Free trade or climate protection? Energy and climate policy-related threats posed by CETA

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There are long-standing tensions between the goals of increasing trade and of protecting the environment from harmful commercial activities. Today's generation of free trade agreements, for example, are designed to remove *'non-tariff barriers'* to trade, a goal that interferes considerably with the political and legal capacity of states to regulate in the public interest, and generally undermines democratic decision-making processes.

Perhaps most controversially, new agreements like CETA and TTIP give investors and corporations strong international legal rights to challenge government measures that have the effect of undermining a commercial activity or investment opportunity—even if the measures were enacted, first and foremost, to protect the environment or reduce greenhouse gas emissions.

These extensive protections offered to investors in CETA, together with the agreement's strong emphasis on the liberalisation of services and procurement, compromise two central aspects of sustainable energy and climate policy: the push to restrict and rapidly phase-out fossil fuel–based energy, and efforts to promote and develop alternative renewable energy sources.

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BACKGROUND

The international community has committed—most recently in the 2015 Paris Agreement—to limit the increase in global average temperature to *'well below 2°C above pre-industrial levels'*, and even to pursue efforts to limit the increase to 1.5°C, in order to significantly reduce the risks and impacts of climate change

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(UNFCCC 2015: Art. 2).[1] If the international community hopes to achieve its goals, greenhouse gas (GHG) emissions will need to be cut drastically—and in many sectors eliminated entirely—in the years and decades to come. In particular, there is an urgent need for governments to pursue the following mitigation efforts:

➜ Phasing out fossil fuels (coal, oil, gas) as an energy source, particularly for the generation of electricity and heat, and for transportation;

➜ Switching to renewable energy sources such as wind and solar power, biomass and hydroelectric, among others;

➜ Significantly improving energy efficiency in all economic and social sectors, as well as reducing energy consumption in the production of goods and services;

➜ Reducing GHG emissions from agriculture (e.g. by reducing destructive industrial agricultural practices); and

➜ Reducing transport distances through the promotion of regional economic cycles.

In contrast, free trade agreements are intended to promote trade in goods and services with little consideration for the environmental consequences. The external costs of climate-related damage—caused by longer transport distances, greater trade volumes, industrial agriculture or the destruction of local economies—are not taken into account, or play a subordinate role, in free trade negotiations.

1 UNFCCC 2015: United Nations Framework Convention on Climate Change, Paris Agreement, 12 December 2015. Downloaded at http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf on 19.08.16.

Environmental regulations that restrict trade may even be targeted for elimination by trade negotiators.

Once an agreement like CETA is in place, however, it creates further risks that climate mitigation measures, like those described above, will be challenged as illegal trade barriers. For example, according to McGlade and Ekins (2015), assuming optimal economic efficiency, limiting the increase in global average temperature to 2°C would require that a third of all oil reserves, half of gas reserves and more than 80 per cent of coal reserves are left in the ground. In Canada, 75 per cent of oil reserves will need to remain undeveloped. These scientific findings clearly imply that increased production of unconventional oil conflicts with the 2°C goal.[2] And so, when assessing CETA from a climate policy perspective, it is crucial to ask whether the agreement facilitates or impedes efforts to reduce the extraction and use of fossil fuels in the future.

The final CETA text almost completely ignores climate change. Only the chapter on Trade and Environment (Chapter 24) mentions climate policy at all: Article 24.9.1 commits the Parties to promote trade and investment in environmental goods and services, while Article 24.12.1(e) provides for cooperation on environmental issues. However, the chapter is not enforceable through CETA's general dispute resolution process. It also does not include clear provisions that would allow climate policies to overrule, or otherwise be exempt from, CETA's market access, services liberalisation or investment protection rules. It is a huge oversight that two countries as committed as they say they are to fighting climate change would not safeguard their discretionary powers to regulate in favour of climate protection. Instead, CETA will make climate considerations secondary to the rights of business.

2 McGlade, Christophe; Ekins, Paul 2015: The geographical distribution of fossil fuels unused when limiting global warming to 2 °C, Nature 517, pp 187-190 (8 January 2015). doi:10.1038/nature14016

ANALYSIS OF KEY PROVISIONS

Investor protection for energy and mining corporations

In contrast to CETA's incomplete and toothless environmental chapter, the agreement's provisions for investor protection are extremely broad and can be enforced directly (i.e. without the support of government) through the agreement's investor–state dispute settlement (ISDS) mechanism (see chapter on ISDS). Essentially, CETA will make it possible for foreign investors of one Party to challenge the government policies, regulations or laws of the other that they feel violate the agreement's investment chapter, and to have these lawsuits decided by paid arbitrators instead of domestic courts. In 2015, for example, Canadian energy giant TransCanada launched a US$15-billion ISDS case against the U.S. government under the North American Free Trade Agreement (NAFTA), claiming the decision to cancel the Keystone XL tar sands pipeline violated the company's investor rights.

Environmental policy is hardly insulated from the threat of such investor lawsuits in CETA. On the surface it may appear Article 28.3.2 shields government measures that are deemed necessary to *'protect human, animal or plant life or health'* or *'for the conservation of living and non-living exhaustible natural resources'*, which cannot be challenged based on the investment chapter clauses (related to the those falling under the headings of *'establishment of investments (Section B)'* and *'non-discriminatory treatment'* (Section C)). But Article 8.2.4 of the investment chapter already rules out ISDS for violations of those sections in general. CETA negotiators could have made the Article 28.3 exceptions much stronger by also applying them to the *'investment protection'* provisions in Sub-Section 8-D of the investment chapter, which are the basis for many ISDS

CETA'S SUSTAINABILITY CHAPTER—WINDOW DRESSING FOR AN EMPTY HOUSE

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EU trade policy has been heavily criticized on social and environmental grounds. The EU has responded by adding socially conscious rhetoric to trade agreements without actually changing the underlying policy logic or legal effect. Although CETA contains encouraging wording, it does not effectively protect workers' rights and the environment or ensure sustainability in Canada and the EU.

CETA's chapter on Trade and Sustainable Development (Chapter 22) is just four pages long and characterised by its use of cautious language. The chapter contains a number of references to non-binding approaches, without any further obligations under international law for the contracting Parties to promote sustainable development. Like the Trade and Environment chapter, the enforceability of CETA's sustainability chapter is limited by purely aspirational terms such as *'dialogue'*, *'promote'*, *'encourage'*, *'voluntary best practices'*, *'review'*, *'monitor'*, *'assess'*, *'transparency'* and *'public participation'*.

In its objectives, the sustainability chapter refers to international norms and declarations without establishing any real commitments. For example, Article 22.1.1 states *'the Parties recognise that economic development, social development and environmental protection are interdependent and mutually reinforcing components of sustainable development, and reaffirm their commitment to promoting the development of international trade in such a way as to contribute to the objective of sustainable development'*. These statements have no legal substance; ultimately they pay mere lip service to the broader objectives of sustainable development.

Any dispute mechanisms contained in Chapter 22 are entirely voluntary. No reluctant government or international investor will be incentivised to promote sustainable management for the benefit of the common good. At best, all the agreement does is encourage Canada and the EU to undertake *'voluntary schemes relating to the sustainable production of goods and services'* and *'the development and use of voluntary best practices of corporate social responsibility by enterprises, such as those in the OECD Guidelines for Multinational Enterprises'* (Article 22.3.2.).

cases related to environmental measures. The fact that they didn't tells us much about what kinds of investors CETA is designed to protect, and against what public policy measures.

The highly problematic and vague term *'fair and equitable treatment'* (FET) forms the substantive legal basis for many investment arbitration cases. Article 8.10.4 of CETA (*'Treatment of investors and covered investments'*) provides that, in determining whether FET has been violated, the arbitration 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'*.

This language strengthens the hand of investors in the fossil fuel sector, as most countries follow a multistage approval and licencing process to conduct research

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on, exploit or extract raw materials. For example, the denial of subsequent authorisation after initial approval is granted may become the basis for an ISDS case (as it did in El Salvador in the case of a rejected gold mine project, and the Canadian province of Quebec, after it implemented a moratorium on hydraulic fracturing under the St. Lawrence River). In addition, the terms *'specific representation'* and *'legitimate expectations'* invite broad interpretation. Whether a friendly letter from a minister to an investor about a potential project creates a *'legitimate expectation'*, for example, would ultimately be determined by a panel of three arbitrators, rather than a legitimate court.

ISDS can also be invoked to challenge environmental measures when an investor (e.g. a multinational oil company) claims there has been an *'indirect expropriation'* of their investments. When assessing whether a measure constitutes indirect expropriation, *'the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations'* (Annex 8A) must be taken into consideration. Like the FET standard, indirect expropriation has been cited in many past ISDS cases to claim compensation from governments for their resource management measures.

Since they are subject to the FET and expropriation rules, investments in fossil fuel extraction projects and energy infrastructure are still largely protected and enforceable through ISDS. Article 8.1 clearly states that *'a concession... including to search for, cultivate, extract or exploit natural resources'* counts as a covered investment for the purposes of initiating investment arbitration. This means that urgently needed climate policies, including rules to increase energy

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efficiency or reduce energy consumption, as well as measures to reduce and phase-out fossil fuel–based energy generation, are at risk of provoking investor–state disputes. Because measures intended to reduce greenhouse gas emissions may soon make the extraction of fossil fuels unprofitable, there is a clear danger mining and resource companies will try to recoup their lost potential profits through ISDS at the cost of taxpayers in Canada and Europe.

Liberalisation of services and public procurement

Services are an increasingly important part of the energy industry related to the delivery of goods. Therefore, the comprehensive liberalisation of services under CETA constitutes a further potential constraint on proactive climate policies (see Trade in Services chapter).

CETA's provisions for market access in Article 9.6 of the Cross-Border Trade in Services chapter largely eliminate economic needs tests or quantitative restrictions on the number of service providers in a given sector. Even though the negative list approach enables contracting parties to include reservations on existing and future regulatory measures, it is doubtful that these will allow for a permanent restriction or prohibition of services, which e.g. fail to comply with certain energy efficiency criteria, or which rely on fossil fuels. On the Canadian side, some of the reservations to the agreement, as incorporated by its provinces and territories, are of considerable scope. On EU side, substantial reservations to the agreement were included only by Belgium, Bulgaria (with a fracking prohibition), Cyprus, Finland, France, Malta, the Netherlands, Portugal and the Slovakian Republic.

Just as the strict regulation of energy service companies becomes more important given the climate change imperative, so too can public procurement play a role in promoting renewable energy. Governments have traditionally been able to impose qualitative requirements, beyond

commercial considerations, when tendering procurement contracts (e.g. to require clean energy use in public buildings). Article 19.9.9 within CETA's Government Procurement chapter permits the inclusion of 'environmental characteristics' among the evaluation criteria for awarding public contracts. However, Article 19.14.5(a) requires that a contract be awarded to the supplier that has submitted the *'most advantageous'* tender, which is not defined and could be used to sideline higher-cost but more environmentally friendly bids. While most of CETA's provisions for public procurement are very detailed, a precise definition is not included for this crucial phrase.

Promotion of renewable energy delayed through regulatory cooperation

For the international community to meet its Paris Agreement commitments, a drastic reduction in fossil fuel–based energy must be complemented by the rapid development of new renewable energy sources. It also requires massive investment and reregulation to transform existing energy grids to link the use of renewables, energy saving technologies and energy efficiency programs.

In this context, it is extremely problematic that CETA's Regulatory Cooperation chapter (Chapter 21) encourages both Parties to improve competitiveness and efficiency through compatible *'regulatory approaches which are technology-neutral'* (Article 21.3(d)(iii)(A)). This concept of neutrality, in the context of the energy industry, directly contradicts efforts to promote clean energy technologies and discriminate against technologies that damage the environment. Though a Party is not required to cooperate on regulatory development, and can withdraw from cooperation activities, *'it should be prepared to explain the reasons for its decision to the other Party'* (see Regulatory Cooperation chapter).

Dilution of the EU Fuel Quality Directive

The European Commission's relative disregard for climate protection in its efforts to promote trade in fossil fuels is also evident in the conflicts surrounding CETA and the 2009 EU Fuel Quality Directive. Under the directive, which was designed to reduce CO^2 emissions in the transport sector by 6 per cent, different kinds of fuel were classified based on the intensity of their GHG emissions. Notably, a Stanford University study commissioned by the European Commission found that emissions from Canadian tar sands oil were 23 per cent higher than those from conventional oil. Because this classification was likely to have negative consequences for Canadian tar sands exports, the Canadian government initiated a lobbying campaign in Europe to oppose the proposal:

'Ministers and parliamentarians visited the Brussels offices, hired PR firms and developed a secret lobby strategy called "Pan-European Oil Sands Advocacy Strategy". Already in the first two years, the Canadians organized 110 lobby events in Europe—more than one per week. The scientific studies of the EU were doubted on the basis of questionable reports, EU politicians were accompanied to one-sided fact-finding visits to Canada and, amongst conservative energy politicians and European industry representatives, willing partners were found.' [3]

The Canadian campaign was supported by U.S. Trade Representative (and chief TTIP negotiator) Michael Froman, as well

3 Pötter, Bernhard 2014: Freier Markt für dreckiges Öl, taz 06.10.14, original German passage: „*Minister und Abgeordnete besuchten die Brüsseler Büros, heuerten PR-Firmen an und entwarfen eine geheime Lobbystrategie namens ´Pan European Oil Sands Advocacy Plan´. Allein in den ersten zwei Jahren organisierten die Kanadier 110 Lobbyveranstaltungen in Europa, mehr als eine pro Woche. Sie stellten mit zweifelhaften Gutachten die wissenschaftlichen Studien der EU infrage, flogen EU-Politiker zu einseitigen Informationsbesuchen nach Kanada und fanden unter konservativen Energiepolitikern und europäischen Industrievertretern willige Partner.*"

as multinational oil corporations such as BP and Shell.[4]

Due in part to this external pressure, the European Commission weakened its own implementing legislation and effectively rendered the directive toothless. While the calculation tables for various types of oil were included as an annex in the directive, it no longer required the origin of oil to be revealed.[5] The European Parliament's Committee on the Environment and a slim majority of MEPs (337 to 325) opposed the dilution of the directive in December 2014, but since the required qualified majority of 376 votes was not achieved it passed anyway.

CONCLUSIONS AND RECOMMENDATIONS

As currently written, CETA is a several-thousand-page-long list of what governments cannot do to interfere with trade. As discussed, the agreement's chapters on investment, cross-border trade in services, regulatory cooperation and procurement, among others, will make it more difficult for governments to phase-out fossil fuels or promote and develop alternative energy sources. The Trade and Sustainable Development and Trade and Environment chapters are mostly rhetorical. From a climate policy perspective, therefore, CETA would be a major setback, to say the least.

Governments need to retain adequate regulatory flexibility to face the climate crisis head-on. For this to happen, the agreement will need to be significantly changed in at least two ways. First, the Investment chapter and ISDS process must be excluded entirely. Modest procedural reforms and the prospect of an Investment Court System (see ISDS chapter) do not go far enough to safeguard public policy, including strong environmental protection measures, from corporate lawsuits outside the regular court system. Second, CETA should include unambiguous language to protect and promote climate policy—including regulations designed to increase the share of renewable energy, to reduce energy use and to improve energy efficiency—meant to address Paris Agreement commitments to reduce GHG emissions.

The urgency of the climate crisis means we need to put the days of binding trade rules and voluntary climate obligations behind us—to flip that logic on its head so that sustainable trade is stimulated and environmental regulation prioritised.

4 Van Beek, Bas and others 2015: Freihandel. TTIP ist schon Realität, ZEIT Online 29.05.15. Downloaded from http://www.zeit.de/wirtschaft/2015-05/ttip-ceta-kosten on 29.05.15.

5 Pötter, Bernhard 2014.