a tangential relationship to core free-trade concerns. Free trade has traditionally meant elimination of tariffs and other barriers to the exchange of goods and services across national borders. The investor-state process, by contrast, is directed at purely domestic regulations and other programs. The latest proposed trade agreement, with Australia, omits it entirely, demonstrating that the free-trade agenda can proceed without it.

Critics have expressed concern that the process will accord foreign investors greater rights in the United States than U.S. investors have—because the agreements' substantive legal rules will be interpreted expansively, or because the panels will exhibit a pro-investor bias. The upshot will be an erosion of government authority to regulate and take other actions to protect the public welfare.

While such concerns are entirely appropriate, the more basic question is whether this new litigation process can be squared with U.S. constitutional traditions.

© 2004 ALM Properties Inc. All rights reserved. This article is reprinted with permission from Legal Times
(1-800-933-4317 • subscriptions@legaltimes.com • www.legaltimes.com).

CONSIDER ARTICLE III

The specific issue is whether the investor-state litigation process violates Article III, which requires that the judicial power of the United States be vested in an independent judiciary with life tenure and guaranteed salary. Our independent federal judiciary is central to our system of government. It helps prevent "the accumulation of all powers . . . in the same hands," which *The Federalist No. 47* termed "the very definition of tyranny." By providing a check on the executive and Congress, it also protects states' authority.

For these reasons, the Supreme Court has struck down judicial delegations that violate Article III, as when the Court in 1982 declared the federal bankruptcy courts unconstitutional (as then structured). Does the investor-state procedure deserve the same fate?

In the investor-state process, panel members hearing claims against the United States are appointed just for that one case, and therefore lack the tenure and salary protection of Article III. Also, they are appointed by executive branch officials, without any congressional involvement, or by representatives of other countries. Therefore, if the panels are exercising the Article III "judicial power," which "extend[s] to all Cases . . . in which the United States shall be a party," they are plainly unconstitutional.

The importance of this legal question has been recognized by, among others, Justice Sandra Day O'Connor, who wrote a few years after NAFTA's adoption: "Article III of our Constitution reserves to federal courts the power to decide cases and controversies, and the U.S. Congress may not delegate to another tribunal 'the essential attributes of judicial power.' Whether our Congress has done so with respect to tribunals created by different treaties and agreements is a critical question."

In the past, the Court has said that not every assignment of judicial responsibilities to non-Article III officers is unconstitutional. The key issue is whether such delegation undermines "the constitutionally assigned role of the federal judiciary." The Court has identified three factors to consider:

• *Scope of the delegation.* Is the non-Article III tribunal restricted to a particular subject or does it have broad-ranging jurisdiction? The broader the tribunal's authority, the greater the likelihood of a violation of Article III.

Under any view, the investor-state litigation process represents a very broad delegation. Panels can consider claims based on almost any federal, state, or local government regulation or other action that affects business or investment activity.

Also relevant here is the standard of review applied to panel decisions by domestic courts. While panel decisions can potentially be set aside for abuse of authority or fraud, domestic courts cannot correct errors of fact or law. Thus, the panel decisions, where they are subject to review by U.S. courts at all, are reviewed under the lightest standard.

• *Importance of the claim.* Is the legal claim being adjudicated important? The Supreme Court has been relatively receptive to delegations of judicial power to adjudicate rights created by a specific statute. It has been less willing to accept delegation of common law or constitutional disputes.

The legal claims addressed in the investor-state process are certainly important. Panels determine whether government actions breach sweeping investor protection standards, including requirements for "national treatment" and "fair and equitable treatment," and against "expropriation." While the terminology may be unfamiliar, these standards mirror—and are just as important as—cardinal constitutional provisions, including the equal protection clause, the due process clause, and the takings clause, respectively.

• *Purpose of the delegation.* What is the pragmatic purpose for the delegation of judicial power? For example, the Supreme Court approved non-Article III courts for U.S. territories on the theory that the courts would be temporary. It has also allowed non-Article III officers to hear certain common-law claims to facilitate the implementation of federal regulatory programs.

The pragmatic case for the investor-state process is weak. No one attempts to justify it on the ground that U.S. courts do not provide foreign investors a generally fair and impartial venue. Rather, defenders contend that subjecting the United States to this process is the quid pro quo to allow U.S. investors to circumvent other countries' domestic courts.

In fact, the United States need not abandon its commitment to an independent judiciary in order to promote U.S. investments abroad—even assuming that circumventing, and thereby undermining, foreign courts is in U.S. long-term interests. The United States could offer up something else—lower agricultural subsidies, perhaps—in exchange for U.S. investors' access to a special litigation process. Furthermore, the United States' considerable diplomatic clout is always potentially available to help resolve U.S. businesses' disputes with other countries.

THE STATES' CHALLENGE

Assuming that the Supreme Court would recognize the constitutional problems, one still might ask how an Article III challenge could make its way there, given that both investors and the executive branch (under Republican and Democratic administrations) have so far supported the investor-state litigation process. One possibility is that a state whose laws or regulations are being attacked could raise the issue.

Certainly the conduct of investor-state proceedings and the risk that claims could succeed impose a real burden on a state. The state's attorney general must devote manpower and resources to assist the United States in defending the claim. A determination that a trade agreement has been violated would seem to support a suit by the United States to pre-empt state law. And, although liability is imposed only on the United States, a major award based on a state law would, as a practical matter, likely make it impossible for the state to continue to implement the law.

Thus, states would appear to have standing to seek a declaration in federal court that the investor-state litigation process violates Article III. When and if a state takes up this challenge, the conclusion will almost certainly be that the investor-state process is unconstitutional. As the Supreme Court said in *Immigration and Naturalization Service v. Chadha* (1983), the mere fact that some view an arrangement as "efficient, convenient, and useful . . . will not save it if it is contrary to the Constitution."

John D. Echeverria is executive director of the Georgetown Environmental Law & Policy Institute at Georgetown University Law Center. He can be reached at echeverj@law.georgetown.edu.