Joint analysis of CETA's Investment Court System (ICS)

Prioritising Private Investment over Public Interest

This analysis is based on the revised Investment Protection Chapter of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, published 29th February 2016.

The new CETA Investment Chapter contains some improvements compared to the previous version: the introduction of an article on the right to regulate; clearer ethics rules; more transparency provisions. Nevertheless, it falls short of addressing some core concerns relating to the protection of public health; animal and plant life and health; the environment; consumers' and labour rights. It may create a 'fright to regulate' as the actual 'right to regulate' in the public interest is not sufficiently guaranteed and protected.

The following analysis highlights key concerns that have not been addressed in the revised CETA investment chapter, meaning that CETA falls short of safeguarding democracy and the rule of law both in Europe and Canada. See Annex 1 for a technical and detailed legal assessment.

ICS in CETA: The Good, the Bad, the Ugly

The Good:

- Recognition of the flaws of Investor to State Dispute Settlement (ISDS)
- Increased transparency in the proceedings

The Bad:

- One-sided system which allows investor claims only, based on broadly defined investor rights
- The right to regulate is not sufficiently protected
- No requirement to exhaust domestic legal remedies
- Negative effects of awards and "loser pays" on small Member States

The Ugly:

- Lack of independence of Tribunal members not fully addressed
- Insufficient public scrutiny and accountability of the CETA Joint Committee
- Lack of justification for such a contentious mechanism between Parties with developed legal systems based on the rule of law
- No legal certainty over compatibility of Investment Court System (ICS) with the EU Treaties

A joint briefing by:

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Key concerns

1. Definition of Investment (Art. 8.1)

The definition is very broad, covering "every kind of asset" under direct and indirect control of an investor. Moreover, it is retroactive and would cover investments made before the entry into force of CETA. The chapter attempts to limit treaty shopping and abuses by mailbox investors, but defining the key concept of "substantial business activity" is left open to interpretation by tribunals. An exhaustive list of covered investments, an enterprise-based definition and thresholds could have ensured that only selected types of investment were protected under the agreement.

2. Establishment of Investment (Arts. 8.4 - 5)

CETA grants extensive market access, which may prohibit a wide range of measures that regulate the entry or treatment of foreign investors. The full extent of liberalisation depends on the market access carve-outs (measures or future measures reserved in Annexes I and II). However, it still risks binding the EU or Member States to longstanding commitments in areas they did not intend to cover. This is due to the negative list approach, which the EU used for the first time in CETA and which still looks very patchy. A further risk is that some of these commitments are subject to investment arbitration. The prohibition of performance requirements in Art. 8.5 is another weakness because it goes beyond obligations at WTO level. Local content or technology transfer requirements can be legitimate policy tools.

3. Non-discriminatory Treatment (Arts. 8.6 - 8)

The articles create obligations to grant national treatment and most-favoured nation (MFN) treatment to each other's investors. The outcome of this is that the EU and Member States have, de facto, undertaken commitments to prospective investors even before the investment is made.

4. Right to Regulate (Preamble and Art. 8.9)

These newly included provisions intend to strengthen the right to regulate. The right to regulate can be understood as defining the balance between the sovereign right of a party to regulate in the public interest and its obligations towards foreign investors. However, Art. 8.9 (1) merely 'reaffirms' this already existing balance. The following paragraph offers some improvement, but it cannot properly be construed as a carve-out for decision-making in the public interest. The formulation of this article is declarative and not legally enforceable. It is merely a guideline for arbitrators. Contrary to public statements by the parties, these provisions therefore fail to effectively limit claims that challenge public policy measures. To protect the right to regulate, the parties should have introduced a carve-out or a binding principle to guide interpretation, see Annex.

5. Investment Protection and Fair and Equitable Treatment (Art. 8.10)

This article accords Fair and Equitable Treatment (FET) to investors and investments, which has become the centrepiece of most modern investor claims. Known as "catch-all" provision, it has allowed investors to challenge public policy measures through arbitration. Art. 8.10 seeks to address this problem by listing the types of conduct that constitute a breach of the FET standard. However, it falls short of a real improvement for three reasons:

- The list is a mere codification of already existing practice under investment law, and does not significantly limit the standard.
- The article codifies the 'frustration' of 'legitimate expectations' of an investor as a breach of the standard. As one of the most far reaching interpretations of FET, codifying legitimate expectations is not a limitation of the standard, but an expansion of it.
- The list of breaches is not exhaustive, and can be amended by the CETA Joint Committee, which would expand the scope of the standard (please see point 13 and Annex).

6. Expropriation (Art. 8.12 and Annex 8-A)

While the definition of indirect expropriation (in Annex 8-A) offers a shield against general investor challenges concerning regulatory measures, the carve-out only applies to non-discriminatory measures that protect legitimate public welfare objectives and to measures that do not 'appear manifestly excessive'. An acceptable solution would have been to exempt all measures that aim at or contribute to public interest, but as it stands, the text fails to ensure full protection of public health, the environment and consumer rights. Furthermore, the calculation of compensation should take into account whether the investment produced negative economic and societal costs from the date of requisitioning or destruction until the date of actual payment.

7. Relationship with Domestic Courts (Arts. 8.22 - 24, Arts. 8.32 - 33)

The revised chapter does not require the exhaustion of domestic remedies, but permits investors to choose between going to national (or international) courts or the investment arbitration mechanism under CETA. The exhaustion of local/domestic remedies is an important rule of international law, which has become common practice in international investment law. It can officially be demanded as a requirement for consent under the ICSID Convention (Art. 26). CETA therefore goes against a standing practice in international law and perpetuates the privileged status of foreign investors under international investment law. Furthermore, both Canada and the EU have advanced legal systems, based on the rule of law, which guarantee adequate judicial protection for foreign investors and there is no evidence of systematic discrimination of foreign investors in either jurisdiction.

8. Independence and Selection of Tribunal Members (Arts. 8.27, 8.28 & 8.30)

The revised chapter seeks to address one of the core criticisms of ISDS - the lack of independence and bias towards investors of ISDS arbitrators - by modifying the selection process of CETA tribunal members. Tribunal members will be randomly selected from a roster of 15 individuals, appointed by the CETA Joint Committee. While the selection process is a step in the right direction, CETA still does not guarantee sufficient independence because (please see Annex for an elaboration of the points below):

- Tribunal members are (still) not financially independent and remain incentivized.
- The selection process of the roster of Tribunal Members is opaque and lacks concrete rules on appointments or scrutiny thereof.
- This system opens the interpretation of complex, sovereign public policy decisions up to tribunal members who will evaluate them from a narrow trade/investment perspective with insufficient knowledge of domestic law or expertise in public policy fields.

9. Appellate Mechanism (Art. 8.28)

While the introduction of an appellate mechanism is to be welcomed, the ad-hoc tribunal merits some criticism. Neither its overall functioning and procedures, appointment of members or their remuneration are defined in the final CETA text. The mechanism is heralded for increasing the legitimacy of the system, yet these fundamental elements are to be defined by the CETA Joint Committee (see also point 13). One of the core features of ICS is thus still pending, enabling it to escape any democratic scrutiny and risking to produce a technocratic court, driven by policy justice rather than public justice.

10. Transparency (Art. 8.36) and Intervention by Third Parties

The chapter contains considerable improvements on transparency. It is based on, and goes further than the UN Commission on International Trade Law (UNCITRAL) transparency rules. Hearings, exhibits and submissions would be made available to the public, which is a novelty, and civil society stakeholders can make *amicus curiae* submissions. However, there are no deadlines for the publication of awards, and redactions of confidential information will have to be monitored by civil society to make sure they are not going too far. Unlike the TTIP ICS proposal, CETA does not offer possibilities for third-party intervention. This is a regrettable choice. Rights and mechanisms for third-party intervention are vital, for example for local population, who are directly affected in cases relating to environmental permits for mining or infrastructure projects.

11. Final Award (Art. 8.39)

The article attempts, but fails to effectively prevent a potential regulatory chill effect, resulting from fear of having to pay high compensation to foreign investors. On the one hand, it excludes the award of punitive damages and limits damages to monetary damages and restitution of property at market value. On the other hand, it fails to clarify that 'the loss suffered by the investor', which will have to be compensated, does not include expected profits. This is relevant in light of claims brought in relation to investor's legitimate expectations (see above). As it stands, investors would be able to sue governments for great sums covering years of expected profits. Moreover, while the "loser pays" principle may in principle deter (frivolous) claims, it might also impose a heavy burden on smaller Member States, considering that proceedings can last 24 months or longer. If, as the chapter claims, frivolous and unlawful claims are already being filtered by the respective articles, this principle is an inadequate choice.

12. Sunset Clauses in CETA (Arts. 30.8 (4) and 30.9 (2) CETA)

Sunset clauses are a controversial mechanism to prolong the applicability of investment agreements so that investors can still bring a claim, even after countries have terminated the agreement. The sunset clause in CETA Art. 30.9 (2) is set for 20 years, which is long in international comparison and longer than the 15 years used in most Member State BITs with Canada. This undermines democratic processes as, particularly in Europe, decisions to terminate international agreements are usually based on internal democratic decision-making. Moreover, CETA contains a sunset clause for provisional application, which is entirely unprecedented (Art. 30.8 (4)). If provisional application was terminated and the agreement does not enter into force, investors could benefit from the chapter for another three years. This means that foreign investors could potentially sue governments under CETA, even if national parliaments reject the deal.

13. The CETA Joint Committee (Art. 26.1)

The CETA Joint Committee has several important powers, but there are no rules which determine how the Committee can be publically held accountable for its decisions, nor are there any clear rules on its composition, decision-making, and transparency. Art. 26.1 establishes the Committee which *"shall be co-chaired by the Minister for International Trade of Canada and the Member of the European Commission responsible for Trade, or their respective designees"*, but further elements of its composition are unclear. It not only appoints the roster of Tribunal members, but it can also adopt definitions of the 'fair and equitable treatment' standard and adopt interpretations of provisions in the investment chapter that will be binding on tribunals, even while a case is ongoing. These factors contribute to making ICS unpredictable and potential prey to influences seeking to undermine public interest decision-making processes. The powers of the CETA Joint Committee are problematic because it can change features of the agreement without democratic oversight or accountability and undermine the power of courts to interpret EU law.

14. Compatibility with EU Law (Art. 8.31 and others)

Art. 8.31 seeks to accommodate one of the key constitutional flaws of ISDS under EU law: its incompatibility with the Treaties. The article seeks to preserve the powers of the European Court of Justice (ECJ) and the autonomy of the EU legal system by limiting the powers of the Tribunals in relation to domestic law. However, these precautions are not sufficient to take into account the fundamental concerns regarding the compatibility of the agreement with the EU Treaties. To respect the powers of the courts of the Member States and the ECJ under the Treaties, the system would require (i) exhaustion of domestic remedies and (ii) prior involvement of the ECJ over questions of EU law.