Investment protection and dispute settlement in CETA

PowerShift e. V. and Canadian Centre for Policy Alternatives (CCPA) *

The European Commission and Canada had the opportunity in the Comprehensive Economic and Trade Agreement (CETA) to drop or significantly limit and reform the controversial investor–state dispute settlement (ISDS) system. They failed to do so. In fact, despite giving it a new name (the Investment Court System), European and Canadian negotiators retained in CETA the worst parts of the ISDS model and even considerably extended its scope geographically.

As the following analysis of CETA's chapter on investment protection (Chapter 8) reveals, the updated provisions in the final text merely adjust certain procedural aspects of the ISDS system without addressing the inherent threats posed by it, namely a limitation of democratic rights and the rule of law. Novel wording in CETA affirming the *'right to regulate'* cannot be relied on to protect public interest regulation from investor–state challenges.

As such, the growing number of European citizens and decision-makers already wary of, or opposed to, the inclusion of ISDS in the EU's Canadian and U.S. free trade agreements cannot feel secure in the Commission's assurances it has made the process more fair, transparent and accommodating of their concerns.[1]

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REFORMING OR REPEATING THE ISDS MISTAKE?

The European Commission is satisfied with the final CETA text, the German Ministry of Economics sees its approach confirmed within it, and many members of the European Parliament are relieved. All welcomed the outcome of the negotiations and believe that CETA will become the cornerstone of a global reform of the investment protection regime. However, this point of view masks one very crucial point: the people of Europe disagree.

During a EU-wide online consultation in 2014, 97 % of participants said they were against the investment provisions in

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1 See the Commission report of 13 January 2015, p.3 (http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf).

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CETA. Since the final report of the public consultation on investment protection was published, many European decision-makers appear to have ignored the heated political debate and the ongoing protests of millions of citizens. Policy-makers in Europe still consider the implementation of new privileges for foreign investors as politically crucial.

Generally speaking, Chapter 8 of CETA enables investors of one Party (Canada or the EU) to sue the other Party for vast amounts in damages if they believe they have suffered losses from a state's regulatory measures (e.g. for the protection of health, the environment, consumers or the stability of the financial system). Cases are not heard by the courts but by private arbitrators with the authority to judge the legitimacy of state actions against the investor protections in treaties such as CETA. EU member states have signed many bilateral investment treaties (BITs) with each other and with non-EU countries. However, the inclusion of ISDS in CETA would considerably expand the global reach of investment arbitration, multiplying the risk of litigation at the expense of the common good on both sides of the Atlantic.[2]

Of particular importance to Europeans is how many US corporations with subsidiaries in Canada will be able to access CETA's ISDS process if they cleverly structure their investments in the EU. According to recent estimates, 81 % of US enterprises active in the EU (about 42,000 firms) would conceivably fit the definition of a Canadian *'investor'* with recourse to ISDS under the EU–Canada agreement. US companies are already known for this kind of aggressive exploitation of the ISDS system.[3] Should the provisions on investment protection in CETA survive, if or when the agreement is ratified, there would be virtually no need to incorporate them in the Transatlantic Trade and Investment Partnership (TTIP).

By the same token, if CETA passes with Chapter 8 intact, any further adaption of the provisions on investment protection in TTIP, without a corresponding change to CETA, would be futile. Companies could simply choose the regional agreement that is more favourable for their purpose, i. e. CETA over TTIP. Therefore, the announced transatlantic *'reformation'* of investment protection would reach a dead end with CETA. The vague promise of a future *'multilateral investment tribunal'* (CETA Article 8.29) could remain unfulfilled indefinitely.

Faced with growing public discontent about the EU–US trade agreement, the European Parliament recently demanded *'to replace the ISDS system [in TTIP] with a*

2 Concerning the parallels between criticism of ISDS in TTIP and CETA, see (in German) Eberhardt, *'Investitionsschutz am Scheideweg – TTIP und die Zukunft des globalen Investitionsrechts, Internationale Politikanalyse'*, May 2014, with problematic real-life examples on p. 7 and 12 (http://library.fes.de/pdf-files/iez/global/10773-20140603.pdf); for an English analysis see Van Harten, *'A Report on the Flawed Proposals for Investor-State Dispute Settlement (ISDS) in TTIP and CETA'*, 10 April 2015, Osgoode Legal Studies Research Paper No. 16/2015, (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2595189).

3 See the report by Public Citizen, *'Tens of Thousands of U.S. Firms Would Obtain New Powers to Launch Investor-State Attacks against European Policies via CETA and TTIP'* (https://www.citizen.org/documents/EU-ISDS-liability.pdf).

new system for resolving disputes between investors and states' that would be more in line with democratic principles and the rule of law.[4] Parliament additionally demanded that foreign investors should *'benefit from no greater rights than domestic investors'*. However, the new CETA investment chapter shows the Commission is not ready for such fundamental changes. If the European Parliament takes its own red lines in the TTIP negotiations seriously it will have to reject CETA.

THE STRONG CASE AGAINST INVESTMENT PROTECTION AND ISDS

To date, no convincing arguments for including investment protection and ISDS in CETA have been put forward. In the EU and Canada, foreign investors already enjoy extensive protection through the legal system: property rights are fully enforceable in impartial courts. There is thus no need for securing special rights for foreign investors under international law—a point that has been stressed time and again by the current German federal government, among others.[5] Equally important, CETA grants these privileges to investors without demanding they take on any responsibilities in return. Investor obligations, such as the provision of employment opportunities, respect for human, workers' and consumer rights, or the observance of health and environmental standards, are not enforceable through ISDS and notoriously difficult to enforce through other international channels.

In practice, CETA offers substantive and privileged protection—above what is available under the law for domestic investors and citizens—for the property and expected profits of foreign investors. These rights by far exceed existing EU law and constitutional protections and can go as far as securing investors' interests from legitimate democratic political change.[6] A more limited protection against discrimination only (an option in the CETA negotiations) would have helped avoid situations where foreign investors are worse off than domestic investors. At the same time, this limited approach would ensure that a state's regulatory discretion in matters of general public interest is protected effectively, as investor rights would no longer exceed the scope of existing laws and constitutions.[7]

Instead, through the protection standards in CETA's investment chapter, foreign investors can sue for compensation against *'indirect'* expropriation measures or when they believe a state action has undermined their lost future profits. The very broadly worded right to fair and equitable treatment (FET) in Article 8.10, as well as the protection against indirect expropriation according to Article 8.12 and Annex 8A CETA, provide extensive levels of protection for foreign investors.[8]

4 See the European Parliament decision of 8 July 2015, with recommendations regarding TTIP negotiations, 2014/2228(INI), p. 2. d) xv. (http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2015-0252+0+DOC+PDF+V0//EN).

5 For a more detailed discussion of the counter-arguments of the Commission, see analysis of PowerShift (footnote 8), p.3 ff. Concerning the position by the federal government, see, inter alia, Federal Minister of Economics Gabriel's speech in the Federal Diet (Bundestag) on 25 September 2014 (http://www.bmwi.de/DE/Themen/aussenwirtschaft,did=656586.html).

6 In particular, investors are protected extensively through the broadly termed right to fair and equitable treatment (FET), Art. 8.10 para. 1-4, as well as the protection from indirect expropriation in Art. 8.12 para 1(2) and Annex 8-A CETA. See also National Treatment, Art. 8.6. para. 2 CETA; compare Art. 3 of the proposal for a more diligent and narrow: *'Modell Investitionsschutzvertrag mit Investor-Staat-Schiedsverfahren für Industriestaaten unter Berücksichtigung der USA'*, p.9f, as drafted by international law professor Markus Krajewski, and as commissioned by the BMWi (http://www.bmwi.de/BMWi/ Redaktion/PDF/M-O/modell-investitionsschutzvertrag-mit-investor-staat-schiedsverfahren-gutachten,property=pdf,bereich=bm-wi2012,sprache=de,rwb=true.pdf).

7 Compare with Krajewski/Hoffmann (footnote 13), p. 9.

8 Also note the standard of National Treatment, Article 8.6(2) CETA; compare Article 3 of the draft for a more narrow and diligent version of the standard in: *'Modell Investitionsschutzvertrag mit Investor-Staat-Schiedsverfahren für Industriestaaten unter Berücksichtigung der USA'*, p. 9f., developed by Professor Markus Krajewski, commissioned by the German federal ministry for economic affairs and energy (partly in English): http://www.bmwi.de/BMWi/Redaktion/PDF/M-O/modell-investitionsschutzvertrag-mit-investor-staat-schiedsverfahren-gutachten,property=pdf,-bereich=bm-wi2012,sprache=de,rwb=true.pdf

WHAT IS INVESTOR–STATE DISPUTE SETTLEMENT?

Canadian Centre for Policy Alternatives

'Investor–state dispute settlement (ISDS) is a non-judicial arbitration process that allows foreign investors to seek compensation for government decisions that adversely affect their investments. ISDS is given the force of international law by being enshrined in trade and investment protection agreements like CETA and the Transatlantic Trade and Investment Partnership, and is available exclusively to foreign investors, who are not required to exhaust domestic legal remedies before launching suits against host governments.

'Multinational companies and wealthy individuals have used ISDS to challenge a broad range of laws, regulations and policies, including measures related to public health, environmental protection, financial regulation and resource management. In some circumstances the threat of an ISDS claim gives foreign investors a powerful tool to deter governments from introducing policies or regulations they don't like.

'ISDS cases are usually decided by tribunals of three members: one chosen by the foreign investor, one by the challenged government and a third by mutual agreement of both parties (or, failing that, by an outside appointing authority). Tribunal decisions are subject to limited or no review in any court, whether domestic or international. Even so, in many countries their awards of public compensation to foreign investors are directly enforceable, comparable to high court decisions.

'Since the 1990s, recourse to ISDS has exploded, from a hardly noticeable number of cases to about 70 per year today. Canada has been sued 39 times under NAFTA's ISDS process, nearly always by U.S. investors, and has paid over $190 million (€ 130 million) in known awards or settlements. This record makes Canada the most-sued developed country in the world. At the same time, Canadian companies are lodging more and more cases internationally against environmental or resource management decisions in countries where they have prominent energy and mining interests.

'European corporations are also highly litigious, being responsible for roughly half of all known ISDS cases worldwide. Seven out of the top 10 countries that are home to companies suing under investment treaties are EU members. The number of ISDS claims and the amount of ordered compensation continues to grow worldwide.'

Efforts to limit and specify the protection standards in CETA (in comparison to older agreements) have not been successful, since many of the legal concepts provide a wide scope of interpretation, leaving far too much discretion to arbitrators. Of particular concern, Article 8.10(4) gives arbitrators the right to consider whether the *'legitimate expectation'* of the investor has been upset by state action. Investment arbitration panels have repeatedly used this criterion in the past to expansively interpret the standard of fair and equitable treatment.

The revised CETA investment chapter includes new wording confirming the state's right to regulate. But it would be a mistake to believe governments will be able to use this provision to successfully defend against challenges to their regulations, since it still leaves arbitrators with huge discretion in deciding if the state measures in dispute are legitimate.

Trade and investment tribunals have consistently ruled that while governments have the right to regulate it is constrained by treaty obligations entered into voluntarily. According to the WTO Appellate Body, for example, trade agreements *'discipline the exercise of each Member's inherent power to regulate by requiring WTO Members to comply with the obligations that they have assumed thereunder'*. Regarding a bilateral investment treaty dispute against Hungary, the panel stated: *'It is the Tribunal's understanding of the basic international law principles that while a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. As rightly pointed out by the Claimants, the rule of law, which includes treaty obligations, provides such boundaries'*.

Having been told repeatedly by tribunals that obligations in trade agreements discipline and set boundaries on the right to regulate, negotiators cannot legitimately claim that simply affirming the right to regulate adequately protects governments from successful treaty challenges to their regulations. In other words, in the current draft of CETA the *'right to regulate'* is merely a vague norm to be interpreted during the ISDS process itself, offering arbitrators considerable leeway to decide in favour of the investor, i. e. against state regulation.

The final CETA text incorporates some long overdue improvements to the ISDS process. For instance, claimants in a dispute (the investors or corporations) no longer directly influence the choice of arbitrators. CETA establishes a permanent investment tribunal, or roster, made up of 15 arbitrators to be appointed by the EU and Canada. Of them, five will be Canadian and five European nationals, with the remainder appointed from third countries. This and a set five-year term (with possibility of one renewal) are meant to safeguard

STATEMENT ON THE ESTABLISHMENT OF AN INVESTMENT TRIBUNAL IN TTIP
by the Association of German judges

*"The German Magistrates Association rejects the proposal of the European Commission to establish an investment court within the framework of the Transatlantic Trade and Investment Partnership (TTIP). The DRB sees neither a legal basis nor a need for such a court." (...) The creation of special courts for certain groups of litigants is the wrong way forward. (...) The German Magistrates Association sees no need for the establishment of a special court for investors. (...) Neither the proposed procedure for the appointment of judges of the ICS nor their position meet the international requirements for the independence of courts. As such, the ICS emerges not as an international court, but rather as a permanent court of arbitration."**[*]

the impartiality of arbitrators. Investment disputes under CETA will be decided by three arbitrators selected from this roster by the investment tribunal president (a rotating position): one must be from the Canadian pool, one from the EU pool, and a final chosen from among the third-country group who will serve as chair of that particular ISDS case.

Despite these procedural changes, which have been given the name of an Investment Court System, there are major deficiencies in the CETA process with regard to the rule of law, in particular around judicial independence. For instance, Investment Arbitrator is not a full-time job. Even though Article 8.30 prevents arbitrators from acting *'as counsel or as party-appointed expert or witness in any pending or new investment dispute under this or any other international agreement'*, they may still sit as arbitrators in other ISDS cases in addition to their role on the CETA investment tribunal.

Additionally, tribunal members will still be paid per case, creating a financial incentive to try a large number of investor claims, which is mainly achieved by ruling expansively in the interest of investors. One obvious solution for avoiding possible conflicts of interest would be to appoint arbitrators on a full-time, salaried basis and prohibit members of the roster from holding a second office, exactly as the Commission considered as late as March 2015. Instead, the final CETA text postpones incorporation of such important safeguards by way of possible future amendments. From a political point of view, despite the Commission's optimism, such an ex post amendment is hardly feasible.

STILL NO IMMEDIATE POSSIBILITY TO APPEAL ISDS RULINGS

A further source of concern is that the Commission apparently did not insist on the full incorporation of an appellate body during the initial phase of CETA's implementation. An appeal mechanism could ensure some degree of accountability over the members of the investment tribunal. It might also guarantee uniform implementation of the agreement, particularly if it operated on the basis of precedent. Furthermore, an appellate body could allow states to get a more accurate understanding of the potential risks of litigation and thereby enable the legislative branch to respond to such risks through sensitive policy choices.

* See statement by the Association of German Judges, http://canadians.org/sites/default/files/tpp-deutsche-richterbund-opinion-0216.pdf

Even though the negotiating parties envisage incorporating an appellate tribunal into the ISDS mechanism, its realisation is deferred into the future, with no concrete deadline.[9] The detailed configuration and establishment of an appellate tribunal could easily drag out for many years. In the meantime, the tribunals' decisions against a state would be enforceable, as they are now under similar treaties, without any possibility of substantial legal recourse.

This aspect of CETA's investment chapter is a step backward in comparison to EU proposals in the TTIP negotiations, which included the immediate incorporation of an appellate body. Furthermore, the Commission has demonstrated half-heartedness in relation to safeguards of due process. While the TTIP proposal foresees new participatory rights for all affected parties (e.g. citizens, NGOs, associations, competitors of the suing investor, etc.), these were swept under the rug during the negotiations with Canada.

CONCLUDING REMARKS

The proposed Investment Court System in CETA, with its permanent roster of arbitrators and potential (but likely unrealisable) appeals process, is not a convincing response to the threats posed by ISDS. Despite some procedural improvements compared to other agreements, an expansion of ISDS to cover transatlantic investments must be firmly rejected. There are further material legal concerns with the ISDS process in CETA and TTIP. The incorporation of a parallel quasi-judicial system disconnected from the European courts could come into conflict with the principle of the autonomy of the European legal order, since ISDS poses a threat to the effective and uniform application of EU law.

Despite these Europe-wide constitutional considerations, the Commission is still proposing that CETA should come into effect provisionally after a decision by Council and with the support of the European Parliament. Acknowledging the strength of public and member state concerns, the Commission appears to have accepted that it must omit CETA's investment protection and ISDS process from provisional application. In fact, as investment protection is not an exclusive competence of the EU, member states government must be involved in the decision-making process concerning ISDS. It is to be hoped that some national parliaments will assert their authority by rejecting these unnecessary and imbalanced investor rights.[10]

9 see Art. 8.28 para. 7 CETA.

10 See analysis by ClientEarth, *'Legality of investor-state dispute settlement (ISDS) under EU law'*, 22th October 2015, p. 3 ad 7 http://documents.clientearth.org/wp-content/uploads/library/2015-10-15-legality-of-isds-under-eu-law-ce-en.pdf.