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IISD REPORT

A Response to the European Commission's December 2013 Document "Investment Provisions in the EU-Canada Free Trade Agreement (CETA)"[1]

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This commentary is based on the draft CETA Investment Chapter dated November 21, 2013 and the draft CETA Investor-to-State Dispute Settlement Text dated February 4, 2014.[2]

[1] Drawn from http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf
[2] Texts are available at http://www.tradejustice.ca/leakeddocs/

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1.0 Introduction

On December 3, 2013, the European Commission issued a document concerning the investment provisions in the EU-Canada free trade agreement (CETA). This document is to be understood as a response to concerns expressed by the European parliament, civil society groups and certain EU member states in relation to the investment chapter.

The European Commission initiates its review with a general question, asking: "How is the right to regulate protected in the investment chapter?" It then answers the question by pointing to a number of specific articles in the text. However, it never provides specific references to the text, just assertions in relation to its contents.

The European Commission argues as a general proposition that "the EU and Canada have agreed to bring very significant clarifications to the key substantive provisions, which are also the most often invoked by investors when bringing claims under the investor-to-state dispute settlement system. In concrete terms, this means that arbitrators will now have strict and detailed guidance when these provisions are invoked by an investor."

In the present paper, we examine the assertions made by the European Commission against the actual text of the draft CETA Investment Chapter dated November 21, 2013 on the substantive provisions and the draft investor–state dispute settlement provisions as of February 4, 2014. It may be noted that the European Commission's statement could not have been based on a later draft than the November 2013 text on the substantive provisions, and thus is presumably based on that text.

The European Commission divides its comments between the substantive provisions in the draft Investment chapter and the investor–state dispute settlement (ISDS) provisions it includes. Our review follows this same division. Yet, it must be noted that the two cannot be wholly separated in terms of their effects. To date, there have been over 600 investment treaty arbitrations initiated by investors against host states under international investment treaties. It is now the most used dispute settlement tool in international law history, and it continues to grow rapidly. This is possible due to the combination of substantive law provisions and investor–state provisions. Thus, fixing one without the other will not accomplish any significant results.

In the European Commission fact sheet on ISDS dated November 2013,[3] the European Commission stresses that EU investors use the investor–state dispute settlement system. The fact sheet is silent, however, on the number of investment arbitration cases brought against EU member states, which account for 119 cases according to the data available to us. While the majority of earlier cases were brought against Eastern European states, new cases have been filed against Belgium, Cyprus, France, Germany, Greece, Italy, Spain, and the United Kingdom. This makes it clear there will be no immunity for any states from investor–state arbitration under the CETA or its anticipated Transatlantic Trade and Investment Partnership (TTIP) partner agreement, for which the CETA will likely form a prototype.

In the end, and whatever the reason for the disconnect, we conclude that the actual draft legal texts in the public domain show that the European Commission's assertions are in most respects incorrect when compared to the draft legal text. The technical legal analysis is set out on each specific point below. In effect, the analysis indicates that the standards by which the European Commission itself seeks to demonstrate the success of the drafting actually show that the drafting has failed to meet its stated objectives, in fact, sometimes with the exact opposite result.

[3] See http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151791.pdf.

2.0 The European Commission's Statement on the Right to Regulate

The European Commission states:

> *The CETA reaffirms the right of the EU and Canada to regulate to pursue legitimate public policy objectives such as the protection of health, safety, or the environment.*

IISD Analysis:

The preamble

The CETA does not include an explicit "right to regulate" provision in the investment chapter. However, it does apparently include a general statement on the right to regulate in the preamble. According to Canada's *Technical Summary of Final Negotiated Outcomes*, the preamble refers to "Reaffirming the party's right to regulate (in a manner consistent with the Agreement)"[4] The parenthesis is, of course, critical here.

The language brings to mind the text of Article 1114(1) of NAFTA: "Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this agreement . . ."

The legal analysis of this approach is extremely clear and simple: it does nothing to establish or enhance a right to regulate. Rather, it does the exact opposite: it makes it clear that the right to regulate is fully subject to the Agreement. All exercises of the right to regulate, at both the federal and provincial levels, must conform to the agreement. Contrary to what is often implied by referring to a "right to regulate" provision, this approach in fact prioritizes conformity with treaty obligations over the right to regulate.

Thus, based on what is available to date, the text appears to do the opposite of what the European Commission argues in its first point.

Exceptions

However, in order to fully assess the European Commission's assertion, we have also examined key exception provisions that might exempt certain types of regulatory measures from the obligations in the draft text.

Overall, the current text has the same range of obligations on governments towards foreign investors as the previous generations of EU investment treaties signed by individual member states with other governments. The bilateral investment treaties (BITs) (of which there are approximately 1,200 that EU states are party to), are the forerunner to the present text in that way. None of the traditional obligations appear to be left out of the current draft CETA. A few have been subject to more extensive drafting, and we will return to those separately below. For this section, we look at the exceptions to this set of obligations on states—exceptions which are new to the EU models—to assess whether they help preserve the right to regulate.

The "general exceptions" clause is modeled on Article XX of the GATT, and drafters appear to assume it can serve a similar function in an investment treaty. We are unaware of any attempt to use such a general exception clause in a

[4] *Technical Summary of Final Negotiated Outcomes: Canada-European-Union Comprehensive Economic and Trade Agreement, Agreement-in-Principle*, based on outcomes to October 18, 2013, p. 24.

treaty arbitration to date, so at best its success in such a role is speculative. Compounding its speculative nature is the fact that there is a dearth of government indications as to how it might even work in such arbitrations.

The key elements of the text read:

ARTICLE X: GENERAL EXCEPTIONS

1. For purpose of the Investment Chapter:

(a) a Party may adopt or enforce a measure necessary:

(i) [EU: to protect public security or public morals or to maintain public order 2];

(ii) to protect human, animal or plant life or health,

(iii) to ensure compliance with domestic law that is not inconsistent with this Agreement, [EU: including those relating to:

a) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on contracts;

b) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;

c) safety];

(iv) [EU: to protect national treasures of artistic, historic or archaeological value];

(v) for the conservation of living or non-living exhaustible natural resources, [EU: if such measures are applied in conjunction with restrictions on domestic investors];

or

[EU: (vi) inconsistent with Articles 3 (National Treatment) and 4 (Most-Favoured-Nation Treatment), provided that the difference in treatment is aimed at ensuring the effective or equitable imposition or collection of direct taxes in respect of economic activities, investors or services suppliers of the other Party 3.]

[Parties to check for the need of paragraph (vi) in relation to coverage in the Article on Taxation.]

(b) provided that the measure referred to in subparagraph (a) is not:

(i) applied in a manner that constitutes arbitrary or unjustifiable discrimination between investments or between investors [EU: where like conditions prevail], or

(ii) a disguised restriction on international [CAN: trade] or investment.

[EU: 2. This Article does not apply to obligations arising out of Articles X [Treatment of Investment] and X [Expropriation] of the Chapter on Investment regarding treatment accorded to investors of a Party in so far as they affect investors and their investments with respect to the operation, management, maintenance, use, enjoyment and sale or disposal of their investments in the territory of one of the Contracting Parties.]

...

We note first that the scope of application of this general exceptions clause was still undecided at the time the European Commission's comments were prepared. Whether it will apply to all the obligations—or just those on non-discrimination—is in particular unclear. In relation to its utility as an exception to the non-discrimination articles, we note that the exception in itself must not be "applied in a manner that constitutes arbitrary or unjustifiable discrimination between investments or between investors," thus introducing a certain amount of circularity in the scope of its application and a limitation on its application.

In addition, the application of the exception clause requires that it not be in relation to a measure that is a "disguised restriction on investment," or, under Canada's proposal, "trade and investment." As the current draft does not cover any pre-establishment issues under the dispute-settlement proposal, it is unclear how the first issue of a disguised restriction on investment would be reviewed. What is the scope intended to be? If the additional language on disguised restriction on trade is included, it is very likely that this would allow an investor to bring all the trade law issues into the investment dispute to show that the challenged state measure amounted to a "disguised restriction on trade." The effect would be the privatization of trade law disputes from the current state–state dispute settlement approaches applied in the WTO.

Perhaps most important here, however, is that the provisions would bring in the GATT/WTO language of "a Party may adopt or enforce a measure ***necessary*** [to achieve one of the listed policy objectives]." The so-called "necessity test" in trade law has sometimes been read to mean least trade-restrictive to meet the government objective. There is no obvious direct transliteration of this to the investment law side. Should the text mean "least trade-restricting"? Least investment- or investor-restricting? Both? Something else? Again, there is no experience with this and no government guidance concerning its use.

And who would decide this? Clearly it would be for three arbitrators to decide if this test were met in the context of a dispute with an investor, with no possibility of a review of this decision to assess whether it was correctly made.

Far from providing any measure of guarantee for a state's right to regulate, this type of general exceptions clause provides an untested transfer of trade law concepts to investment law, a vastly different domain of regulatory interaction between government-investment as compared to government-product regulatory interaction at a border. In our view it is miscast, but whether or not that is so, its utility in an investment context has never been tested, its scope and means of application is manifestly unclear, and there is no way to review a wrong application of the provision as there is in trade law through the WTO Appellate Body. Thus, this provision cannot be called a guarantor in any form of the right to regulate.

Finally, there is the problem that in trade law a finding against the state entails that the measure found to be in violation must be brought into conformity with the treaty. In investment law, the remedy is a monetary award. It is by no means clear in its present form that the general exception proposed would actually mean that the government would not be subject to any monetary award. In other words, a government might not be forced to repeal a measure if it qualified as an exception but might still be required to pay compensation to an investor. In order to avoid this type of situation, the exceptions clause might instead begin with: "Nothing in this Agreement shall be construed to oblige a State Party to pay compensation for adopting or enforcing measures taken in good faith and designed and applied to . . . ."

3.0 The Fair and Equitable Treatment (FET) Obligation

The European Commission states:

> *For the first time ever, the CETA agreement provides for a* **precise definition of "Fair and Equitable treatment."** *This will avoid overly wide interpretations and provide clear guidelines to tribunals.*
>
> *Under the agreement, a breach of the fair and equitable treatment obligation arises in the following cases:*
>
> - *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.*
>
> *In addition, a breach of legitimate expectations is limited to situations where the investment took place only because of a promise made by the State that was subsequently not honoured.*
>
> *The goals the European Commission statement sets out are clear: It is to achieve a precise definition of the "fair and equitable treatment" standard that will avoid overly wide interpretations and give tribunals clear guidance. On each of these, the November 2013 draft shows the European Commission has failed to achieve these goals, for the very specific and precise reasons set out below.*

Draft text on fair and equitable treatment (FET):

ARTICLE X.9: TREATMENT OF INVESTORS AND OF COVERED INVESTMENTS

1. Each Party shall accord in its territory to investors and to covered investments of the other Party fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 7.

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

   a. Denial of justice in criminal, civil or administrative proceedings;

   b. Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.

   c. Manifest arbitrariness;

   d. Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;

   e. Abusive treatment of investors, such as coercion, duress and harassment; or

   f. A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 4 of this Article.

3. In addition to paragraph 2, a breach of fair and equitable treatment may also arise from any other treatment of covered investments or investors which is contrary to the fair and equitable treatment obligation recognized in the general practice of States accepted as law.

4. In accordance with X *[exact reference to be determined regarding the procedure]*, the Parties shall every X years *[or regularly]*, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment.

5. 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.

...

IISD Analysis:

The fair and equitable treatment (FET) obligation is the most widely invoked standard in investment treaty arbitration. Due to the broad and vague wording associated with traditional formulations of this obligation, tribunals have delivered such widely differing interpretations that it is difficult to predict when the actions of a state will violate the standard. The fundamental uncertainty regarding the meaning of the obligation has prompted states to explore options to prevent the steadily growing expansive reading of the standard, which it is feared can be used as a tool to force states to pay for the development of law in the public interest where changes in the law or its implementation leads to costs or reduced profits for the investor. In order to avoid this, the negotiating parties appear at first blush to have taken a new approach to drafting, but unfortunately, the provision remains highly—if not even more—problematic.

The two prongs of the fair and equitable treatment obligation

The November 2013 draft text starts with a general enunciation of the FET obligation. It then goes on to paragraph 2, which is a list of government conduct that is meant to provide clarity and certainty, and restrict the scope for arbitral mischief. This closed list seems very reasonable and also useful to provide the investor with clear protection from unacceptable treatment by the state. For states, it enunciates certain thresholds above which government conduct will be considered a breach: *fundamental* breaches of due process, *manifest* arbitrariness, *targeted* discrimination on manifestly wrongful grounds, and *abusive* treatment of investors, such as coercion, duress and harassment. For many experts who take a more conservative view of the scope of FET, this list would seem to cover the full content it is meant to embody. But it is not the result based on the November 2013 text.

Our analysis indicates that the desired predictability is in fact completely reversed by the second prong in the text, based on the EU proposals, which appear to have been merged with the Canadian proposals—a useful negotiating technique perhaps but a menacing legal result.

The second prong in paragraph 3 makes it clear that in addition to the list, "a breach of fair and equitable treatment may also arise from any other treatment of covered investments or investors which is contrary to the fair and equitable treatment obligation recognized in the general practice of States accepted as law."

Here, the parties introduce the notion of fair and equitable treatment as recognized under customary international law (i.e., "the general practice of States accepted as law"). The approach to explicitly link the FET standard to customary international law has been used by Canada and the United States ever since the early 2000s as a way to reign in its expansion. However, recent case law has introduced many uncertainties as to the scope and meaning of the customary international law standard. As a consequence, we see that the clarity and restraint the European Commission argues for is not present here. On the contrary, because this is clearly stated to be in addition to the list, it means expressly that the list seen by many as the full scope of the FET standard is **not** the scope applied here, but just one prong of its scope. This is troublesome because the drafters have left the scope of this second prong entirely undefined except to say that it is *in addition* to the first prong. Moreover, we do not see any thresholds being applied or a process for determining the fair and equitable treatment obligation recognized in the general practice of states, the exact point that has been subject to such different approaches by arbitrators. Even the question of who carries the burden of proof is not established here.

In the end, all we know is that fair and equitable treatment expands beyond the list, and that lawyers on behalf of investors are being invited to argue what the second prong should include. Ultimately, the arbitrators will be entitled to decide what it should include without any guidance from negotiators whatsoever.

The European Commission's statement on Legitimate Expectations as part of the fair and equitable treatment standard:

As part of the FET article, the European Commission's statement asserts that ***a breach of legitimate expectations is limited to situations where the investment took place only because of a promise made by the States that was subsequently not honoured.***

Again, these assertions are not matched by the text, reprinted here for ease of reference:

> *5. 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.*

The European Commission states that legitimate expectations are triggered by "a promise." The text itself refers to "a specific representation", a much more open term. It requires the representation to have been made to induce the investment, but not that the investment took place only because of this. It is clearly enough that it was a factor considered.

The most critical point is likely the open language of a "specific representation." One need only compare it to the draft language in the subsequent un-numbered draft article proposed by the EU on the so-called "umbrella clause" (still in brackets) to see the difference already embedded in the drafting record. The un-numbered umbrella clause reads:

> *Each Party shall observe <u>any specific written obligation</u> it has entered into with regard to an investor of the other Party or an investment of such an investor.*

While the umbrella clause refers to "any specific written obligation" in the umbrella clause text proposed by the EU, the reference in paragraph 5 of the fair and equitable treatment provision is to a "specific representation." Clearly, a specific representation is more open than a specific written obligation. Indeed, not even the word "written" appears in regard to legitimate expectations.

In sum, the legal uncertainty in the full text on FET is the exact opposite of the clarity the European Commission states it achieved through the list. The introduction of a broad basis for reviewing the legitimate expectations of an investor adds increased uncertainty and subjectivity. It is beyond any reasonable legal doubt that the European Commission's statements on FET are false, and that the FET provision in the November 2013 draft is as open—if not more open—as any previously existing text.

4.0 The European Commission's Clarification of Indirect Expropriation

The European Commission states:

> *For the first time in EU agreements, CETA contains detailed language on what constitutes indirect expropriation:*
>
> *a. Clarifying that indirect expropriation can only occur where there is* ***substantial deprivation*** *of the attributes of property;*
>
> *b. Providing for a detailed step-by-step analysis to determine whether an indirect expropriation has taken place and clarifying that the sole fact that a measure increases costs for investors* ***does not give rise in itself to a finding of expropriation****;*
>
> *c. Providing that* ***legitimate public policy measures taken to protect health, safety or the environment do not constitute indirect expropriation****, except in the rare cases where they are manifestly excessive in light of their objective.*

The draft text on expropriation:

ARTICLE X.11: EXPROPRIATION

1. 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.9.1 on the clarification of expropriation.

[…]

Annex: Expropriation

The Parties confirm their shared understanding that:

1. Expropriation may be either direct or indirect:

a) direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and

b) indirect expropriation occurs where a measure or series of measures by a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.

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

a) 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;

b) the duration of the measure or series of measures by a Party;

c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and

d) 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 by 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.

…

IISD Analysis:

Expropriation provisions in investment chapters and treaties determine in which situations a state will have to compensate the affected rights holder. While generally allowing states to expropriate, investment treaties require that any expropriation must be compensated. In addition, investment treaties require that an expropriation be for a public purpose, non-discriminatory and in accordance with the due process of law. Thus, the crucial question is: What qualifies as a direct or indirect expropriation in the first place?

Especially with regard to the interpretation of indirect expropriation, tribunals have applied fundamentally different concepts to their assessment of the issue. In some cases, only the financial impact of the measure on the investor—not its purpose—was considered relevant, while in others, non-discriminatory measures taken in good faith for public welfare reasons were deemed to not constitute expropriation and therefore were not compensable. Under the first approach, virtually any environmental, health protection, consumer protection of similar measures could potentially qualify as an expropriation requiring compensation to foreign investors by the government.

In order to be clear, the CETA draft specifies in an annex what characteristics should be looked at when determining what constitutes an indirect expropriation, including economic impact, the expectations of the investor and the character of the measure. More importantly, the annex specifies that certain measures do not constitute an indirect expropriation subject to compensation in the first place. In particular, it carves out from the definition of indirect expropriation, "non-discriminatory measures . . . to protect legitimate public welfare objectives, such as health, safety and the environment." These non-discriminatory measures will in principle not be compensable because they cannot be viewed as indirect expropriation.

However, the wording "except in rare circumstances" allows the possibility that certain public welfare measures (specifically, those that appear manifestly excessive in terms of purpose) would constitute indirect expropriation. This wording has been criticized by some as potentially undermining the character of the "carve-out" for police measures, as the reference leaves to the tribunal to decide the issue, instead of formulating a clear definition.

Overall, the CETA draft reflects a long period of Canadian drafting and is now a better text than the traditional European BIT model.

5.0 Compulsory Licenses in Relation to Intellectual Property Rights

The European Commission states:

> *The issuance of compulsory licenses in accordance with WTO provisions* ***guaranteeing access to medicines*** *cannot be considered an expropriation.*

Draft text on expropriation and intellectual property rights (IPRs):

ARTICLE X.11: EXPROPRIATION

[…]

[CAN: 5. This article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights or to the revocation, limitation or creation of intellectual property rights, to the extent that these actions are consistent with the TRIPS Agreement. For greater certainty, a determination that these actions are inconsistent with the TRIPS Agreement does not establish that there has been an expropriation.]

[EU: 5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ("TRIPS Agreement").]

IISD Analysis:

A compulsory license of intellectual property rights (IPRs) is normally set out by law and allows the licensee to use the IPRs without obtaining consent from the holder of the rights. The clarification in the text responds to the fears that because they restrict the property rights of IPRs holders, compulsory licenses may be regarded as expropriation under investment treaties. The carve-out, apart from preserving states' policy space to use compulsory licenses to pursue public policy objectives, could contribute to the harmony of investment treaties and other related treaties, e.g., the WTO Agreements.

However, the effect of the clarification is limited specifically to compulsory licenses. Limitations of IPRs in other ways, such as in the context of tobacco control, for instance, will continue to be covered and subject not only to expropriation provisions but also the fair-and equitable treatment, the national treatment, and the most-favored nation treatments standards. Intellectual property rights are themselves protected investments under the draft CETA text.

The question of scope was unresolved in the November 2013 text. Canada essentially proposes a broader scope of carve-out, covering compulsory licenses as well as the revocation, limitation or creation of IPRs, to the extent that they are in consistency with the TRIPs Agreement. Moreover, Canada clarifies that "a determination that these actions are inconsistent with the TRIPS Agreement does not establish that there has been an expropriation." By contrast, the EU's proposal only covers the compulsory licenses that are consistent with the TRIPs Agreement. So other permissible measures by states to limit the IPRs of the holders according to the TRIPs Agreement may face the risk to be deemed as expropriation under investment treaties, potentially leading to incoherent rulings under different treaties.

6.0 *Definition of Investment*

The European Commission states:

> ***The definition of investment*** *covers only assets that possess the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration.*

The term "investment" is arguably the most critical term to define. The definition will determine which foreign capital flows will be covered by the agreement. It determines the scope of the treaty and which investments benefit from the CETA provisions.

The draft definition of investment:

> **'investment'** means:
>
> Every kind of asset that an investor owns or controls, directly or indirectly, which has the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration. Forms that an investment may take include:
>
> a) an enterprise;
>
> b) shares, stocks and other forms of equity participation in an enterprise;
>
> c) bonds, debentures and other debt instruments of an enterprise;
>
> d) a loan to an enterprise;
>
> e) any other kinds of interest in an enterprise;
>
> f) an interest arising from:
>
> i. a concession conferred pursuant to domestic law or under a contract, including to search for, cultivate, extract or exploit natural resources,
>
> ii. a turnkey, construction, production, or revenue-sharing contract, or
>
> iii. other similar contracts;
>
> g) intellectual property rights;
>
> h) any other moveable property, tangible or intangible, or immovable property and related rights;
>
> i) claims to money or claims to performance under a contract;
>
> [For greater certainty, "claims to money" does not include claims to money that arise solely from commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to a natural person or enterprise in the territory of the other Party, domestic financing of such contracts, or any related order, judgment, or arbitral award.]
>
> Returns that are invested shall be treated as investments. Any alteration of the form in which assets are invested or reinvested does not affect their qualification as investment.

IISD Analysis:

Canada and the EU seem to have opted for a traditional open-ended asset-based definition of investment, as opposed to an enterprise-based definition (which requires the establishment or acquisition of an enterprise in the host state), or a closed asset-based definition (which sets out an exhaustive and limited list of situations that constitute an investment).

The CETA text defines investment as "every kind of asset." It then provides an indicative list of such assets that can qualify as investment, covering enterprises, equity, bonds and debt instruments, intellectual property rights and others—independent of whether or not they are associated with an existing enterprise in the host state.[5]

The open-ended list is problematic because it allows for the most expansive interpretation by tribunals of what that definition encompasses, since the list that follows is merely indicative. This definition is therefore the least predictable for host states. This increases the risks of being sued.

Canada and the EU seem to have taken note of the problems of expansive interpretation to some extent, as they have set out some specifications. Building on the approach taken by the United States since 2004, they have required that an asset needs to have certain characteristics of an investment in order to qualify as an investment under the treaty. These are the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration. However, the language (i.e., the phrase "such as") seems to indicate that to qualify for protection under the treaty, investments do not need to fulfill all listed requirements. Whether this qualification is sufficient to protect host states from bad surprises regarding the meaning of this open-end definition of investment is questionable. Indeed, it is much more likely that the ability to satisfy one of the criteria listed is pretty simple for any form of non-enterprise investment, and this will have limited impact on the initial expansive language of "any asset."

[5] This "could include such tangible or intangible properties as an offshore bank account, holiday home, rights under domestic law or contract, minority shareholding in a foreign company, and a company's "goodwill." Even contracts for the sale of goods manufactured by the investor in its home country, or services performed by the investor in its home country, and then sold to consumers in the host country" (p. 11). See IISD (Nathalie Bernasconi-Osterwalder, Aaron Cosbey, Lise Johnson, Damon Vis-Dunbar), *Investment Treaties and Why They Matter to Sustainable Development: Questions and Answers* (2011), available at http://www.iisd.org/pdf/2011/investment_treaties_why_they_matter_ sd.pdf

7.0 Definition of Investor

The European Commission states:

> ***Shell companies are not protected***. *To be qualified as an "investor", it is necessary to have substantive business operations in the territory of one of the Parties.*

The Draft Definition of Investor:

ARTICLE X.3: DEFINITIONS

[...]

investor means [CAN: a Party] a natural person or an enterprise of a Party, that seeks to make, is making or has made an investment in the territory of the other Party. But "investor" does not mean:

a) an enterprise of a Party, if the enterprise [CAN: is owned or controlled by an investor of the other Party or of a non-Party and the enterprise] has no substantial business activities in the territory of the Party under whose law it is constituted or organized; or,

b) a branch or representative office of an enterprise of a Party or a non-Party.

Section 5: Reservations and Exceptions

[...]

[CAN: Article X.15: Denial of Benefits

1. A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of that Party and to investments of that investor if:

a) investors of a non-Party own or control the enterprise; and

b) the denying Party adopts or maintains measures with respect to the non-Party that:

i. are related to maintenance of international peace and security or the protection of human rights; and

ii. prohibit transactions with the enterprise or would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

IISD Analysis:

Alongside the definition of investment, the definition of investor circumscribes the scope of the agreement. It determines which investors are protected, and may also exclude certain types of investors—either to prevent opportunistic use of the agreements or to target investors with real operational investment.

The broad definitions of investor in traditional EU BITs open the door to so-called "treaty shopping." By registering their office in a country that has a large treaty network, investors can make use of that BITs network without having substantive business activities in that country. They can strategically choose a home country for their investment to sue the host country through ISDS.

To avoid this type of situation and limit treaty shopping, the CETA provides that:

> *But "investor" does not mean:*
>
> *a) an enterprise of a Party, if the enterprise [CAN: is owned or controlled by an investor of the other Party or of a non-Party and the enterprise] has no substantial business activities in the territory of the Party under whose law it is constituted or organized*

This is a useful addition to avoid misuse of the Canada–EU CETA by so-called "mailbox" investors, though the number of potentially covered investors will remain high. However, it does not in any way reduce the use of the investor–state process by the existing thousands of potentially covered investors.

8.0 Free Transfer of Capital

The European Commission statement notes that prudential measures related to the restriction of transfers outside of a state by an investor are allowed for under the draft text. We generally agree this is a significant improvement on prior EU texts. This will add some level of protection for governments in financially stressed times. However, the draft text is still heavily bracketed and some of the options provide for only limited flexibility. We cannot, therefore, properly assess the legal impact of the provision. Moreover, the fact that disputes between an investor and the state involving highly complex macroeconomic issues will be subject to non-specialist arbitral panels remains problematic. In past treaties, Canada has introduced special state–state processes instead. For instance, the China–Canada BIT (2012) provides that, with regard to whether a financial prudential measure constituted an exception, the investor–state tribunal must seek a joint decision from contracting states or a decision by a state–to–state arbitral tribunal, if established. The CETA parties did not follow this approach in the November 2013 draft text.

9.0 *What the European Commission Does Not Talk About: The Most-Favoured Nation (MFN) Provision*

IISD Analysis

What is unsaid is often as important, and sometimes more important, than what is said. The European Commission statement simply does not refer to what is known as the most-favoured nation (MFN) treatment clause. Yet, this clause alone is sufficient to undermine all of the objectives the European Commission states it seeks in the drafting. The reason why is explained here.

Article X.8 of the November 2013 draft contains the MFN provision. In essence, it requires, for present analytical purposes, a European state to treat a foreign investor from Canada no less favourably than it treats an investor from any third state. The problem arises from the legal reality that such treatment has been defined in investment arbitrations as including the rights of other investors under investment treaties with the host state. So, if an EU member state that has a Canadian investor also has a treaty with an African, Latin American or any other state, the investor from Canada can import the provisions of that treaty if they are more favourable than the provisions of the CETA.

The impact of this is straightforward. The European Commission statement notes the need to "bring very significant clarifications" in order to give arbitrators "strict and detailed guidance when these provisions are invoked by an investor." Now, we have already seen from the preceding analysis that this objective has not been met in the November 2013 draft text. But let us suppose, for the sake of understanding the current issue, that it had been met. The MFN provision would in any event undo this.

Arbitrators now routinely allow investors to essentially cherry-pick provisions from other investment treaties that are more favourable to it. To continue our example of a Canadian investor, let's assume it makes a claim against an EU member state for expropriation under CETA. The exceptions and carve-outs would apply to it. However, if the same state has an old treaty with any other state, the investor can argue that the expropriation provision from that treaty, without the exceptions or carve-outs included in the CETA, should apply to its claim as a result of the CETA's MFN provision. The benefits to the states of the more careful drafting are thus, quite simply, lost.

There are options available to fix this, such as making an MFN clause apply only to treaties later in time, or to have it not include other investment treaties or chapters at all. These options have not been chosen. As a result, even if the improvements in the text had all met the goals expressed by the European Commission, the benefits would be wiped out by the current MFN provision. This, in itself, negates all of the claims of the European Commission in its December statement alleging that the obligations in the CETA have been clarified, so as to give strict and detailed guidance to arbitrators.

10.0 Investor–State Dispute Settlement in CETA

The European Commission statement does not address the overriding question of why an investor–state dispute settlement (ISDS) process is necessary in the context of a free trade agreement between Canada and the EU. The European Commission statement also does not address the role of the CETA as a forerunner to the TTIP negotiations. It will, of course, be much more difficult, if not impossible, for the EU to conclude an agreement with the United States that does not include investor–state arbitration (also referred to as investor–state dispute settlement or ISDS) if the CETA does contain one.

Many experts, academics, and organizations have taken the view that the expansion of the ISDS system into the context of transatlantic investments between Canada, the United States and the EU is unnecessary. There is certainly no empirical evidence to support the need for this in the context of such investments. Instead, there may be significant potential for harm in allowing foreign investors to bypass domestic courts and specific contract-based remedies in favour of treaty arbitrations that include elements going well beyond the rights domestic investors have.

These general observations noted, the present text concentrates on the specific assertions of the European Commission designed to achieve the objectives it sets out: **to ensure that the system is effective and efficient, while providing important safeguards that will improve the control of the parties of the interpretation of the agreement and ensure that frivolous cases are discouraged or swiftly dismissed.**

Based on this overall set of goals, the European Commission statement then addresses 13 specific ISDS-related concerns. The comments below are grouped by issue rather than the specific concerns in the European Commission paper. This is to reduce overlap and duplication and to focus on the issues to be highlighted rather than just a list of individual drafting points. In this way, we continue to focus on whether the objectives behind the European Commission statement are being achieved, rather than simply reviewing a set of draft articles.

10.1 Scope of ISDS

Protection from frivolous claims

The European Commission states:

. . . that the following step has been taken to weed out certain types of claims through:

> *5. Exceptionally **strong protections against frivolous claims**—stronger than in any existing ISDS mechanism. 2 systems which permit frivolous claims to be rejected very quickly—one where the case is manifestly unfounded, the other where the tribunal, even if facts are assumed to be correct, cannot rule in favour of the investor;*

The relevant draft text (February 2014 draft):

> **ARTICLE X-14: CLAIMS MANIFESTLY WITHOUT LEGAL MERIT**
>
> 1. The respondent may, either no later than 30 days after the constitution of a tribunal pursuant to Article x- (Constitution of Tribunal) and in any event before the first session of the Tribunal, EU [or 30 days after the respondent became aware of the facts on which the objection is based,] file an objection that a claim is manifestly without legal merit. . . .
>
> **ARTICLE X-15: CLAIMS UNFOUNDED AS A MATTER OF LAW**
>
> 1. Without prejudice to a tribunal's authority to address other objections as a preliminary question or to a respondent's right to raise any such objections at any appropriate time, the Tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim, or any part thereof, submitted under this section is not a claim for which an award in favour of the claimant may be made under Article (Submission of a Claim to Arbitration), even if the facts alleged were assumed to be true. The Tribunal may also consider any relevant facts not in dispute. . . .

IISD Analysis:

A frivolous claim is a claim that is without any legal merit, sometimes brought in bad faith for the purpose of harassing the other side. The European Commission explains that there are two situations that permit frivolous claims to be rejected very quickly—either where the case is manifestly unfounded, or "where the tribunal, even if facts are assumed to be correct, cannot rule in favour of the investor."

The European Commission stresses that the CETA includes in Articles 14 and 15 on ISDS "exceptionally strong protections against frivolous claims—stronger than in any existing ISDS mechanism." However, frivolous claims are by far not the biggest problem in investment arbitration, if one at all. These provisions may in some cases help reduce the costs of some arbitration by having unmeritorious cases terminated without the time and expense of full hearings on the merits. But these provisions will only address this cost issue. A case dismissed on either ground would have been won by the state in any event and thus these provisions do not address the expansive interpretations by some tribunals on the merits or on jurisdiction issues. A tribunal determined to take an expansive interpretation of any provisions will also be able to do so from the beginning of these frivolous claims procedures.

Consequently, this feature, while it may be useful, will only find its utility in reducing the costs of arbitration, not the scope of any decisions that would otherwise be made on jurisdiction or the merits.

Role of Alternative Dispute Resolution Mechanisms

The European Commission states:

. . . that the following step has been taken to introduce other types of dispute settlement through:

> *9. **Encouragement of alternative dispute resolution**—explicit provisions for mediation for investment disputes—again a first in an ISDS mechanism;*

The relevant draft text (February 2014 draft):

ARTICLE X-5: MEDIATION

1. The disputing parties may at any time agree to have recourse to mediation.

2. Recourse to mediation is voluntary and without prejudice to the legal position or rights of either disputing party under this chapter and shall be governed by the rules agreed to by the disputing parties including, if available, the rules established by the Services and Investment Committee pursuant to Article x-26(5)(d).

. . .

IISD Analysis:

The European Commission also asserts that the CETA text encourages alternative dispute resolution with explicit provisions for mediation. These rules are a nice-to-have, but in our view will do little to prevent disputes. The current draft Article x-5 on mediation simply states in paragraphs 1 and 2 that the disputing parties "may at any time agree to have recourse to mediation" and that "recourse to mediation is voluntary and without prejudice to the legal position or rights of either disputing party under this chapter." Since disputing parties can always agree to submit to mediation, this adds nothing at all. There is no requirement for meditation on an investor prior to going to ISDS.

Limitation of ISDS to Post-Establishment

The European Commission states:

. . . that the following step has been taken to limit the scope of ISDS:

> *13.* ***Limited to post-establishment rights****—ISDS only applies to alleged breaches of the investment protection standards and does not apply to market access;*

The relevant draft text (February 2014 draft):

ARTICLE X-1: [SCOPE OF A CLAIM TO ARBITRATION]

[1. Without prejudice to the rights and obligations of the Parties under Chapter [XY](Dispute Settlement), a claimant may submit to arbitration under this section a claim that the respondent has breached an obligation under:

a) section 3 (Non-Discriminatory Treatment) of this Chapter, with respect to the expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of its covered investment; or

b) section 4 (Investment Protection) of this Chapter;

where the claimant claims to have suffered loss or damage as a result of the alleged breach.]

[1BIS. A Tribunal established under this chapter shall determine whether the EU [treatment] CAN [measure] in question is inconsistent with [Section 3 or Section 4 of this chapter].]

[**Note:** *Parties agree on substance. EU to propose alternative drafting/location*]

CAN [2. With respect to a measure relating to the 'expansion' of an investment, an investor may submit to arbitration a claim that another Party has breached an obligation under Section 3 (Non-Discriminatory Treatment), only to the extent that the measure is alleged to incur loss or damage to the investor by reason of, or arising out of, its impact on a covered investment. For greater certainty, such claims would be subject to any reservation or exception taken by a Party pursuant to Section 5 (Reservations and Exceptions).]

[3. For the purpose of this Section and without prejudice to Article x-(subrogation), an investor EU [claimant] does not include a Party.]

IISD Analysis:

The scope of the investment chapter extends beyond investment protection to investment liberalization, including far-reaching market access provisions and pre-establishment rights granted through the national treatment clause, and the prohibition of performance requirements. While EU member states' BITs did not include these liberalization elements, Canada has done so for over a decade, though not to the extent seen here. We are not analysing or assessing the impacts of including such clauses here, and the European Commission does not address them in terms of their substantive implications in its note. There is only one reference in which the issue is addressed indirectly, namely in the context of the scope of arbitration claims. Here, the European Commission states that "ISDS only applies to alleged breaches of the investment protection standards and does not apply to market access." This statement is correct and reflects the EU's position from early in the negotiations. If one finds a need to include these provisions in a treaty in the first place (they are not included in many agreements), excluding these elements from investment arbitration and reserving these only to state–state dispute settlement is a welcome development.

The Problem of Multiple Claims and the Role of Domestic Courts

The European Commission states:

The European Commission states that it has taken steps with respect to the problem of multiple claims through:

> *1.* ***Prohibitions on seeking remedies in domestic courts and through ISDS*** *at the same time, whilst encouraging the use of domestic court;*

The relevant draft text (February 2014 draft):

ARTICLE X-7: PROCEDURAL AND OTHER REQUIREMENTS TO SUBMIT A CLAIM TO ARBITRATION

1. A claimant may submit a claim to arbitration under Article x (Submission of a Claim to Arbitration) only if the claimant:

. . . .

e) provides an attestation, where it has initiated a claim or proceeding, seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration, that:

i. a final award, judgment or decision has been made; or

ii. it has withdrawn any such claim or proceeding;

The attestation shall contain, as applicable, proof that a final award, judgment or decision has been made or proof of the withdrawal of any such claim or proceeding; and

f) provides a waiver of its right to initiate any claim or proceeding seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration.

IISD Analysis:

The CETA text is no different from other investment treaties, in that it allows an investor to sue the state directly before international investment arbitration panels without first having to exhaust local remedies, as is the case in other areas of public international law. We do not see that anything in the text "encourages the use of domestic courts" as the European Commission claims it does.

On the other hand, we agree with the European Commission that the CETA text tries to address the problem of multiple parallel proceedings. The text succeeds in this respect. In order to submit a claim to arbitration, the claimant investor is barred from engaging in a parallel domestic process about the same measure. If the investor wishes to submit to arbitration, proof will have to be provided that the domestic proceeding has been completed and closed or that the investor has withdrawn from the proceeding. Moreover, the investor must waive the right to initiate such proceedings. In our view, this is a positive development. However, we do not see this favouring or encouraging domestic courts in any way.

10.2 Lack of Transparency in Investor–State Arbitration

The European Commission states:

… that the following step has been taken to address concerns relating to the lack of transparency in investment arbitration:

> *7. **Full transparency**—all documents will be public, all hearings open, interested parties (NGOs) can make submissions. This is the first agreement applying in substance the new United Nations rules on transparency in ISDS (UNCITRAL);*

The relevant draft text (February 2014 draft):

ARTICLE X-18: [TRANSPARENCY OF PROCEEDINGS]

CAN [

1. [The provisions in Annex I on "Rules on transparency" or FULL TITLE] ALT [Cross reference to UNCITRAL rules] shall apply to the disclosure of information to the public concerning disputes under this [Section].

2. Nothing in this Chapter 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.]

EU [

1. Subject to paragraph 2, the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration shall apply to the disclosure of information to the public concerning disputes under this [Section].

2. The following provisions of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration shall be adjusted:

a) Article 5 shall not apply.

b) In addition to Article 2, the request for consultations, request for determination […] shall be communicated by the respondent to the repository.

Nothing in this Chapter 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.]

IISD Analysis:

Unlike domestic and most international judicial proceedings, investment arbitration proceedings are typically not public and can remain secret from beginning to end, including with respect to the commencement of a proceeding, the awards and other documents, as well as hearings. This is due to the arbitration rules that apply in investment arbitration cases, including ICSID and UNCITRAL Rules. These arbitration rules are also the rules of choice in the CETA. Some states have supplemented these rules through their treaties in order to ensure transparency. The United States and Canada began this practice a little over a decade ago, and it is now steadily expanding to other treaties as well. The majority of the treaties existing today remains silent on transparency, and simply refers to the applicable arbitration rules, including those of EU member states.

The CETA now integrates transparency through incorporation of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, which will officially come into effect on April 1, 2014. These provide for a significant degree of openness throughout the arbitral proceedings.[6] The CETA text adopts the Rules for all arbitrations conducted under it, including in ICSID arbitrations and others. This is a very welcome development.

10.3 Lack of Independence and Impartiality of Arbitrators

Introducing a Roster of Arbitrators

The European Commission states:

. . . that it has taken the following steps to address concerns about the lack of independence and impartiality of investment arbitrators:

> *3. increased consistency and strengthened* ***protection against possible conflicts of arbitrators*** *through the need for agreement on the arbitrators, failing which the arbitrator will be chosen from a list (rosters) of arbitrators, jointly decided by the European Union and Canada (this is a first in an ISDS mechanism);*

[6] *UNCITRAL Rules on Transparency in Treaty-based Investor- State Arbitration*, Pre-release publication of July 30, 2013. Available at http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/pre-release-UNCITRAL-Rules-on-Transparency.pdf. See also Lise Johnson and Nathalie Bernasconi-Osterwalder (2013), *New UNCITRAL Arbitration Rules on Transparency: Application, Content and Next Steps.* Available at http://www.iisd.org/pdf/2013/uncitral_rules_on_transparency_commentary.pdf.

The relevant draft text (February 2014 draft)

ARTICLE X-10: CONSTITUTION OF THE TRIBUNAL

1. Unless the disputing parties have agreed to appoint a sole arbitrator, the Tribunal shall comprise three arbitrators. One arbitrator shall be appointed by each of the disputing parties and the third, who will be the presiding arbitrator, shall be appointed by agreement of the disputing parties. If the disputing parties agree to appoint a sole arbitrator, the disputing parties shall seek to agree on the sole arbitrator.

2. If a Tribunal has not been constituted within 90 days from the date that a claim is submitted to arbitration, or where the disputing parties have agreed to appoint a sole arbitrator and have failed to do so within 90 days from the date the respondent agreed to submit the dispute to a sole arbitrator, a disputing party may request the Secretary-General of ICSID to appoint the arbitrator or arbitrators not yet appointed. The Secretary General of ICSID shall appoint the remaining arbitrators from the list established pursuant to paragraph 3. In the event that such list has not been established on the date a claim is submitted to arbitration, the Secretary-General of ICSID shall make the appointment at his or her own discretion taking into consideration nominations made by either Party and, to the extent practicable, in consultation with the disputing parties. The Secretary-General of ICSID may not appoint as presiding arbitrator a national of a Party, such as a national of any Member State where a Member State is a disputing party, unless all disputing parties agree otherwise.

3. Pursuant to Article x-26(2), the Committee on Services and Investment shall establish, and thereafter maintain, a list of individuals who are willing and able to serve as arbitrators and who meet the qualifications set out in paragraph 5. The Committee on Services and Investment shall ensure that the list includes at least 15 individuals.

. . .

IISD Analysis:

Several characteristics of the investment arbitration process have led to concerns regarding the independence and impartiality of the arbitrators. As noted above, the European Commission asserts that the CETA provides "strengthened protection against possible conflicts of arbitrators through the need for agreement on the arbitrators, failing which the arbitrator will be chosen from a list (rosters) of arbitrators, jointly decided by the European Union and Canada'. It stresses that this is 'a first in an ISDS mechanism.'" It is true that to date investment treaties typically do not provide for a "roster" of arbitrators, but the ICSID system does use a roster system under which the Secretariat maintains a list of Conciliators and of Arbitrators, so the idea is actually not new. Also, the roster approach at ICSID has not helped mitigate concerns of impartiality and independence of arbitrators.

We are of the view that the kind of roster approach proposed in the CETA will also fail to address these concerns. Like in ICSID, the first two arbitrators under CETA are nominated by the investor and the state unilaterally, and there is no need whatsoever to choose an arbitrator from the roster. The roster only comes into play where the parties fail to appoint the presiding arbitrator within three months of the submission of the claim, or fail to appoint their own arbitrator (this latter situation is not expected to be common under CETA). This is very similar to the ICSID roster system, where the presiding arbitrator is only chosen from the roster when one of the arbitrators is not nominated. The roster is therefore only a backup and does not have the power of an exclusive roster for all the arbitrators fulfilling strict conditions of experience, independence and impartiality.[7] As a consequence, all the problems resulting from party appointments, such as arbitrators focusing more on pleasing the nominating parties and being re-appointed in future cases, are not resolved through the roster system proposed in the CETA draft.

[7] For example, in the area of sports arbitration, ALL arbitrators are chosen from a roster and those listed may not act as counsel in sports arbitration cases. No such safeguards are present in the November draft CETA text.

Code of Conduct for Arbitrators

The European Commission states:

. . . that it has taken the following steps to address concerns about the lack of independence and impartiality of investment arbitrators:

*4. Introduction of a **binding Code of Conduct** for arbitrators—again a first in an ISDS mechanism;*

The relevant draft text (February 2014 draft)

ARTICLE X-10: CONSTITUTION OF THE TRIBUNAL

5. Arbitrators appointed pursuant to this section shall have expertise or experience in public international law, in particular international investment law. It is desirable that they have expertise or experience in international trade law, and the resolution of disputes arising under international investment or international trade agreements.

6. Arbitrators shall be independent of, and not be affiliated with or take instructions from any disputing party or the government of a Party with regard to trade and investment matters. Arbitrators shall not take instructions from any organisation, government or disputing party with regard to matters related to the dispute. Arbitrators shall comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration or any supplemental rules adopted pursuant to article x-26 [Committee on Services and Investment]. Arbitrators who serve on the list established pursuant to paragraph 3 shall not, for that reason alone, be deemed to be affiliated with the government of a Party

. . .

ARTICLE X-26: COMMITTEE

[. . .]

2. The Committee shall, on agreement of the Parties, and after completion of the respective legal requirements and procedures of the Parties, decide to:

a) establish and maintain the list of arbitrators pursuant to Article x- 10(3)(Constitution of the Tribunal);

b) adopt a code of conduct for arbitrators to be applied in disputes arising out of this chapter, which may replace or supplement the rules in application, and that may address topics including:

i. disclosure obligations;

ii. the independence and impartiality of arbitrators; and

iii. confidentiality.

The Parties shall make best efforts to ensure that the decisions referred to in (a) and (b) are adopted no later than the entry into [application/force] of the Agreement, and in any event no later than two years after the entry into [application/force] of the Agreement.

*[***Note to scrub:** *agreed in principle that the time periods run from provisional application, if any. Drafting to be checked in the light of the general and final provisions of CETA]*

. . .

IISD Analysis:

The European Commission appears to acknowledge the problems associated with arbitrators' impartiality and independence. One step taken in this respect is the reference to the International Bar Association Guidelines on Conflicts of Interest in International Arbitration with which arbitrators are to comply. In addition to the IBA Rules, the CETA draft also states that arbitrators must comply with the Code of Conduct. However, this Code does not yet exist. Instead, the CETA draft states that the Committee on Services and Investment "shall, on agreement of the Parties, and after completion of the respective legal requirements and procedures of the Parties, decide to" adopt a code of conduct for arbitrators which will cover disclosure obligations; the independence and impartiality of arbitrators; and confidentiality. We agree that the CETA should address these issues because they have been identified as problematic. However, we cannot know whether this Code will adequately deal with these problems because the adoption of the Code is postponed by up to two years after the entry into force of the agreement. In our view, the Code of Conduct should be finalized along with the rest of the investment text. Given the uncertainty as to whether this Code will ever be finalized and the uncertainty regarding its content, we cannot, at this point in time, agree with the European Commission that steps have been take to address the issue of arbitrator impartiality and independence. Any assessment of impact of the Code would be mere speculation.

10.4 Consistency and Correctness of Arbitral Awards in Law

There is a widespread concern about inconsistency and lack of legal correctness in the application of investment treaties by arbitrators. In many instances, tribunals have made decisions based on very different interpretations of the same provisions in a treaty, or similar provisions between treaties. In addition, it is now widely understood that under the rules governing international arbitration in domestic law and at ICSID, arbitrators have the right to be wrong and that the finality of the award and the arbitration process are more important than legal correctness. As a result states can be compelled to pay awards over hundreds of millions of US dollars (and more), even when the decision is wrong in law. The EU seeks to address these types of issues in the text.

Binding Interpretation

The European Commission states:

. . . that it has taken the following steps to address concerns about inconsistent and incorrect arbitration awards:

> *11. Effective mechanisms for the Parties to the agreement (the EU and Canada) to issue* ***binding interpretations*** *on what they originally meant in the agreement and to take part in arbitrations on questions of interpretation...*

The relevant draft text (February 2014 draft)

ARTICLE X-12. APPLICABLE LAW AND RULES OF INTERPRETATION

. . .

2. Where serious concerns arise as regards matters of interpretation that may affect investment, the Committee on Services and Investment may recommend to the CETA Trade Committee the adoption of interpretations of the Agreement. An interpretation adopted by the CETA Trade Committee shall be binding on a Tribunal established under this chapter. The [CETA Trade Committee] may decide that an interpretation shall have binding effect from a specific date.

IISD Analysis:

Provisions on joint interpretation were first included in the NAFTA and can be found in the U.S. and Canadian Model BITs and treaties derived from them. The parties to NAFTA have early on issued such an interpretative statement to restrict the broad interpretation of FET by arbitration tribunals ruling under that treaty.

The inclusion of a process for binding joint interpretation in the CETA is useful, as it can effectively preclude unintended interpretations through arbitration panels from being binding on the parties over the longer term.

The Possibility of an Appeals Process

The European Commission states:

. . . that it has taken the following steps to address concerns about inconsistent and incorrect arbitration awards through:

> *8. A **possible appellate mechanism**: The first EU agreement which provides for the possibility to establish an appellate mechanism (the US has included such provisions in all of its agreements since 2004.).*

The relevant draft text (February 2014 draft):

ARTICLE X-26: COMMITTEE

1. The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

a) difficulties which may arise in the implementation of this chapter;

b) possible improvements of this chapter, in particular in the light of experience and developments in other international fora; and,

c) whether, and if so, under what conditions, an appellate mechanism could be created under the Agreement to review, on points of law, awards rendered by a tribunal under this Section, or whether awards rendered under this section could be subject to such an appellate mechanism developed pursuant to other institutional arrangements. Such consultations shall take into account the following issues, among others:

i. the nature and composition of an appellate mechanism;

ii. the applicable scope and standard of review;

iii. transparency of proceedings of an appellate mechanism;

iv. the effect of decisions by an appellate mechanism;

v. the relationship of review by an appellate mechanism to the arbitration rules that may be selected under Article x- (Submission of a Claim to Arbitration); and

vi. the relationship of review by an appellate mechanism to domestic laws and international law on the enforcement of arbitral awards.

IISD Analysis:

The idea of introducing an appellate system is a good one in our view. As we can see from WTO experience, the WTO appellate mechanism is working well. The Appellate Body is well respected, and has contributed to a more predictable trading system through its clarifications regarding key questions of interpretation. The result has been not only better law and consistency but also improved compliance and trust in the system. In its December 2013 note, the European

Commission states that the CETA is the "first EU agreement which provides for the possibility to establish an appellate mechanism," and then adds "the U.S. has included such provisions in all of its agreements since 2004." The 10-year U.S. experience of including such provisions has led to nothing, however. It might therefore be taken as an indication that a provision stating that parties will "discuss whether, and if so, under what conditions, an appellate mechanism could be created under the Agreement," might also fail to materialize. Certainly, at this stage, we cannot conclude that the CETA has solved the problems relating to lack of consistency, predictability, and legal correctness just by including the possibility of establishing an appellate mechanism.

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