European Commission

INVESTMENT PROVISIONS IN THE EU-CANADA FREE TRADE AGREEMENT (CETA)

CETA reflects a turning point in the European approach to investment policy. It is the first agreement that puts all EU investors on the same, equal footing. It is also the first agreement to introduce important innovations to investment protection, ensuring a high level of protection while preserving the EU and Canada's right to regulate and pursue legitimate public policy objectives such as the protection of health, safety, or the environment. The most progressive system to date is also being established for Investor-to-State Dispute Settlement.

CETA represents a significant break with the past, at two different levels:

1) Clearer and more precise **investment protection standards**, i.e. the rules, as set out in CETA, that arbitration tribunals will apply;

2) New and clearer rules on the conduct of **procedures** in arbitration tribunals.

1. CETA sets new, precise standards on investment

- CETA makes clear from the outset that **the EU and Canada preserve their right to regulate** and to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity;

  Relevant CETA provisions: Preamble

- **A precise and specific standard of treatment of investors and investment is introduced.** Unlike other agreements, the standard of "fair and equitable treatment" in CETA is neither a floor or a minimum standard nor an evolving concept. Rather, a clear, closed text defines precisely the standard of treatment without leaving unwelcome discretion to arbitrators. Both the EU and Canada have to agree to review the standard for it to be revisited.

A breach of the fair and equitable treatment obligation can only arise when there is:

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

The concept of "legitimate expectations" is limited to situations where a specific promise or representation was made by the State.

Relevant CETA provisions: Article X.9 Treatment of Investors and Covered Investments

- **CETA makes clear what constitutes "indirect expropriation".** For the first time in an EU agreement, detailed language has been agreed upon to clarify what constitutes indirect expropriation in order to avoid claims against legitimate public policy measures:

  - 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.

  - Indirect expropriation can only occur when the investor is substantially deprived of the fundamental attributes of property such as the right to use, enjoy and dispose of its investment;
  - A detailed case-by-case analysis is introduced to determine whether an indirect expropriation has taken place. The sole fact that a measure increases costs for investors does not give rise in itself to a finding of expropriation;

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

  Relevant CETA provisions: Annex X.11: Expropriation and Declaration to Investment Chapter Article X.11 Paragraph 6

- **CETA does not protect so-called "shell" or "mailbox" companies.** To be qualified as an investor, it is necessary to have real business operations in the territory of one of the Parties. Protection is also granted only when investors have already committed substantial resources in the host state, not when they are merely at the stage of planning to do so.

  Relevant CETA provisions: Article X.3: Definitions

- **CETA does not allow investors to "import" and use in the dispute settlement procedures the substantive provisions** from other agreements (e.g. from Treaties of EU Member States) that they consider are more advantageous to their interests.

  Relevant CETA provisions: Article X.7: Most-Favoured-Nation Treatment

- **Only specific concerns can be brought to arbitration.** Only claims relating to non-discriminatory treatment (Section 3 of the CETA investment chapter) and investment protection (Section 4) can be submitted to arbitration under CETA. Other provisions of the CETA cannot. In the field of financial services, a specific filter mechanism is established to ensure the Parties can take legitimate prudential measures, as enshrined also in the so-called prudential carve-out.

  Relevant CETA provisions: Article X.17 Scope of a claim to arbitration, Chapter on Financial Article 15: Prudential carve-out

2. CETA sets new and clearer rules on the conduct of procedures in investment arbitration tribunals

Choice and conduct of arbitrators

- CETA is the first agreement **that has a binding code of conduct** for arbitrators acting in an ISDS dispute. The code is based on the ethical rules of the International Bar Association, subject to further revision. It prevents conflicts of interest. In case an arbitrator is found not to comply with the code, he/she will be replaced. That decision is taken by an outside party (the Secretary General of the International Centre for the Settlement of Investment Disputes (ICSID) and not by the fellow arbitrators. This is important, because the fellow arbitrators risk being perceived as being more lax on possible conflicts of interest. (NB ICSID is a World Bank body, and the Secretary General is elected by 2/3rds majority of the 150 countries which are party to the Convention).

  Relevant CETA provisions: Article X.25 Constitution of the Tribunal, paragraphs 5-11.

- CETA also provides for a list of arbitrators pre-agreed by the Union and Canada. In case of disagreement between the disputing parties (i.e. investor -Canada or investor –Union/Member State), the arbitrator will be selected from this list. This ensures that the Union or Canada have **always agreed to at least two of the three arbitrators that will act under CETA and will have vetted them to ensure that they live up to the highest standards**.

  Relevant CETA provisions: Article X.25 Constitution of the Tribunal, paragraphs 1-4.

Scope

- **ISDS under CETA is strictly limited to breaches of few investment protection provisions which enshrine fundamental principles such as** non-discrimination, expropriation only for a public purpose and against adequate compensation and fair and equitable treatment (see explanations above) and which has caused damage to a specific investor. It cannot be used by an investor to claim a breach of another part of the agreement. For example, it cannot be used to obtain market access. This is an important clarification.

  Relevant CETA provisions: Article X.17 Scope of a claim to arbitration

Conduct of proceedings

- **CETA introduces full transparency in ISDS disputes:** all documents (submissions by the parties, decisions of the tribunal) will be publicly available on a website which the EU will finance. All hearings will be open to the public. Interested parties (NGO's, trade unions) will be able to make submissions. This will be binding and cannot be waived by the tribunal or the parties to a dispute. As is also the practice in national/local courts in the Union and Canada, information can potentially be withheld in case of business secrets and information considered confidential under the national laws of the responding state. These instances are clearly defined. Of the 3,000 agreements with ISDS in existence, only the ones to which the United States and Canada are party to have transparency arrangements. In other cases no such documents are available or access permitted.

  Relevant CETA provisions: Article X.33 Transparency of proceedings applying the UNCITRAL Rules on transparency

  The UNCITRAL rules are available here.

- CETA **prohibits parallel proceedings: investors cannot seek remedies in domestic courts (or other international tribunals) and through ISDS at the same time**. The aim is to avoid double compensation and divergent verdicts. Most of the 3,000 existing agreements have no such mechanisms. The system in CETA is more advanced than similar ideas in the ISDS provisions in Canadian and US treaties.

  Relevant CETA provisions: Article X.21 Procedural and other Requirements for the Submission of a Claim to Arbitration; Article X.23 Proceedings under different international agreements.

- CETA has rules **preventing fraudulent or manipulative claims**. For example, the making of an investment or business re-organisation for the purpose of bringing a case (as is alleged Philip Morris has done to bring its case against Australia) is explicitly prohibited. No other ISDS agreement contains such a provision.

  Relevant CETA provision: Article X.17.3 Scope of a Claim to Arbitration

- Also, it is clearly stated that ISDS under CETA **cannot lead to the repeal of a measure adopted by Parliaments** in the Union, a Member State or Canada; the most which can be required of a country is compensation and this only to the level of the losses actually suffered. It is not possible under ISDS to also impose punitive fines, as may be possible under domestic laws. This is an important clarification, not present in most of the 3,000 agreements.

  Relevant CETA provision: Article X.36 paragraphs 1, 3 and 4 Final Award

- CETA also introduces **statutory limits** (3 years, extended if a domestic court proceeding is pursued) for bringing a claim. Again of the 3,000 agreements with ISDS in existence, only the ones to which the United States and Canada are party to have such arrangements.

  Relevant CETA provision: Article X.18.5 Consultations

- CETA has a **fast track system for rejecting unfounded or frivolous claims**. Frivolous claims can be thrown out in a matter of weeks. These are innovative provisions, broader in scope of application and in functioning than any existing comparable systems.

  Relevant CETA provisions: Articles X.20 Claims manifestly without legal merit and Article X.30 Claims unfounded as a Matter of Law

- **The losing party pays the costs.** This is important because under all existing agreements there are no clear rules, with the result that often even if a government successfully defends itself it still bears all of its costs. This is the first ever ISDS agreement with such provisions.

  Relevant CETA provision: Article X.36 paragraph 5 Final Award

- CETA contains specific provisions on **mediation** to encourage an amicable solution. It also introduces the possibility of a sole arbitrator when both parties agree and limits on the fees paid to arbitrators. These changes are intended for SMEs. These are also firsts.

  Relevant CETA provisions: Article X.19 Mediation; Article X.22.5 Submission of a Claim to Arbitration, Article X.38 Fees and Expenses of the Arbitrators

Control by the Parties (EU and Canada)

- As an additional safeguard, CETA makes clear that the Union and Canada have the right to adopt **binding interpretations and to make submissions when they are not defendants**. The reason for this is to permit the Parties to control and influence the interpretation of the agreement. The ability to adopt binding interpretations is a safety valve in the event of errors by the tribunals (the likelihood of which is in any event eliminated by the clear drafting of the relevant investment protection standards).

  Relevant CETA provisions: Article X.27 Applicable Law and Interpretation, paragraph 2; Article X.35 the non-disputing Party to the Agreement.

Further work foreseen in the agreement

- The agreement also provides for the possible creation of an **Appeal Mechanism** an objective first mentioned in the Commission's Communication on Investment Policy in 2010. US agreements have similar provisions. This is the first agreement to which the US is not party which has such a reference.

  Relevant CETA provision: Article X.42, paragraph 1(c).