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Foreign Investment in the United States

Todd Weiler

Nancy L. Perkins

Frank J. Schuchat

Melissa R. Kaufman

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TODD WEILER, NANCY L. PERKINS, FRANK J. SCHUCHAT, MELISSA R. KAUFMAN, RICHARD L. GOLDMAN, AND HENRY M. BURWELL*

I. NAFTA Investor-State Dispute Settlement Gains Steam

The year 2000 witnessed an increase in the frequency and importance of North American Free Trade Agreement (NAFTA) investor-state claims involving U.S. investors in Canada and Mexico, and Canadian claims against the United States. During 2000, two NAFTA tribunals rendered final merits awards in favor of claims made by U.S. investors, and a significant number of procedural orders and jurisdictional awards were also made by various tribunals during 2000. One tribunal even heard the first application by non-parties to intervene in investor-state proceedings.[1]

As a result of the many awards and procedural orders that have emanated from these independent, ad hoc tribunals, many NAFTA provisions have received their first interpretation and a number of fundamental procedural issues have been addressed. This short article reviews the most notable procedural issues that arose before NAFTA tribunals in 2000, and then outlines what those tribunals have said about two of the substantive provisions of the NAFTA.

A. TRIBUNAL COMPOSITION

In its November 2000 merits award, the Tribunal in *S.D. Myers, Inc. v. Canada*[2] (the *Myers* Tribunal) noted that its composition changed as a result of a challenge by the investor

*Todd Weiler advises governments, investors, and their counsel on NAFTA investor-state arbitration matters and on international trade law and policy. Nancy L. Perkins is a special counsel with Arnold & Porter in Washington, D.C.; her practice focuses on international trade and investment; she also represented Argentina in the arbitration discussed in Part II. Frank J. Schuchat, partner, and Melissa R. Kaufman, associate, are with Ireland, Stapleton, Pryor & Pascoe, P.C., in Denver, Colorado, practicing international law, import and export law, technology transfers, and corporate law. Richard L. Goldman is a partner with Goldman & Gladstone in New York, concentrating on international tax and trusts and estates law; he is a past president of the International Fiscal Association (USA Branch). Henry M. Burwell is a partner with Nelson, Mullins, Riley, & Scarborough in Greenville, South Carolina, practicing international business and trade, immigration, and corporate law.

1. Copies of all NAFTA awards and pleadings that have been made public can be found at: http://www.naftaclaims.com, including all of the awards and orders discussed in this article.

2. S.D. Myers, Inc. v. Canada (NAFTA Arb. Trib. 2000).

to Canada's choice of arbitrator, the Honorable Bob Rae. The investor challenged Mr. Rae's appointment when it learned that Mr. Rae was planning to engage in lobbying activities involving the Canadian Department of Foreign Affairs and International Trade, which is responsible for performing the roles shared by the United States Trade Representative (USTR) and the Department of State in the United States. The Secretary General of the International Center for the Settlement of Investment Disputes (ICSID), who is designated under the NAFTA as the Appointing Authority for all arbitrations, was asked to determine whether it would be appropriate for a NAFTA arbitrator to be lobbying one of the NAFTA parties while judging a dispute involving that party. The Secretary General's Office communicated its preliminary impression of the challenge to the parties and Mr. Rae resigned his position as arbitrator soon thereafter.

B. The Waiver and Consent Requirement

While Mexico suffered its first major NAFTA investor-state loss in 2000, it also experienced its second win. This victory came through a successful motion for dismissal of a claim by Waste Management, Inc., concerning the alleged expropriation of its investment in Mexico.[3]

NAFTA Article 1121 provides that an investor may submit a claim only if it submits notice of its consent to arbitration under the NAFTA and a waiver of the right to pursue any proceedings with respect to the measure at issue in its claim.[4] Notices of waiver and consent must be filed on behalf of both the investor and its investment (if that investment takes the form of a legal person in the host country). Article 1121 does include a major exception, however, that permits an investor to continue "proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages" before an administrative tribunal or court found in the country responsible for the measure.[5]

Waste Management filed a waiver that a majority of the Tribunal concluded only foreclosed on Waste Management's ability to seek damages locally for claims founded upon breaches of international law. The majority concluded, however, that the purpose of the waiver was to prevent concurrent domestic and international proceedings that might result in double recovery for the same "measure" (i.e., government conduct that would constitute a measure under the NAFTA). As Waste Management had continued to seek damages for alleged breaches of concession and line-of-credit agreements that were bound up in the measure, the majority determined that its waiver (which Waste Management consistently admitted did not preclude its carrying on with the domestic proceedings) was insufficient for the purposes of NAFTA Article 1121, and that therefore it lacked jurisdiction to hear the claim.

The lesson of this case appears to be that investors must choose carefully between seeking damages either under the NAFTA or domestically, regardless of whether the government action complained of (i.e., "the measure") would constitute a breach of a different kind of law, depending upon the forum chosen. As the majority indicated in its award, the same

3. *See* Waste Management, Inc. v. United Mexican States, ARB(AF)/98/2 (NAFTA Arb. Trib. 2000).

4. *See* North American Free Trade Agreement, Aug. 12, 1992, U.S.-Mexico-Canada, art. 1101, 31 U.S.T. 4919 [hereinafter NAFTA].

5. *See id.* art. 1121.

kind of local government conduct that might be found to constitute a breach of domestic contract law may also constitute failure to accord fair and equitable treatment to an investment under NAFTA Article 1105.[6] But the investor must choose one forum or the other or risk having the choice made for it by either the domestic or the international tribunal from which it has sought damages.

One might wonder what the result would have been if an unequivocal waiver had been submitted, rather than a conditional one. It is submitted that the NAFTA Tribunal's response to evidence of noncompliance of an unconditional waiver would be to inform the NAFTA party in question to submit the investor's waiver in defense to the local proceedings and to continue on with its hearing. Had the majority not concluded that Waste Management's conditional waiver was defective (as evidenced in both its conduct and argumentation), the arbitration most likely should have continued.[7]

C. Article 1101—How Must a Measure Relate to Investors and Their Investments?

NAFTA Article 1101 provides that the obligations contained within Chapter 11 only apply to measures adopted or maintained by a NAFTA party "relating to" the investors of another NAFTA party, and to their investments in that NAFTA party's territory.[8] In 1998, Canada argued before the tribunal in *Ethyl Corporation v. Canada* (*Ethyl*),[9] that it had no jurisdiction to hear the claim because it concerned a measure relating to trade in goods and, thus, could not also be "related" to the investor or its investment. The Ethyl Tribunal did not directly address this argument in its award and the claim was subsequently settled. In 2000, similar arguments were made (unsuccessfully) by NAFTA governments in many other arbitrations, including the Tribunal hearing *Pope & Talbot, Inc. v. Canada* (*Pope & Talbot*).[10] The *Pope & Talbot* Tribunal appears to have been the first, however, to render a decision directly on point.

The *Pope & Talbot* Tribunal issued an award in January 2000, stating that although a measure may be primarily designed to affect trade in goods, it could nonetheless have an impact upon investors and their investments such that it could be said to "relate to" those investments. This award, which appears to implicitly follow the lead of the WTO Appellate

6. *See* Monsieur Keba Mbaye, *Societe Quest Afriaine de Betons Industriels contre La Republique du Senegal*, ICSID Review, Vol. 6, No.1, Spring 1991, at 235. This view was rejected by the dissenting member of the Tribunal, who recalled the *obiter dicta* of the *Azinian* Tribunal that a mere breach of contract under local law cannot constitute a breach of international law. While this statement appears eminently reasonable, it does not preclude the possibility that what might constitute a breach of domestic law might also constitute a breach of international law. While the former cannot be pleaded as evidence of the latter, the same evidence used to establish one kind of breach might very well be used to also establish the other.

7. *See Waste Management* (NAFTA Arb. Trib. 2000). Of course, the *Waste Management* Tribunal appears to have neglected that, by filing its claim, Waste Management constructively consented to the arbitration and waived all of its rights to proceed domestically as a matter of international arbitral law. Nonetheless, it would appear from a notice posted on the ICSID website that Waste Management may have refilled its NAFTA claim (presumably with an amended waiver) by the end of 2000.

8. *See* NAFTA, *supra* note 4, art. 1101. Article 1101 also provides that Chapter 11 applies to all investments in a NAFTA party's territory—with respect to the chapter's prohibition on performance requirements (Article 1106) and its environmental provision (Article 1114).

9. Ethyl Corp. v. Canada (NAFTA Arb. Trib. 1998).

10. Pope & Talbot, Inc. v. Canada (NAFTA Arb. Trib. 2000).

Body in cases such as *Canada–Periodicals* and *EC–Bananas*,[11] clarifies that measures can have multiple impacts upon different types of trade and investment—thereby attracting the simultaneous coverage of various chapters of the NAFTA. This award appears to have confirmed that whenever a "trade" measure impacts negatively upon a NAFTA investment, so long as that impact can be couched in the terms of a breach of NAFTA Chapter 11, a remedy may be available to the investor that requires the filing of a Section 301 action to convince the USTR to launch a state-to-state dispute settlement proceeding under the appropriate trade treaty.

D. Claims for Consequential Losses by an Investor

The *Pope & Talbot* Tribunal was presented with another jurisdictional motion from Canada that it disposed of early in 2000.[12] The investor's statement of claim included a claim for losses it had incurred through the consequential damages suffered by its investment in a pulp and paper company called Harmac Pacific Corp. This was not the investment in Canada that was the primary focus of Pope & Talbot's claim—but its subsidiary that operated three softwood lumber mills in the interior of British Columbia. Pope & Talbot's claim was that its softwood lumber investment was directly affected by the measure. Pope & Talbot's pulp and paper investment only experienced indirect harm as a result of the secondary impact of Canada's measure on the pulp and paper sector. The measure was an export restraint mechanism that hindered the export of softwood lumber from Canada and thus changed the nature and quantity of wood fiber available for use in the pulp and paper sector.

Canada argued that the investor could not make a claim for losses it incurred through its pulp and paper investment unless (1) a waiver for the pulp and paper investment was filed with the statement of claim and (2) the statement of claim contained an allegation that the investment was directly affected by a breach of NAFTA Chapter 11 (not consequentially affected). Since Pope & Talbot had only filed waivers on behalf of itself and its softwood lumber investment, and since its statement of claim did not allege that the measure directly impacted upon its pulp and paper investment in a manner that breached the NAFTA, Canada argued that this part of the claim had to be dismissed. Moreover, because three years had elapsed since the date upon which the loss had occurred, under NAFTA Article 1116(2), time has essentially "run out" on the investor to amend its claim.

Article 1116(1) permits an investor to make a claim for any losses it has incurred "by reason of, or arising out of" a breach of the NAFTA.[13] The *Pope & Talbot* Tribunal determined that Canada had failed to prove that three years had definitely elapsed since the secondary loss to its pulp and paper investment had taken place. It further found that an investor was entitled under Article 1116(1) to make a claim for all losses it suffered as a result of an alleged breach, including consequential ones, and it found that the waiver requirement contained within Article 1121[14] (and discussed above) was not an essential precondition for the validity of a claim. Recalling the jurisdictional award of the *Ethyl*

11. *See European Communities—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS/27/AB/R (WTO Appellate Body: 9 September 1997); *Canada—Certain Measures Affecting Periodicals*, WT/DS31/AB/R (WTO Appellate Body: 30 June 1997).

12. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

13. NAFTA, *supra* note 4, art. 1116.

14. *See id.* art. 1121.

Tribunal, the *Pope & Talbot* Tribunal stated that the very act of filing a statement of claim under the United Nations Commission on International Trade Law (UNCITRAL) rules constituted a constructive waiver and consent to arbitration on behalf of Pope & Talbot and its investments. The NAFTA Article 1121 waiver only benefited the investor, because it permitted Pope & Talbot to file a limited waiver that permitted it to pursue proceedings other than those for damages. Accordingly, as any failure to file a formal waiver notice could in no way have prejudiced Canada, Pope & Talbot's claim was allowed to proceed in its entirety.

E. The Proper Scope for Arguments on Jurisdiction

While admittedly less glamorous, and perhaps more arcane than merits awards, awards dealing with the NAFTA parties' motions to dismiss are generating a significant body of arbitration law. This body of law may well guide the development of NAFTA arbitration for years to come, and the aforementioned decisions by the *Pope & Talbot* Tribunal are excellent examples of decisions that can guide NAFTA lawyers in framing their claims.

One reason for the development of this body of law is the consistent practice of NAFTA parties of bringing motions for dismissal in almost every claim filed, even though only one has thus far been successful. One reason for this less-than-stellar record may be that the NAFTA parties have brought motions that did not have a very high chance of success. To establish the jurisdiction of a tribunal to hear a claim under the NAFTA, a NAFTA investor must merely make a claim that the measure of a NAFTA party breached one of the obligations mentioned in NAFTA Article 1116 or 1117, in relation to it or its investment in that NAFTA party's territory and that as a result of this breach it has suffered a loss. At that point, a tribunal is fully empowered under the NAFTA to proceed. Nonetheless, motions to dismiss have been brought, not only over alleged procedural defects, but also over "merits" defenses that are not properly the subject of a jurisdictional hearing.

For example, in 2000, the United States brought a five-part motion to dismiss the claims of Canadian investors Raymond Loewen and The Loewen Group, Inc., regarding the conduct of a Mississippi tort case that resulted in a $500,000,000 judgment against their investment.[15] In January 2001, the Tribunal dismissed the motion, on every ground. Three of the grounds alleged by the United States were dismissed because the Tribunal determined that they were more appropriately addressed at a merits hearing. A fourth was dismissed summarily, because it was "not pressed" strongly at the hearing. The Tribunal appears to have only regarded one ground of the motion of belonging in a jurisdictional phase—which was whether the judgment of a state court constituted a "measure" under the NAFTA. It concluded that the judgment was indeed a "measure" under the definition contained within NAFTA Article 201.

This final aspect of the *Loewen* award confirms that NAFTA Tribunals are apparently prepared to regard most forms of state action or inaction (regardless of the branch of state, or—as a result of Article 105—the level of government, involved) as constituting a measure for the purposes of a Chapter 11 claim. In yet another interim award made by the *Pope & Talbot* Tribunal in 2000, it was also established that a claim would remain valid even if the regulatory regime at issue were modified by new regulations that did not even exist at the time the claim was made.[16] The measure in that case was amended almost two years after

15. *See* The Loewen Group, Inc. v. U.S., ICSID Case No. ARB(AF)/98/3 (ICSID Arb. Trib. 2001).
16. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

the claim was brought, with the effect of making it even more difficult for the investment to export its product to the United States. The Tribunal found that while the amendment represented a significant change to the measure, it nonetheless resulted in the same kind of harm alleged by Pope & Talbot and was therefore captured by its original claim that an export restriction was harming its business in Canada. The Tribunal's focus appears to have been on whether the statement of claim identified a course of state conduct resulting in some kind of loss or harm, rather than on the technicalities of whether the legislative or regulatory means through which the measure was imposed remained the same throughout the course of the arbitration.

F. Confidentiality and Amicus Submissions

One area in which NAFTA investor-state practice has not resulted in a consistent pattern is with respect to the treatment of confidentiality. It appears that in NAFTA arbitrations involving the ICSID Additional Facility Rules, either the parties have consented to or their tribunals have ordered rules on confidentiality that are apparently less restrictive than arbitration proceedings conducted under the UNCITRAL rules.[17]

Both in the *Loewen* arbitration and in the arbitration between *Methanex Corporation v. United States* (*Methanex*),[18] it appears that the parties are essentially permitted to release their own written arguments at their discretion. The parties in Loewen appear to have gone so far as to agree on the release of all written submissions, and even the minutes of hearings, upon completion of their arbitration. Article 44(2) of the ICSID Additional Facility Rules provides that the minutes of hearings are to remain confidential unless the parties to the arbitration agree otherwise.[19] In contrast, Article 25(4) of the UNCITAL rules provides that all hearings are to be conducted *in camera*, and to this effect NAFTA Tribunals operating under the UNCITRAL rules in 2000 have ordered the parties before them not to unilaterally release the contents of either oral or written communication concerning their arbitrations, and have strictly enforced these prohibitions.[20]

The year 2000 also brought the issue of confidentiality into a different focus, with the first application by nonparties for standing to participate in a NAFTA arbitration. The application was made by two environmental interest groups to gain access to the *Methanex* arbitration. In January 2001, the *Methanex* Tribunal issued an award stating that while it had the authority under the UNCITRAL rules to accept unsolicited written submissions by interested nonparties (i.e., amicus curiae), it did not have the authority to permit access to the hearings or written pleadings without the consent of the parties to the arbitration. It also noted that if it were to accept amicus submissions, it would only do so on the condition that they were deemed necessary for the Tribunal to make a better decision and would not otherwise violate the rules of the NAFTA or the equality of the parties to the arbitration. Accordingly, not unlike the practice that has developed within the World Trade Organization (WTO) context,[21] while arbitrators have asserted the power to accept amicus

17. *See* NAFTA, *supra* note 4, art. 1120. Under NAFTA Article 1120, the investor makes the choice of arbitral rules under which the arbitration will proceed.

18. Methanex Corporation v. United States (NAFTA Arb. Trib. 2000).

19. *See Additional Facility Rules*, ICSID, art. 44, para. 2.

20. *See Arbitration Proceedings Rules*, UNCITRAL, art. 25.

21. *See United States—Imposition of Countervailing Duties on Steel Products*, WT/DS138/AB/R (WTO Appellate Body: 10 May 2000) at 13; *United States—Import Prohibition on Shrimp*, WT/DS58/AB/R (WTO Appellate

submissions, they have reserved using that right to the very limited circumstances in which they determine that amicus submissions would be appropriate and helpful to them in completing their task.

G. No "Crown Privilege" in International Law

Another interesting award, which attracted little North American press coverage in 2000, was the decision of the *Pope & Talbot* Tribunal concerning Canada's refusal to produce documents under something it referred to as "crown privilege."[22] Canada had made similar refusals to produce a wide array of documents that it claimed were prevented from disclosure under its domestic law in recent WTO proceedings.[23] Both the panel and the WTO Appellate Body confirmed that while Canada could not be compelled to produce the documents it had withheld, an adverse inference could be drawn about the contents of those documents based upon Canada's refusal.

After indicating that Canada's articulation of its obligation (i.e., ability) to withhold cabinet documents under its own access to information law might be more narrow than had been argued,[24] the *Pope & Talbot* Tribunal came to essentially the same conclusion as did the WTO tribunals. The Tribunal indicated that for Canada to even argue for the applicability of the "state secrets" doctrine in international law (which is widely regarded as justifying only the refusal to disclose documents of vital interest to the security of the state), Canada would have to produce more information, and specific argumentation about the documents it planned to withhold, rather than a blanket assertion over all of the documents it withheld.[25] This award clarifies that while NAFTA parties maintain the right to withhold whatever documents they consider appropriate, their decision to do so is made at the peril of a Tribunal determining that the NAFTA party may have something to hide.

H. Interpretation of NAFTA Article 1105

Two awards were made in 2000 that provided a first look at the interpretation of NAFTA Article 1105. This provision promises to rise in importance over the coming years, given the meanings that appear to be readily discernable from the plain meaning of its text. Article 1105(1) provides that: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."[26]

Every tribunal that had occasion to comment upon the proper approach to interpretation of the NAFTA text in 2000 found that the NAFTA investment provisions must be accorded a broad and remedial reading to ensure that the liberalizing goals of the NAFTA are re-

Body: 12 October 1998); *European Communities—Measures Affecting Asbestos and Asbestos Containing Products*, WT/DS135/9 (WTO Appellate Body: Nov. 8, 2000).

22. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

23. *See Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (WTO Panel: 14 April 1999) at 166; *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (WTO Appellate Body: 2 August 1999) at 47.

24. The Canadian appointee to the *Pope & Talbot* Tribunal was a retired judge of the superior court in Quebec, who would not be unfamiliar with Canadian access to information legislation.

25. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

26. NAFTA, *supra* note 4, art. 1105.

alized. Accordingly, while NAFTA parties have argued that NAFTA Article 1105 has little more than a historical significance (establishing a *minimal* standard of treatment that would encompass little more than protection against the investor being beaten or jailed without trial), NAFTA Tribunals have adopted a broader interpretation that would appear to be correct on the face of Article 1105.

NAFTA Article 1105 provides that the investments of NAFTA investors must be treated in accordance with international law.[27] "International law" is not defined in the NAFTA, although the traditional sources of international law are well known: treaty, custom, principles followed by the decisions of other international tribunals, and the writing of renowned "publicists." A majority of the *Myers* Tribunal appear to have sensibly refined this list of international law sources to suggest that the "international law" mentioned in Article 1105 refers primarily to international economic law, including treaty obligations, that are related to (or perhaps oriented to) the protection or promotion of the rights or economic interests of investors.

After having already found that a strong discriminatory animus existed against S.D. Myers and its investment in Canada "at all levels" of Canadian federal government decision making (which constituted a breach of NAFTA Article 1102—national treatment),[28] a majority of the *Myers* Tribunal took the logical step of concluding that such behavior also constituted a breach of Article 1105.[29] Accordingly, the Tribunal found it unnecessary to address in further detail how or whether the various individual incidents involved in the case could also be characterized as a failure to act in accordance with the principles of international economic law, including fair and equitable treatment.

The Tribunal in *Metalclad Corporation v. Mexico* (*Metalclad*)[30] had the opportunity to explore the scope of the international law principle of "fair and equitable treatment" in its award, delivered at the end of the summer of 2000. In that case, a U.S. investor in Mexico had gone about applying for, and received, all the necessary federal and state permits to build a waste treatment facility in the Mexican state of San Luis Potosi. It built its facility and, just as it came time to open for business, the investment was hit with a flurry of state and municipal government actions that had the effect of permanently closing the facility before it could ever open.

In analyzing the consistency of these various governmental actions with the "fair and equitable" treatment standard, the *Metalclad* Tribunal made the kind of findings that would not seem unfamiliar to a domestic administrative law practitioner. It would accordingly appear that the same type of conduct that constitutes a breach of fundamental fairness domestically may also fall below the international standards of treatment that have been prescribed under NAFTA Article 1105. From the *Metalclad* award, that list of international standards would appear to include

- The right to a fair hearing;[31]
- Protection against decisions made with a lack of sufficient evidence on the record;[32]

27. *See id.*
28. *See id.* art. 1102.
29. *See S.D. Myers, Inc.* (NAFTA Arb. Trib. 2000).
30. Metalclad Corp. v. Mexico (NAFTA Arb. Trib. 2000).
31. *See id.* paras. 51, 91.
32. *See id.* para. 52.

- The right to be compensated for a breach of legitimate expectations;[33]
- Protection from *ultra vires* actions by government officials (i.e., activities by officials acting beyond the scope of their regulatory authority);[34]
- Protection against decisions made on the basis of irrelevant considerations (i.e., factors not contemplated in the legislative or regulatory framework);[35] and
- Compensation for actions that fall below a minimum standard for transparency.[36]

While it is understandable that government officials in the three NAFTA parties might not be pleased to hear that the NAFTA provides a special remedy to NAFTA investors to have an international tribunal review their conduct, businesses and their lawyers should be thrilled to learn that an effective "new" remedy exists through which to protect their vital interests. That remedy is compensation, which can be sought at the same time that the investor seeks a *writ of certiorari*, or some other form of special relief from a domestic court.

I. Interpretation of NAFTA Article 1110

When NAFTA investor-state arbitration first gained attention a few years ago, it appeared that NAFTA Article 1110 was the "effective new remedy" to be used by NAFTA investors to protect their vital interests.[37] While it still remains a powerful obligation, three tribunals in the year 2000 rendered awards that have clarified exactly when application of NAFTA Article 1110 may be appropriate.

In late 1999, trade and investment lawyers learned from the Tribunal in *Azinian v. Mexico*[38] that not every "disappointment" experienced by an investor as a result of the action or inaction of a NAFTA party would result in an obligation to pay compensation under NAFTA Article 1110. More specifically, it appeared from this fact-intensive decision that under NAFTA Article 1110, a government was more than entitled to abrogate a contract with an investor or its investment if it could be established that to do so would be perfectly in accordance with the domestic law of contract and minimum international standards. In 2000, from a majority of the *Waste Management* Tribunal, we also learned that if the abrogation of such a contract cannot be justified under minimum international standards, the NAFTA may well provide an alternative remedy to investors who would prefer to make their case before an international tribunal under NAFTA Articles 1105 and 1110, rather than a domestic court using local contract law.[39]

We learned from the *Myers* Tribunal that even if a measure has all of the characteristics of an expropriation under NAFTA Article 1110, but is not permanent (or at least of long-term effect), compensation will not be owed under the specific terms of Article 1110(2).[40] We also learned from the *Pope & Talbot* Tribunal that unless the impact of a measure is

33. *See id.* para. 80.
34. *See id.* paras. 86, 95.
35. *See id.* para. 92.
36. *See id.* para. 88.
37. *See* NAFTA, *supra* note 4, art. 1110.
38. Azinian v. United Mexican States, Case No. ARB(AF)/97/2, Nov. 1, 1999.
39. *See Waste Management, Inc.* (NAFTA Arb. Trib. 2000).
40. *See* NAFTA, *supra* note 4, art. 1110. The essential effect of NAFTA Article 1110(2) is to consider the investment "sold" to the NAFTA party as of the date that the expropriation was imposed, including compensation for future profits and any consequential losses. There are no specific provisions to guide the valuation of damages under the other NAFTA provisions and recourse must accordingly be had to the jurisprudence of damages under international law.

one of "substantial interference" with an investment, Article 1110 will not be breached.[41] It is unclear from the facts of that case exactly what the standard of "substantial interference" should be, but it appears that if an investment can remain profitable, despite suffering a 10 to 20 percent hit to its capacity to conduct its business,[42] a tribunal may be unwilling to find that compensation is owed under NAFTA Article 1110.[43]

Another interesting conclusion that can be drawn from the awards of both the *Pope & Talbot* Tribunal and the *Myers* Tribunal, which both found that NAFTA Article 1110 had *not* been breached, is that the "investment" that needs to be established to meet the threshold for obtaining jurisdiction to bring a claim under the NAFTA is not necessarily the "investment" to be considered under NAFTA Article 1110. In other words, an investor apparently does not need to prove that its subsidiary in the territory of another NAFTA party has actually been taken over or shut down to seek compensation under Article 1110. It need only prove that some form of economic interest that can be identified as its "investment" under NAFTA Article 1139 has suffered from substantial interference as a result of the imposition of some government measure. For example, the *Pope & Talbot* Tribunal determined that Pope & Talbot did not have to prove that Canada owned or controlled its Canadian subsidiary to prove expropriation.[44] The subsidiary's access to the U.S. market was an "investment" that was protected from substantial interference under NAFTA Article 1110. The *Myers* Tribunal made a very similar conclusion with respect to S.D. Myers's access to the Canadian market for its PCB waste remediation business.[45]

What remains of particular concern to some observers, however, despite the obvious limitations already outlined above, was the *Pope & Talbot* Tribunal's interpretation of the plain meaning of the terms of Article 1110 regarding "regulatory takings." The Tribunal held that the NAFTA parties may owe compensation to affected foreign investments for "non-discriminatory measures of general application," even if they do not otherwise fall below minimum international standards.[46] It remains to be seen whether this conclusion can be used by a polluting business to seek compensation for an otherwise legitimate or justifiable regulatory taking. It would appear that the open-ended compensation criteria outlined in Article 1110(2) could be used to prevent the "polluter pays" principle from ever being converted into a "pay the polluter" principle under the NAFTA, and thus effectively resolve this potential problem.[47]

The only Tribunal to have found in favor of an investor under Article 1110 is the *Metalclad* Tribunal, whose September 2000 award was far more focused on the application of

41. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

42. *See id.* This evaluation is in no way related to the specific damages incurred by Pope & Talbot, Inc., or its investment. Rather, it is based on publicly available Canadian government documents that suggest that most softwood lumber businesses suffered more than a 15 percent loss in their ability to export to the United States as a result of the imposition of its export-control measure.

43. *See id.* Based on the conclusion of the *Pope & Talbot* Tribunal, one wonders whether a less profitable enterprise (or a small business) that is more seriously injured by same measure that only irritates a larger competitor will actually be entitled to a compensation under NAFTA Article 1110 that would not be owed to the larger, more profitable players in the same market.

44. NAFTA, *supra* note 4, art. 1139.

45. *See S.D. Myers, Inc.* (NAFTA Arb. Trib. 2000).

46. *See Pope & Talbot, Inc.* (NAFTA Arb. Trib. 2000).

47. NAFTA Article 1110(2) provides that "Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, ***and other criteria, as appropriate***, to determine fair market value" (emphasis added). NAFTA, *supra* note 4, art. 1110.

NAFTA Article 1105 than on Article 1110. Moreover, the *Metalclad* award says little about the aforementioned controversy because its Article 1105 analysis indicates that since the measures involved fell below minimum standards of fairness and equity in international law, they constituted an unjustifiable or illegal taking under Article 1110 anyway.[48] It remains to be seen whether a case exists, or that a NAFTA Tribunal will ever find, that an otherwise valid measure will require compensation under NAFTA Article 1110—or whether under the circumstances of such a case, compensation would not actually be justified for the taking of a NAFTA investment.

J. Conclusion

The year 2000 was a good year for those who study NAFTA investor-state arbitration, and for NAFTA investors. The trickle of claims that began late in the last decade is now resulting in a slow but steady stream of substantive and procedural case law that promises to contribute substantially to international economic law in general, and to the elimination of unnecessary barriers to the growth of a North American free market in particular.

II. ICSID Decision on Federal Responsibility to Foreign Investors for Provincial Government Conduct

In a decision with significant implications for foreign investors in the United States and other countries with similar constitutional structures, a tribunal of the International Centre for Settlement of Investment Disputes (ICSID) determined that a federal government is not necessarily responsible for acts of its constituent subdivisions that may transgress the rights of foreign investors under a national bilateral investment treaty. The decision, issued on November 21, 2000, in *Compania de Aguas del Aconquija S.A. v. Argentina*,[49] marks an important development in clarifying the circumstances in which foreign investors may invoke a federal government's international commitments as a basis for relief from acts that the federal government itself did not take, direct, or control.

The ICSID case arose from a dispute associated with a concession contract that a French company, Compagnie Générale des Eaux, and its Argentine affiliate, Compañía de Aguas del Aconquija, S.A. (collectively Claimants), entered into with Tucumán, a province of Argentina. The central government of Argentina (Republic) was not a party to the concession contract or to the negotiations that produced it, nor did the Republic agree to guarantee any investments by the Claimants in connection with the contract. The Republic's involvement in the case was prompted by requests from the Claimants, who, when disagreements erupted between them and Tucumán several years after the contract was signed, sought the Republic's help in attempting to renegotiate the contract terms. Despite the provision of such assistance by the Republic, the renegotiations ultimately failed.

The Claimants then sought relief for what they characterized as an expropriation of their investments under the concession contract. They did not deny that their claims arose out of the concession contract but, rather than pleading breach of contract, they styled their pleadings as a case against the Republic under Argentina's bilateral investment treaty with the Government of France (the BIT). Under the BIT, foreign investors of either party's

48. *See Metalclad Corp.* (NAFTA Arb. Trib. 2000).

49. Compania de Aguas del Aconquija S.A. v. Argentina, ICSID Case No. ARB/97/3 (ICSID Arb. Trib. 2000).

nationality may, subject to certain conditions, sue the other party in ICSID for failure to provide such "fair and equitable" treatment or protection against expropriation of their investments.

When the Claimants presented their claims to ICSID, Argentina immediately protested on jurisdictional grounds. Under the express terms of the concession contract between the Claimants and Tucumán, disputes over the contract—either its interpretation or application—were to be submitted to the exclusive jurisdiction of the courts of Tucumán. In addition, when Argentina consented to ICSID jurisdiction over disputes with foreign investors generally, it did not extend such consent to cases brought directly against any of the Argentine provinces. Both for these legal reasons and because, as the Republic put it, the Republic was "a stranger" to the prolonged concession contract dispute between the Claimants and Tucumán, ICSID arguably lacked jurisdiction over the case.

The Claimants, however, countered that they were not suing Tucumán under the concession contract; rather, they were suing the *Republic* for breach of its obligations under the BIT. According to the Claimants, the Republic itself bore responsibility for the alleged wrongs of Tucumán, both by virtue of the "attribution" to the Republic of those wrongs and because the Republic had failed to prevent them. The Republic protested that it could not, under its own federal Constitution, legally have taken any of the various actions against Tucumán that the Claimants alleged were due, but the Claimants asserted that such a domestic legal bar was no excuse for the violation of international law they alleged.

After considering these competing arguments, the Tribunal found:

> Under international law, and for purposes of jurisdiction of this Tribunal, it is well established that actions of a political subdivision of federal state, such as the Province of Tucumán in the federal state of the Argentine Republic, are attributable to the central government. It is equally clear that the internal constitutional structure of a country can not alter these obligations.[50]

Based on this finding and because the Claimants alleged certain wrongful acts and omissions of the Republic itself, not relying on any principle of attribution, the Tribunal found that neither the forum selection clause of the concession contract nor the fact that Argentina had not consented to ICSID jurisdiction over claims against the Argentine provinces barred ICSID jurisdiction in the case.

Having found the existence of an international law principle of "attribution" of acts of subfederal entities to federal central governments for jurisdictional purposes, the Tribunal might have been expected then to treat all the claims in the case as involving alleged wrongdoing by the Republic, irrespective of the fact that the vast majority of wrongful acts asserted were actions of Tucumán. But the Tribunal did not take such a simplistic approach. It set forth the parties' respective key legal positions and how it would deal with those positions:

> Claimants contend . . . that every action of the Province of Tucumán, taken in the exercise of sovereign power and not as a party to a contract, is directly attributed to the Argentine Republic. . . .
>
> Claimants argue that the Argentine Republic is subject to a strict liability standard under the BIT and that any action of the Province that violates the BIT creates liability on the part of Respondent. . . .

50. *Id.*

> The Argentine Republic maintains that the standard of its liability is limited to what the parties and the Tribunal have sometimes termed "due diligence" but which may be more appropriately termed "good offices," *i.e.*, a duty to undertake a good faith effort through actions of its federal officials to help resolve the controversy between the Province and Claimants.
>
> Claimants respond that this lesser standard of obligation . . . applies only if the actions of private parties are involved —not actions of a political subdivision such as a Province. In any event, Claimants contend that the Argentine Republic violated its obligation under the BIT and applicable international law even under this lesser standard because the Argentine Republic "failed . . . to take reasonable measures to solve the conflict and protect or redress damage to Claimants."[51]

The Tribunal reasoned that despite having found, for jurisdictional purposes, the existence of an international law principle of "attribution," as discussed above, in order to make a decision on the merits, it did not have to determine the validity of the Claimants' "strict liability" attribution theory. The Tribunal stated:

> To resolve these issues in this case, the Tribunal need not determine generally whether bilateral investment treaties with provisions forbidding expropriation in the absence of full compensation and requiring fair and equitable treatment under international law impose a strict liability standard on a central government for actions of a political subdivision. Instead, the Tribunal resolves this case on the basis of the specific allegations on which the Claimants base their claims and their legal significance in light of the terms of the Concession Contract and the BIT.[52]

The Tribunal then proceeded to analyze each of the various ways in which the Claimants asserted the Republic was either derivatively responsible for Tucumán's actions or failed, either by insufficient action or inaction, "to have caused Tucumán (i) to refrain from exercising governmental powers that abrogated the rights of Claimants, or (ii) to comply with the terms of the Concession Contract."[53] With respect to the Republic's alleged derivative liability, the Tribunal observed that all of the acts of Tucumán that the Claimants relied on to show such liability were closely linked to the performance or non-performance of the concession contract, and thus specifically arose from disputes between the Claimants and Tucumán under the contract. The Tribunal found that "[b]ecause of the crucial connection . . . between the terms of the Concession Contract and th[e] alleged violations of the BIT," the Republic could not be held liable "unless and until the Claimants asserted their rights in proceedings before the courts of Tucumán—as required by the forum selection clause in the concession contract—and were denied their rights in those courts, either procedurally or substantively."[54] This was imperative, the Tribunal explained, because in order to make determinations as to whether the relevant acts of Tucumán had been taken as an exercise of Tucumán's sovereign authority or rather as a party to the contract would require "detailed interpretation and application" of the concession contract, which was "a task left by the parties to the contract to the exclusive jurisdiction of the administrative courts of Tucumán."[55] The Claimants' failure to seek remedies in those courts, therefore, precluded any

51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*

ground for an ICSID decision that Argentina was liable under the principle of "attribution" asserted by the Claimants.

With respect to the Claimants' separate claims that the Republic was liable under the BIT for failing to prevent or otherwise interfere with Tucumán's allegedly wrongful actions, the Tribunal found the facts on record to be decisive. The record evidence, the Tribunal observed, plainly contradicted Claimants' assertions that, inter alia, (1) Argentina's officials had ever failed to take any specific action requested by the Claimants; (2) Tucumán had so violated the contract as to require Argentina to seek a legal remedy against Tucumán; or (3) Argentina had failed to respond to the situation in Tucumán or the Claimant's requests in accordance with Argentina's obligations under the contract. Indeed, the Tribunal found "ample evidence in the record that federal officials of the Argentine Republic played a constructive role" in the attempts by the Claimants and Tucumán to resolve their disagreements. Thus, the Tribunal held, "the record of these proceedings does not provide a basis for holding that the Argentine Republic failed to respond to the situation in Tucumán and the requests of the Claimants in accordance with the obligations of the Argentine government under the BIT."[56]

The Tribunal's decision, while carefully limited to the facts of the case, nevertheless does provide important clarification of international law. Most significantly, while not resolving whether a federal government may in some circumstances be subject to "strict liability" for acts of constituent subdivision governments, the decision confirms that, under current international law, there is no rule that acts of a political subdivision allegedly breaching rights of foreign investors under a BIT may *automatically* be "attributed" to the subdivision's central government for purposes of determining liability under the BIT.

III. Acquisitions of Telecommunications Companies

The year 2000 saw a noteworthy intervention by the Committee on Foreign Investment in the United States (CFIUS) in connection with a multibillion-dollar Japanese acquisition of the world's largest operator of websites for businesses and a provider of comprehensive Internet services, including high-speed access and a national Internet backbone infrastructure.

Pursuant to the Exon-Florio Amendment to the Defense Production Act of 1950,[57] CFIUS is charged with investigating foreign acquisitions of U.S. companies to determine whether the foreign interest exercising control over a U.S.-acquired entity "might take action that threatens to impair the national security."[58] The president may block or restrict a transaction if the president finds "credible evidence" that "the foreign interest exercising control might take action that threatens to impair the national security" and the national security concerns raised by the transaction are not adequately addressed by other means under U.S. law.[59]

In an average year, CFIUS reviews between sixty and seventy cases, without much public attention. There have been approximately 1,350 cases reviewed by CFIUS since the law

56. *Id.*

57. The Exon-Florio Amendment was enacted as part of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, 1425–26 (1988) (amending Title VII of the Defense Production Act of 1950, 50 U.S.C. § 2158 *et seq.*)

58. *Id.*

59. *Id.*; *see also* http://www.treas.gov/oii/.

came into effect in 1988. In the overwhelming majority of these reviews, the transactions were allowed to proceed without government interference as originally structured by the parties. There were seventy-two CFIUS cases in 2000, but only one in particular received significant scrutiny and widespread coverage in the news media. This was Nippon Telegraph and Telephone Corporation's (NTT) proposed acquisition of Colorado-based Internet service and web hosting provider Verio, Inc. for approximately $5.5 billion.

When first announced, this transaction raised concerns for the Department of Justice and the FBI, which had been utilizing Verio facilities to conduct court-ordered wiretaps, and did not want to lose that cooperation.[60] A similar issue can arise in any foreign person's acquisition of a U.S. telecommunications services provider, however, the U.S. government has statutory authority to require support for wiretapping activity if the target of the acquisition is a telecommunications carrier regulated by the Federal Communications Commission (FCC). The FCC also has the authority to approve communications license-transfers and can request foreign acquiring companies to "voluntarily" adhere to certain U.S. policies in order to obtain a license.

In the case of the NTT-Verio transaction, however, there were no FCC-regulated telecommunications services provided by Verio and, thus, the FCC had no basis to review.[61] Therefore, the fact of the Exon-Florio review provided the U.S. government with its only leverage opportunity to negotiate with NTT to encourage NTT to permit Verio to make an accommodation of FBI wiretapping needs following the acquisition. After NTT agreed to assist the FBI in the future, CFIUS completed its review of the acquisition in August 2000 and did not recommend any blocking action.[62] U.S. government officials involved in the negotiations reported that because NTT agreed to accept conditions for law enforcement access beyond statutory requirements, the FBI and Department of Justice concerns were satisfied.

A similar concern about access for wiretaps following a telecommunications acquisition by a foreign government-owned carrier arose in the case of Deutsche Telekom's proposed acquisition of Voicestream, a leading wireless company.[63] In that transaction, the FCC had to agree to the transfer of licenses and thus had jurisdiction to review the acquisition and insist on preservation of the FBI's ability to access Voicestream facilities. It appears that the FBI's concerns were adequately addressed in that transaction in the review process before the FCC.

In any event, both the NTT and Deutsche Telekom transactions were situations in which a foreign government had an ownership interest in the foreign company/acquiring entity. Some members of Congress, most prominently Senator Ernest F. Hollings (Democrat—South Carolina), raised objections to these transactions.[64] The Commerce Com-

60. *See* Glenn R. Simpson & David S. Cloud, *FBI Concerned About NTT-Verio Deal*, WSJ Interactive Edition, July 6, 2000, http://www.zdnet.com/zdnn/stories/news/0,4586,2598979,00.html.

61. *See* Martin Williams, *NTT Rejects U.S. Complaints on Verio Buy*, IDG NEWS SERVICE, June 5, 2000, http://www.computerworld.com; Michelle M. Yamada, *NTT/Verio Merger Target of U.S. Probe*, THE INDUSTRY STANDARD, July 5, 2000, http://www.computerworld.com.

62. *See NTT Communications and Verio Announce Exon-Florio Clearance*, http://search.onramp.net/company/newsroom/2000/in_08_24_00.cfm; *see also* http://www.verio.com.

63. *See* Jay Wrolstad, *U.S. to Review Deutsche Telekom-Voicestream Merger*, WIRELESS NEWSFACTOR, Dec. 20, 2000, *at* http://wireless.newsfactor.com/perl/story/6210.html.

64. *See Foreign Telecom Ownership Ban Could Be Cut*, http://www.telekomnet.com/news/10-19-00_foreign_ownershipban.asp, Oct. 19, 2000.

mittee of the House of Representatives also called a hearing in 2000 to consider the proposed acquisitions by NTT and Deutsche Telekom. Some members of Congress very strongly object to state-owned communications carriers making telecommunications acquisitions in the United States, because these companies at least theoretically have "deep pockets" and other unfair advantages doing business in the United States and may also benefit from restrictions against U.S.-based companies operating in their home markets.

At the end of the last Congress, restrictive legislation directed against foreign-owned carriers did not become law. However, the attention given to NTT and Deutsche Telekom's acquisitions suggest that the next time a foreign government-owned telecommunications company announces an acquisition in the United States, it should anticipate heightened scrutiny.

IV. Foreign Trusts: New Developments

Treasury Regulations were proposed on August 7, 2000, under reforms of Section 679 of the Internal Revenue Code (IRC) enacted in the Small Business Job Protection Act,[65] as amended by the Taxpayer Relief Act of 1997.[66]

Briefly, the reforms had reinforced prior rules intended to prevent the use of foreign trusts to evade or avoid tax. Those rules had extended the treatment of a U.S. grantor as the "owner" of any trust with trust income, deductions, and credits being reportable by the grantor[67] and, under case law, with other income tax consequences flowing from treating the foreign trust estate as if owned by the grantor.[68]

Notice the consequence: a grantor "owner's" gain from a sale by him to his foreign, or domestic, grantor trust for value is not taxable to him.[69]

The foreign trust rules apply whether or not the transferor or someone else such as a beneficiary has any "power or interest" sufficient to make that person the "owner" under IRC Sections 671 through 678.

Any person making a transfer to a foreign trust can be treated as the "owner" without limitation to the nominal settlor.[70]

Such treatment applies generally if there is a U.S. person as a beneficiary during the particular taxable year of the transferor.[71] However, if it does apply, then the transferor's income for that year includes past-accumulated net income as at the close of the next-preceding year,[72] subject to an interest charge for the deemed delay in distribution.[73] Almost

65. Small Business Job Protection, Pub. L. 104-188, § 1907(a), 110 Stat. 1755, 1916 (1996).

66. Taxpayer Relief Act of 1997, Pub. L. 105-34, § 1161, 111 Stat. 788, 987 (1997).

67. I.R.C. § 671 & 679.

68. Rev. Rul. 87-61, 1987-2 C.B. 219 (excise tax under I.R.C. § 1491 held inapplicable to the appreciation in property transferred to the foreign trust until the grantor surrendered grantor-trust powers—the Service having refused in Rev. Rul. 85-13, 1985-1 C.B. 184, to follow the rationale limiting the tax attributes to those specified in the statute as propounded in Rothstein v. United States, 735 F.2d 704, 84-1 USTC ¶ 9505 (2d Cir. 1984)); *Cf.* Letter Ruling 199912026 (1998) (grantor trust's gain on sale of his residence *held* excludible by him as "owner" of the residence under I.R.C. § 121).

69. *Cf.* W. Clarke Swanson v. Comm'r, 518 F.2d 59, 75-2 USTC ¶ 9528 (8th Cir. 1975), *affirming* 33 TCM 296 (1974).

70. *See* Prop. Treas. Reg. § 1.679-1(c)(1), 65 Fed. Reg. 48,185 (2000); [citations to sections herein being to those of the Proposed Regulations unless otherwise indicated].

71. I.R.C. § 679(a)(1) (2000).

72. *See* I.R.C. § 679(b) (2000).

73. *See* I.R.C. § 668 (2000).

any U.S. person can be regarded as a U.S. beneficiary, that is, unless no trust income or principal may be paid to or accumulated for him during the year, including (but not limited to) what would be distributable if the trust were to be terminated during the year,[74]—with transparency for a nominal beneficiary that is a U.S.-"controlled foreign corporation," a foreign partnership with a U.S. partner, or a foreign trust or estate having a U.S. beneficiary—and no apparent limitation to the U.S. person's interest.[75] No exception appears in the statute for the case where a person's interest is contingent on a future event "unless the [Service] is satisfied that the contingency is so remote as to be negligible."[76] A possibility of distribution to a U.S. person in the event of a termination of the trust, including after the transferor's death, would be fatal here.[77]

However, a beneficiary is not to be treated as a U.S. person once more than five years have elapsed between the transfer to the trust and his becoming a U.S. person.[78] The interim possibility of becoming a U.S. person is disregarded[79] unless it has become a reality, that is, unless the beneficiary became a U.S. resident for any period in the interim on the principle that he did not "first" become a resident after five years.[80]

Specific exemptions were provided by statute for a transfer by reason of the transferor's death, ending the transferor's status as "owner" of the trust, or a transfer to the trust for fair market value[81] other than an obligation if it is of the trust—or a grantor, "owner", or beneficiary or a person deemed related to any of them or is guaranteed by any of them.[82] An "obligation" to pay would include an annuity contract, without apparent exception for an unrelated legal obligation such as one to support a beneficiary who is the transferor's child.[83]

An obligation flowing from the trust or a related person will be disregarded and not be taken into account in considering whether the transfer is made for value to the trust, except for "qualified obligations": in writing, with a maximum term of five years, stated in United States dollars, providing for at least 100 percent, but not more than 130 percent, of the "applicable Federal rate" at the time of issue. And even then, it is indispensable that the transferor "extends the period of assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes" to three years beyond maturity.[84]

A "guarantee" is defined broadly as "any form of credit support."[85]

And there is a special note for the too-aggressive planner: a transfer is not for fair market value when rent, royalties, interest, compensation and the like are paid except on "arm's length terms."[86]

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74. *See* I.R.C. § 679(c)(2) (2000).
75. *Id.*
76. Prop. Treas. Reg. § 1.679-2(a)(2), 65 Fed. Reg. 48,185 (2000); (disregarding the trustee's possible exercise of discretion, Example 7).
77. *See id.* Example 5.
78. *See* I.R.C. § 679(c)(3) (2000).
79. *See* Prop. Treas. Reg. § 1.679-2(a)(3), 65 Fed. Reg. 48,185 (2000).
80. *See id.* Example 2.
81. *See* I.R.C. § 679(a)(2) (2000).
82. *See* I.R.C. § 679(a)(3) (2000).
83. *See* Prop. Treas. Reg. § 1.679-1(c)(6), (d), 65 Fed. Reg. 48,185 (2000).
84. Prop. Treas. Reg. § 1.679-4(c), (d), 65 Fed. Reg. 48,185 (2000).
85. Prop. Treas. Reg. § 1.679-3(c)(4), 65 Fed. Reg. 48,185 (2000).
86. Prop. Treas. Reg. § 1.679-4(b)(1)), 65 Fed. Reg. 48,185 (2000).

A transferor to a trust who is a nonresident alien and who becomes a U.S. resident within five years, is to be treated as a transferor to the trust as from his residency starting date.[87] This treatment would be extended to income accumulated at that time.[88]

Similarly, a domestic trust becoming a foreign trust during a U.S. transferor's lifetime would result in treating the latter's transfer to the trust as if made at that time, with such treatment being extended to net accumulated income up to that time.[89]

Not naming a U.S. person as beneficiary in the trust agreement does not afford absolute protection. Reference can be made to "written and oral agreements and understandings; . . . [m]emoranda or letters of wishes; . . . records that relate to the actual distribution of income and corpus; and . . . other documents that relate to the trust, whether or not of any purported legal effect," or possible amendment or foreign laws benefiting a U.S. person unless the Service is satisfied that they are "not reasonably expected to be applied or invoked . . . or if the parties ignore the trust terms or it is reasonably expected that they will do so."[90] Finally, using an "intermediary" is attacked at several points in the Proposed Regulations.[91]

The regime just described above is made inapplicable by IRC Section 679(a)(1) to a trust described in IRC Section 6048(a)(3)(B)(ii): an employees' deferred-compensation trust or plan described in Section 402(b), 404(a)(4) or 404A, or an exempt organization, which is determined by the Treasury, or its delegate to be described in Section 501(c)(3).

Notice that the rules of Section 1.679.1 through 1.679.4 generally will apply to transfers made after August 7, 2000.[92] Exceptionally, Section 1.679-4(c) and (d) will apply to any obligation issued after February 6, 1995 (or if a "significant modification" is made after that). Section 1.679-5 applies to persons whose U.S. residency starting date is after August 7, 2000, and Section 1.679-6 applies to trusts becoming foreign after that date.

V. New Investment Incentives in Georgia, North Carolina, and South Carolina

A. Introduction

Many states in the southeastern United States have developed a comprehensive scheme for encouraging investment. North Carolina, South Carolina, and Georgia have been among the leading jurisdictions within the southeastern United States that have developed such incentives. This section gives a brief summary of legislation passed in 2000 that focuses on economic development initiatives.

B. Georgia

The Business Expansion and Support Act (BEST) is a new effort to induce job growth where it is most needed. This new legislation introduced a tier system for the seventy-one most economically depressed counties by allocating job credits to the least developed coun-

87. *See* I.R.C. § 679(a)(4) (2000).
88. *See id.*
89. *See* I.R.C. § 679(a)(5) (2000).
90. Prop. Treas. Reg. § 1.679-2(a)(4), 65 Fed. Reg. 48,185.
91. *See* Prop. Treas. Reg. § 1.679-3(c), 65 Fed. Reg. 48,185.
92. *See* Prop. Treas. Reg. § 1.679-7, 65 Fed. Reg. 48,185.

ties. Effective January 1, 2001, the law requires certain health benefits for jobs that qualify for the tax credit system and sets a wage threshold for jobs to qualify within the system. Thus, the tier system is divided into four tiers ranking the seventy-one least developed counties. Tier one provides a $3,500 credit that may be taken against payroll tax or 100 percent of the enterprise corporate income tax liability provided five new jobs are created. The thirty-five tier two counties set a $2,500 credit per job provided the wages are 5 percent above the average wage of the county and ten new jobs are created with the investment. The next thirty-five counties in tier three get a credit of $1,250 for the creation of fifteen new jobs provided the wages are 10 percent above the average wage of the county. The eighteen counties in tier four get a $750 credit for the creation of twenty-five new jobs provided the wage level is 15 percent above the average wage of the county. If a company currently offers no health benefits to any employees, health benefits will not be a requirement to qualify for the jobs tax credit.

The credit may be maintained for five years from the date of the establishment of the position, and may be transferred to a subsidiary or to a successor in interest if the company is sold, merged, acquired, or goes bankrupt. Businesses in tiers three and four may take the credit against up to 50 percent of their income tax liability and the excess may be carried forward for ten years. Businesses in tiers one and two can take the credit up to 100 percent of their income tax liability. A business is defined very broadly with respect to location in any of the forty least developed counties. The definition is narrower for companies or enterprises that move into the remaining 119 counties of the state.

Other incentives were updated including tax credits for distressed areas, extension of the investment tax credit for tier three counties, and extension of the optional tax credit for tier four counties.

Additionally, the new legislation established a tax credit for companies placing corporate headquarters in Georgia. To qualify, a business must create a hundred new jobs in the headquarters' operation and invest at least $1,000,000. The credit provided is $2,500 per job to be an offset against the company payroll withholding tax for a period of five years. If the job created pays twice the average of the county where the headquarters is located, the credit increases to $5,000 per job. The credit may be carried forward for up to ten years.

C. South Carolina

The South Carolina General Assembly took several significant steps in passing economic development legislation in its 2000 session. Act No. 289[93] provides for high technology companies to be afforded the same kinds of tax incentives that have been available to manufacturing, distribution, and processing facilities. The new Act defines "technology-intensive facilities" as those engaged in the design, development, and introduction of new products for innovative manufacturing processes through the systematic application of scientific and technical knowledge. It establishes a research and development income tax credit comparable to the existing federal Georgia and North Carolina income tax credits. The credit equals 5 percent of the taxpayer's annual increase in qualifying research and development expenditures. The credit may not offset more than 50 percent of its tax liability after all other credits have been applied but may be carried forward for ten years. Employee relo-

93. 2000 S.C. Act 289.

cation expenses associated with new or expanded technology intensive facilities and the cost of retraining production and technology employees will qualify under the new credit for offset. The Act adds an exemption from state sales and use tax for the purchase and use of machinery used "directly and primarily" in research and development and affords the property tax exemption for research and development facilities by providing a five-year exemption from the non-school portion of county property taxes for facilities engaged primarily in research and development activities.

Act 283[94] provides more flexibility for companies to pay a fee in lieu of tax instead of paying an ad valorem property tax. The new provision allows unrelated entities to combine their investments to meet the minimum statutory threshold of $5,000,000 within a county to obtain the benefits of the reduced assessment. The Act provides more flexibility for the financing of a fee in lieu of tax transaction with a county by authorizing equipment leases, build-to-suit leases, synthetic leases, Nordic leases, defeased tax benefit leases and transfer leases. Thus, a company participating in a transaction need only have a leasehold or other interest in the project property in order to qualify provided it meets the other requirements.

D. North Carolina

The North Carolina General Assembly passed legislation that modified the Bill Lee Act and established the Rural Redevelopment Authority and the Rural Internet Access Authority. The modifications to the Bill Lee Act (HB1814/SB1507)[95] clarified that there will be no application fee for investment tax credit applications in Development Zones. The Act changes the period of carry-forward for the application of investment tax credits to provide a five-year period for $50,000,000 investments and below, a ten-year carry-forward for investments between $50,000,000 and $150,000,000, and a twenty-year carry-forward for investments greater than $150,000,000. It establishes a wage test for the Industrial Recruitment Competitive Fund to encourage the use of these resources to recruit higher paying jobs and introduced a similar test for non-manufacturing projects with respect to the qualification for Industrial Development Funds. It set forth new provisions for making airline maintenance facilities and interstate air carrier hubs eligible for credits and clarified the type of "buy-out" for employees seeking qualification.

HB1819/SB1516[96] established the Rural Redevelopment Authority (RRA) as an independent public authority to make loans to local governments and economic development entities for industrial site development projects. The RRA is responsible for capitalizing the Rural Internet Access Authority, which is charged with overseeing the extension of high-speed Internet access to all of rural North Carolina by 2003.

94. 2000 S.C. Act 283.
95. 2000 N.C. Sess. Law H1814.
96. 2000 N.C. Sess. Law H1819.