

## Comments on Investment Protection under CETA:

### Good or bad; new or old?

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## Summary and Introduction

On 26 September 2014, the EU and Canada concluded the negotiation of the Canadian EU Comprehensive Economic and Trade Agreement (CETA). Ratification of the agreement will be the next step. The European Commission heralded CETA as a new, innovative agreement. Speaking on investment protection, Former Commissioner De Gucht<sup>1</sup> stated that the agreement establishes a system that sets a new standard for investor-to-state dispute settlement procedures, adding that CETA directly addresses all the concerns that have emerged so far.

This begs for the question: Is CETA the beginning of a new era of investment protection under free trade agreements, one that addresses long standing concerns surrounding investment protection?

The answer to these questions is, by and large: No. Although investment protection under CETA contains a number of positive elements, including the omission of an umbrella clause, improved investor-state-dispute settlement provisions (ISDS), and the prohibition of cherry picking under the MFN, CETA is not the beginning of a new era of innovative free trade agreements that addresses *all* concerns.

The investment chapter of CETA is still based on the fair and equitable treatment clause, the national treatment requirements, the 'most favoured nation' clause and the indirect expropriation rule--as are virtually all other investment treaties. Investors can still base claims on these ambiguous concepts. CETA maintains investment protection, although the EU and Canada have developed and functioning legal system, which provide for high levels of investment protection. Against the backdrop of developed legal systems, CETA's investment chapter is not only superfluous, but harmful because it is distorts competition at the expense of domestic competitors. Domestic companies have no access to ISDS while foreign competitor can bring claims on vague provisions to arbitration.

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<sup>1</sup> [http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152789.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152789.pdf)

This brief note comments on a number of key provisions of CETA's investment protection chapter: the fair and equitable treatment requirement, expropriation, most favoured nation treatment and investor-state dispute settlements.

## I. Fair and equitable treatment (FET, article X.9)

Article X.9 introduces the FET obligation, an essential standard obligation of investment protection. Practically, the FET obligation is the heart of international investment protection, routinely invoked by investors when bringing a case to arbitration. The clause in CETA is as follows (emphasis added):

Each party shall accord in its territory to covered investments of the other party and to investors with respect to their covered investments **fair and equitable treatment** and full protection and security in accordance with paragraphs 2 to 6.

A party **breaches** the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:

- **Denial of justice** in criminal, civil or administrative proceedings;
- Fundamental breach of due process, including a **fundamental** breach of transparency, in judicial and administrative proceedings.
- **Manifest** arbitrariness;
- **Targeted** discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
- Abusive treatment of investors, such as coercion, duress and harassment; or
- A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with **paragraph 3** of this Article.

The parties shall regularly, or upon request of a party, review the content of the obligation to provide fair and equitable treatment. The **Committee on Services and Investment may develop recommendations in this regard and submit them to the Trade Committee for decision.**

When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a party made a **specific representation** to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the party subsequently frustrated.

For greater certainty, 'full protection and security' refers to the party's obligations relating to physical security of investors and covered investments.

### Comments:

- Paragraph 2 contains wording widely used in other investment treaties. It limits FET violations to *manifest* arbitrariness; *targeted* discrimination on *manifestly* wrongful grounds, or *abusive* treatment. This list defines FET more narrowly

than older treaties, accounting for comparatively high levels of legal certainty.<sup>2</sup> However, the wording of paragraph 2 continues to use vague terminology, giving tribunals ample discretion in interpreting the clause. Terms such as “fundamental breach of due process, manifest arbitrariness, targeted discrimination or abusive treatment” of investors give investors protection in relatively extreme cases, but such terms remain ambiguous.

- A previous draft linked FET to “recognized international practice of (s)tates accepted as law.” This reference substantially blurred the content of the FET obligations under CETA. This link to general international law is not included in the final text--an important improvement.
- Paragraph 3 contains an opening clause, making it possible for parties to review and possibly adapt the content of FET. This clause can potentially make FET a moving target.
- Paragraph 4 refers to “a specific representation,” a broader term than “promise” or “written obligation.” This provision gives tribunals considerable discretion in determining which state action has frustrated legitimate expectations of an investor. Practically, this could become a catch-all provision.

## 2. Most Favoured Nation Treatment (MFN, Article X.7)

Article X.7 introduces the MFN obligation, another essential element of international investment protection. According to this obligation, a party must treat an investment no less favourably than it treats an investment from a third country “in like situations.” The clause in CETA reads as follows (emphasis added):

1. Each party shall accord to investors of the other party and to covered investments, treatment **no less favourable** than the treatment it accords in like situations, to investors and to their investments of **any third country** with respect to the establishment, acquisition, expansion, conduct, the operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.[...]
4. For greater certainty, the “treatment” referred to in Paragraph 1 and 2 does not include investor-to-state dispute settlement procedures provided for in **other international investment treaties and other trade agreements. Substantive obligations in other international investment treaties** and other trade agreements do not in themselves constitute “treatment”, and thus cannot give rise

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<sup>2</sup> Nathalie Bernasconi-Osterwalder, Howard Mann (2013): A Response to the European Commission's December 2013 Document “Investment Provisions in the EU-Canada Free Trade Agreement (CETA)”

to a breach of this article, absent measures adopted by a party pursuant to such obligations.

### **Comments:**

There are concerns that the MFN obligation would allow investors to import more favourable obligations from other BITs into CETA. Essentially, investors could cherry pick the most favourable rule.<sup>3</sup> This concern has been addressed by paragraph 4, which is an important improvement.

## **3. Expropriation (article X.11)**

Article X.11 allows parties to expropriate--directly or indirectly--investors only under specific circumstances. Investors may only be expropriated for a public purpose, under due process of law, non-discriminatorily and against payment of compensation. Expropriation clauses are an essential element of international investment protection and of great practical importance. Allegations of indirect expropriation, in particular, have been brought forward on numerous occasions. For this reason, the definition of indirect expropriation is critical. The clause in CETA is as follows (emphasis added):

### **Article X.11**

Neither party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as “expropriation”), except:

- (a) for a public purpose;
- (b) under due process of law;
- (c) in a non-discriminatory manner; and
- (d) against payment of prompt, adequate and effective compensation.

For greater certainty, this paragraph shall be interpreted in accordance with Annex X.11 on the clarification of expropriation.

### **Annex X.11**

The determination of whether a measure or series of measures of a party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:

- the economic impact of the measure or series of measures, although **the sole fact** that a measure or series of measures of a party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;

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<sup>3</sup> Nathalie Bernasconi-Osterwalder (2013): The Draft Investment Chapter of the Canada-EU Comprehensive Economic and Trade Agreement: A Step Backwards for the EU and Canada?, <http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/>

- the **duration** of the measure or series of measures by a party;
- the extent to which the measure or series of measures interferes with distinct, **reasonable investment-backed expectations**; and
- the character of the measure or series of measures, notably their object, context and intent.

3. For greater certainty, **except in the rare circumstance** where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, **non-discriminatory measures of a party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.**

### Comments

- Article X.11 contains standard wording, similar or identical to the wording of other investment treaties.
- Annex X.11 specifies that certain measures do not constitute an indirect expropriation subject to compensation in the first place. Accordingly, it excludes “non-discriminatory measures . . . to protect legitimate public welfare objectives, such as health, safety and the environment.” This is an important clarification.
- The clarification contained in Annex X.11 provides important guidance, but it is not a completely new concept. Other investment treaties contain similar clarifications, often using similar or even identical language. A few investment treaties, such as the US and Canadian model BITs contain explanatory annexes more, specifically defining the expropriation clause.
- Annex X.11 determines, however, an important exception. In rare circumstances, public welfare measures would constitute indirect expropriation if their impact is manifestly excessive in light of its purpose. This clause introduces a proportionality test which weakens the general exception of public policy measures. This wording has been criticized by some as potentially undermining the character of the “carve-out” for police measures, as the reference leaves it to the tribunal to decide the issue, instead of formulating a clear definition.
- According to IISD, the CETA draft reflects a long period of Canadian drafting and is now a better text than the traditional European BIT model.

## 4. Investor-State Dispute Settlement (ISDS, Articles X.17-X.43)

ISDS is an exceptionally contentious subject, particularly in light of the discussions and negotiations of TTIP. ISDS raises concerns on the rule of law, transparency, inherent conflicts of interests and impartiality of tribunals – to name the most critical worries. The Commission has alleged on various occasions that CETA addresses these concerns.

In general, there are no strong arguments for including ISDS rules in investment treaties between parties with developed legal systems, such those in Canada or the EU. There is no evidence that investors have systematically lacked appropriate legal protection through these systems. The Commission's claim<sup>4</sup> that the legal systems of Canada or EU member states may not always guarantee foreign investors adequate protection is misleading. The Commission argues that national legal system in these countries would, for example, not always protect against discrimination, restricted access to court or expropriation without proper compensation. By and large, these arguments are wrong, since all countries involved protect against specific types of discrimination or expropriation without complementation. In general, investors would have even a constitutional right against such unlawful action of host states. Various international human rights treaties also forbid discrimination or expropriation without compensation – provided certain requirements are met. Furthermore, ISDS provides foreign investors with an additional judicial remedy that is not available to domestic competitors; this additional avenue of legal redress discriminates against domestic companies and has the potential to distort competition.

However, it is a reality that the CETA draft contains a chapter on investment protection, including ISDS. Although it would be a right decision to exclude investment protection from CETA altogether, it is worthwhile to analyse the CETA's specific ISDS provisions, in particular those on conflict of interests, transparency, or appeal.

## a. Arbitrators: Conflict of Interests

A small number of arbitrators have served in various cases, sometimes in different capacities. Occasionally, arbitrators have been counsel to a party and served as an arbitrator in another case. A recent study showed that only 12 arbitrators have been involved (typically as one or more of three arbitrators) in 60% of a large sample of ICSID cases (a total of 158 cases out of 263 tribunals).<sup>5</sup> This has created various conflicts of interests.

CETA addresses this concern in Article X.25 to some extent. Accordingly, arbitrators must “be independent of, and not be affiliated with or take instructions from, a disputing party or the government of a party with regard to trade and investment matters. In more detail, arbitrators must comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration (IBAGCI), or any supplemental rules adopted by the Committee on Services and Investment. The IBAGCIA rules contain a system of (waivable

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<sup>4</sup> [http://ec.europa.eu/trade/policy/in-focus/ceta/index\\_en.htm#outcome](http://ec.europa.eu/trade/policy/in-focus/ceta/index_en.htm#outcome)

<sup>5</sup> Gaukrodger and Gordon,

and non waivable) red, orange and green lists. Depending on specific requirements, an arbitrator falls under the red, orange or green list. The non waivable Red List includes situations in which no person can be an arbitrator. Cases falling under the orange list require arbitrators to disclose all relevant facts; cases of the green list contain no limits on the appointment of an arbitrator.

### **Comments**

- In comparison to old investment treaties, the incorporation of IBAGCIA marks an improvement. Old treaties often contained no or only lax rules on conflict of interests.
- The IBAGCIA does not bar arbitrators from serving as arbitrator in a case he or she has given counsel to a party. The IBAGCIA only stipulates that arbitrators have to disclose facts in case “he/she has within the past three years served as counsel for one of the parties or an affiliate of one of the parties or has previously advised or been consulted by the party or an affiliate of the party making the appointment in an unrelated matter, but the arbitrator and the party or the affiliate of the party have no ongoing relationship”. This rule does not solve the fundamental problem of specific individuals serving as counsel and arbitrators for the same party in different cases, which is practically the most relevant conflict of interest.

## **b. Transparency**

ISDS has been criticised for its lack of sufficient transparency. CETA attempts to address this concern in Article X.33. According to this provision, the UNCITRAL Transparency Rules apply. Accordingly, a number of documents must be made public, including, for example, orders, decisions and awards of the arbitral tribunal or expert statements. Confidential information, however, may not be made public. Confidential information includes “confidential business information”, or information which with “disclosure would impede law enforcement”. Information that a state considers to be contrary to its essential security interests may not be made public either.

Furthermore, CETA stipulates that hearings are open to the public. Where the tribunal determines that there is a need to protect confidential or protected information, it shall make the appropriate arrangements to hold in private that part of the hearing requiring such protection. Importantly, CETA determines that “nothing in this (c)hapter requires a respondent to withhold from the public information required to be disclosed by its laws. The respondent should endeavour to apply such laws in a manner sensitive to protecting from disclosure information that has been designated as confidential or protected information”.

### Comments:

- Although CETA sets the general principal to make all documents public, it contains practically important exceptions. The tribunal has a considerable discretion whether to make documents public or not. Practice will demonstrate whether ISDS under CETA has fully addressed transparency concerns.
- Making hearings public is an important improvement compared to other ISDS provisions. However, the tribunal has wide discretion to exclude the public from hearings, which could in practice undermine the general principal of public hearings.

## c. Appeal and relation to domestic courts

The relation between ISDS and domestic courts is another contentious issue. In this respect there are two threads of arguments:

- Is the award under ISDS final or appealable in domestic courts?
- Does ISDS require exhaustion of domestic remedies?

CETA itself contains no appeal system, like other international investment agreements. The award is final – in principle. Only in rare circumstances, revision or annulment of an award is possible. If the ISCID Convention is applicable, only later discovery of facts that *decisively* affect the award give ground for revision. Annulment of an award may only be requested if the tribunal was not properly constituted or has manifestly exceeded its powers. Corruptions on the part of a member of the tribunal or a serious departure from a fundamental rule of procedure are other examples of grounds for annulment (Article 52 ISCID Convention).

CETA does not require exhaustion of local remedies. An investor is entitled to file for arbitration without seeking legal redress in domestic courts. CETA only requires investors to seek consultation. Only if a dispute has not been resolved through consultations, a claim may be submitted to arbitration.

### Comments:

- CETA contains no proper appeal system like in many other investment treaties. As such, it does not address a fundamental concern and falls short of any national court system. It is positive that CETA foresees future consultations on appeal systems and modes.
- It is unusual that individuals may bring a state to arbitration under international law. Next to investment protection, only human rights law gives individuals specific remedies. However, international human rights law requires individual persons to exhaust local remedies before a claim can be brought to an international court or other institution. Human rights law requires exhaustion of local remedies, largely to

avoid bypassing the national court systems. For the same reasons, a similar system should apply to investment protection.<sup>6</sup>

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<sup>6</sup> In April 2011, the European Parliament demanded an obligation to exhaust local judicial remedies „where they are reliable enough to guarantee due process....” .