ESIL Reflections
Editorial Board: Samantha Besson, Jean d'Aspremont (editor-in-chief), Jan Klabbers and Christian Tams

May 9, 2017 Volume 6, Issue 4


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'Much Ado About Nothing'? An Appraisal of CETA's Investment Chapter

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I. Introduction

Passionate and sometimes fierce debates about international investment law (IIL), especially investor-state arbitration, have emerged in the context of the negotiation of mega-regional trade agreements, like the TTIP[1] and the CETA.[2] These debates are taking place in various spheres: domestic and international political settings, the media, or the epistemic community of international lawyers.[3] As often the case with such debates, it is tinged with ill-founded perceptions, mistakes and caricatures. This is true, most notably among opponents to IIL who too often portray it as a 'pro-investor' regime that is seized by private interests and entities to the detriment of domestic public interests and the regulatory freedom of States. Of course, IIL has traditionally placed obligations only upon States; of course, some foreign investors exercise, or threaten to exercise, their right to initiate arbitration proceedings to put pressure on host States; of course, a few awards may be criticized for unduly favouring investors' interests. That being said, it is worth emphasizing that States' obligations, as enforced by most arbitration tribunals, do not annihilate the regulatory power of host States and that the community of arbitrators cannot be said to be 'pro-investor'. It is all the more surprising that some of the opponents to IIL disseminate such caricatures as they are not necessary to legitimize a public debate about it. What is needed is a well-informed discussion based on concrete facts and sound arguments, as well as a close

[1] Transatlantic Trade Investment Partnership under negotiation between the United States and the European Union, see http://ec.europa.eu/trade/policy/in-focus/ttip/index_en.htm.
[2] Comprehensive Economic and Trade Agreement between Canada and the European Union and its Member States (signature: 30 October 2016), available at http://ec.europa.eu/trade/policy/in-focus/ceta/index_en.htm (CETA).
[3] See for instance the various contributions on this topic in the ESIL Reflection and on EJIL Talk.

examination of the proposals formulated by the various stakeholders involved in the debates.[4]

In this spirit, this ESIL Reflection focuses on key provisions of CETA's investment chapter which depart from the traditional treaty practice in IIL. More specifically, it aims at appraising whether these provisions appropriately address the criticism, which led the EU and Canada to include them in the CETA. In this respect, it is claimed that, to a large extent, all this boils down to 'much ado about nothing'. Beyond the fact that much of the criticism formulated against IIL is ill-founded, it is argued here that the reforms regarding both substantive treaty standards and the settlement of investor-state disputes are of limited added-value, viewed from the perspective of the critics of the current investment treaty and arbitration practices. Taking the provision and the annex on indirect expropriation as an example,[5] I first put forth in this Reflection that the drafting of substantive standards does not add much to the protection of States' regulatory freedom, despite the specific provision on the right to regulate included in the CETA (II).[6] By the same token, I argue that the substitution of investor-state arbitration with an investment court system (ICS) only partially addresses the legitimacy concerns formulated against the former (III).

II. Indirect Expropriation and the Right of States to Regulate

As is well-known, indirect expropriation standard provisions are characterized by their terseness; indeed, international investment agreements (IIA) traditionally do not set out the criteria to determine the existence of measures equivalent to expropriation. This has led arbitration tribunals to rely on various criteria and refer to specific doctrines, i.e., the 'sole effect' and the 'police power' doctrines. There is no room in this Reflection to analyse them in detail and to recount the evolution of arbitration practice.[7] Suffice it to say that contemporary arbitration tribunals increasingly rely on a test of proportionality, be it explicit or implicit.[8] The explicit test of proportionality was first formulated in investor-state arbitration by the Tribunal in *Tecmed v Canada*, according to which:

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[4] See e.g. Caroline Henckels, 'Protecting Regulatory Autonomy through Greater Precision in Investment Treaties: The TPP, CETA, and the TTIP', 19:1 Journal of International Economic Law (2016); A Köppen and J d'Aspremont, 'Global Reform vs Regional Emancipation: The Principles on International Investment for Sustainable Development in Africa', 6:2 ESIL Reflection (2017).

[5] The same argument can be made with respect to the fair and equitable treatment and the notion of legitimate expectations. In line with mainstream arbitration practice, art 8(10)(4) CETA limits the basis of investors' legitimate expectations to specific representations made by the Parties. For an illustration of this arbitration practice, see Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, Award, 8 July 2016, paras 426-27 (Philip Morris v Uruguay). All the awards referred to in this Reflection are available at http://www.italaw.com.

[6] See Art 8(9) CETA and the Joint Interpretative Instrument on the CETA, available at http://ec.europa.eu/trade/policy/in-focus/ceta/index_en.htm.

[7] See Y Radi, La standardisation et le droit international – Contours d'une théorie dialectique de la formation du droit (Bruylant 2013), 331-36.

[8] See e.g. EnCana Corporation v Republic of Ecuador, Award, 3 February 2006, para 173.

> [I]n addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality … There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.[9]

This approach, albeit not explicit, has been adopted by other arbitration tribunals. For instance, in *Encana v Ecuador*, the Tribunal stated:

> In the first place, foreign investments like other activities are subject to the taxes and charges imposed by the host State. In the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment. Of its nature all taxations reduce the economic benefits an enterprise would otherwise derive from the investment; it will only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed.[10]

To sum up, those tribunals which rely on an explicit or implicit proportionality test are guided by the following approach to determine whether host States indirectly expropriated investors. Foreign investors cannot expect that States will not regulate. Moreover, they cannot expect to be compensated whenever they are negatively impacted by a state measure. However, the significance of the impact of the measure can lead to the conclusion that it amounts to an expropriation. In this respect, it is worth noting that the proportionality approach is akin to the 'sole effect' doctrine.[11] The test of proportionality also allows other circumstances to be taken into account; for instance, when investors have legitimate expectations.

Against the backdrop of this mainstream arbitration practice, one can appraise the merits of the CETA provision on indirect expropriation, which is to a large extent intended to address the concerns that this standard harms the right of States to regulate. Classically, Article 8(12)(1) provides that a Party shall not nationalise or expropriate, directly or indirectly, an investment except (a) for a public purpose, (b)

[9] Tecnicas Medioambientales Tecmed S.A. v The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, para 122.
[10] EnCana Corporation v Republic of Ecuador, Award, 3 February 2006, para 173.
[11] See Radi (n 7).

under due process of law, (c) in a non-discriminatory manner and (d) on payment of prompt, adequate and effective compensation. It further specifies that this paragraph shall be interpreted in accordance with Annex 8-A.

In a way reminiscent of the US and Canadian practices,[12] this Annex defines indirect expropriation by focusing on the impact of the measure ('substantial deprivation') and provides for a non-exhaustive list of criteria to determine instances of indirect expropriation, including: the economic impact, the duration, the interference with distinct, reasonable investment-backed expectations and the character of the measure, notably their object, context and intent.[13] Finally, the Annex provides:

> For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of 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.

From the perspective of the critics of IIL, the last component of the Annex is critical for assessing the added-value of the CETA. It provides for *an exception*: a non-discriminatory measure aiming to protect a legitimate public welfare objective does not constitute an indirect expropriation. Interestingly, the Annex creates *an exception to the exception*: in the rare circumstances when the impact of the measure is so severe in light of its purpose that it appears manifestly excessive, it shall be characterized as an indirect expropriation.

This language is very similar to the language and test used by the Tribunals in *Tecmed* and *Encana*. In fact, the CETA is not more protective of the right of States to regulate than mainstream arbitration practice on indirect expropriation. It has no substantive added-value in this respect. That being said, the Annex has the merits of avoiding the risk that the Court will depart from this practice in the future. Furthermore, it has a symbolic value in the sense that, by explicitly acknowledging the importance of legitimate public welfare objectives in the Annex, it shows local populations that their concerns were taken into account by the EU and Canada.

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[12] See art 6 and Annex B of the 2012 US Model Bilateral Investment Treaty and art 13 and Annex B.13 (1) of the 2004 Canadian Model Bilateral Investment Treaty, available at http://www.italaw.com/investment-treaties.

[13] For a discussion of these criteria, see Y Radi, 'Realizing Human Rights in Investment Treaty Arbitration: A Perspective from Within the International Investment Law "Toolbox"' 37:4 North Carolina Journal of International Law and Commercial Regulation (2012) 1107.

So, much ado about nothing? Symbolically, no; substantially, to a large extent, yes. Should it be criticized? Certainly not, because the criticisms formulated against the application of the indirect expropriation standard by arbitration tribunals are, as such, much ado about nothing. The above-mentioned approach of most arbitration tribunals, as codified in the CETA, does not annihilate the right of States to regulate; it is only in rare circumstances that state measures are characterized as indirect expropriation. This is all the more true since only a limited number of legislative measures are at stake in investor-state arbitration and studies show that the claim which challenged legislative acts usually fail. In fact, most of the measures challenged are decided by the executive and, among them, foreign investors mainly contest the legality of measures relating to existing guarantees, and not new measures.[14]

To meet the demands of the opponents to IIL, the drafters of the CETA should have gone as far as to remove *the exception to the exception*, thereby implying that *bona fide* non-discriminatory measures aiming at the protection of a legitimate public welfare objective never constitute an indirect expropriation. Such a radical approach, which is sometimes viewed as the embodiment of 'the police power' doctrine, is problematic.[15] From a legal point of view, it seems nonsensical and, in any case, very difficult to implement: a measure protecting a legitimate public welfare objective and whose impact is so severe in light of its purpose that it appears manifestly excessive shall not be compensated, but an expropriatory measure protecting a public purpose shall be compensated, following the criteria of legality of expropriation. What is the difference between a legitimate public welfare objective and a public purpose? If there is any, will arbitration tribunals or an international court be recognized as having the legitimacy to make this distinction? In fact, this approach could lead to a situation where foreign investors are denied protection from *bona fide* non-discriminatory measures equivalent to expropriation. This has to be criticized. Of course, public interest deserves a high level of protection and foreign investors must accept that measures aiming, for instance, at the protection of human health can negatively affect their investment without entitling them to compensation. Of course, foreign investors must be diligent and endeavour to evaluate the regulatory environment to know the measures that host States may adopt. Of course, foreign investors cannot, for instance, pollute the environment and claim to have been expropriated by host States reacting to their conduct. However, the possibility to characterize a *bona fide* non-discriminatory measure as an indirect

[14] See J Caddel and N Jensen, 'Which Host Country Government Actors are Most Involved in Disputes with Foreign Investors?' Columbia FDI Perspectives (No 20, 28 April 2014); C Tietje and F Baetens, 'The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (24 June 2014), 45-46.

[15] For an illustration of the ambiguity of this doctrine, see Philip Morris v Uruguay (n 5), paras 287-307.

expropriation to be compensated should not be excluded and its impact should also be taken into account when determining its nature.[16]

III. Investor-State Disputes and the Question of Legitimacy

Investor-state arbitration has attracted controversy and criticism over the past number of years. Its opponents target in particular the inconsistency of arbitration practice and the lack of legitimacy of arbitration tribunals to settle disputes involving public interest considerations. This criticism manifests most clearly in the answers following the public consultation organized by the EU Commission in the context of the TTIP.[17] In response and during the negotiation of this treaty, the EU proposed to the United States to replace arbitration with an investment court system (the 'ICS'). Meanwhile, it managed to convince Canada to redraft the CETA to replace arbitration with the ICS. From a legal perspective, this mechanism raises many issues, most notably its hybrid nature that is a mix of arbitration and a proper permanent court. The purpose of this Reflection is not to analyse these issues, nor to reflect upon the true nature of this mechanism. It takes the ICS as it is conceived by the EU and Canada - an innovative mechanism replacing arbitration - and, as explained above, appraises whether this mechanism can aptly address the concerns formulated against arbitration.

For this purpose, it suffices to recall some of the main features of the ICS. It is by now widely known that this mechanism is first of all made of a Tribunal. Its 15 members are to be appointed by the CETA Joint Committee, five having the nationality of an EU Member State, five being Canadian nationals, and five having the nationality of third countries.[18] The members of the Tribunal shall meet the ethical requirements set forth in Article 8(30) and refrain from acting as counsel or as party-appointed expert or witness in any pending or new investment dispute under the CETA or any other international agreement. In addition to this Tribunal, the CETA creates an Appellate Tribunal whose Members shall also be appointed by the CETA Joint Committee and who shall comply with the same ethical obligations as the members of the Tribunal. Finally, the Parties to the CETA commit to work towards the establishment of a multilateral investment tribunal and appellate mechanism.

Undoubtedly, such a mechanism is designed to ensure the consistent interpretation of CETA's investment chapter provisions. However, the issue of the (in)consistency of interpretation in relation to other IIA will remain, at least as long as the multilateral permanent mechanism is not in place, which will likely not happen any time soon, if at

[16] For a detailed discussion, see Radi (n 13).
[17] Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP), available at http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179.
[18] Art 8(27) CETA.

all. In meetings convened by the EU and Canada in December 2016 and January 2017 to discuss this project, some countries, including India and Japan, expressed their opposition to the project.[19]

Beyond consistency concerns, there remains the issue of legitimacy, which is at the core of the criticism formulated by local populations and NGOs. Of course, this new system institutionalizes and 'publicizes' the settlement of investor-state disputes. Notably, the Members of the Tribunal and of the Appellate Tribunal will be part of a permanent institution and they will be appointed by CETA's Parties. This can only but please the opponents who stigmatize investor-state arbitration as being a 'private-type' of mechanism and who criticize the appointment of arbitrators by the parties to the dispute. And the rules about conflicts of interests will please these opponents as well.

However, it is argued here that this development will not suffice to meet the concerns expressed by local populations. To understand this, let us imagine a basic scenario: what will be the reactions when the Tribunal and the Appellate Tribunal reach the conclusion that a *bona fide* non-discriminatory measure aiming at the protection of the environment is so severe in light of its purpose that it appears manifestly excessive and, therefore, constitutes an indirect expropriation to be compensated? Local populations and their representatives will very likely decry the lack of legitimacy of an *international* tribunal to rule over such a measure and the fact that it deprives States from their regulatory power. Such reactions can *mutatis mutandis* be witnessed against the European Court of Human Rights, as illustrated by the statements of the former UK Home Secretary and current British Prime Minister, Theresa May.[20] In other words, what the CETA fails to take into account is the fact that local populations not only criticize the *private* dimension of arbitration, but also its *international* dimension. This clearly appears in the answers to the above-mentioned consultation organized by the EU Commission in 2014, in which many participants expressed the view that domestic tribunals should have exclusive competence to settle investor-state disputes, or at least that investors should be under the obligation to seek redress in domestic courts. To really address these criticisms, CETA's parties, and the EU in particular, should have given a greater role to domestic courts, as the new India BIT model does for instance.[21]

So much ado about nothing? From the perspective of the critics of IIL, to some extent, yes. Criticism will continue to exist and focus on the issue of the international nature of the ICS. They will likely combine their effects with two interconnected criticisms

[19] See http://trade.ec.europa.eu/doclib/press/index.cfm?id=1600.
[20] See https://www.theguardian.com/politics/2016/apr/25/uk-must-leave-european-convention-on-human-rights-theresa-may-eu-referendum.
[21] Art 15, Model Text for the Indian Bilateral Investment Treaty, available at http://finmin.nic.in/reports/ModelTextIndia_BIT.pdf.

regarding first, the issue of the cost and financing of a permanent ICS and second, the question of the need for such a system in the context of EU-Canada relations. Because of the lack of disputes to settle,[22] and because of the availability of domestic judiciaries respecting rule of law standards, [23] many will argue that the ICS is basically needless.

IV. Conclusion

This ESIL reflection has appraised two key aspects of CETA's investment chapter – the indirect expropriation standard and the ICS – in light of the criticism and concerns that its drafters intended to address. For various reasons, it has been put forth that all this is, to a large extent, much ado about nothing: first, because it is likely to fail to fundamentally address the criticisms of IIL opponents and second, because these criticisms are, as such, largely ill-founded.

That being said, it is necessary to ease anxieties and IIL needs to be adjusted to adapt to current times. But in the process of reforming IIL, policymakers should remember the past and take stock of the present. They should not forget that the involvement of States in the settlement of investor-state disputes has proven to be both unsatisfactory for foreign investors and harmful to inter-state relations. Furthermore, they should sort through the various criticism and be cautious not to give credit to those critics who, far beyond arbitration, aim at dismantling international cooperation. Otherwise, these policymakers will involuntarily contribute to weakening international institutions in a context characterized by the rise of discourses and practices hostile to international cooperative mechanisms, be they international courts and tribunals or international organisations.

Cite as: Yannick Radi, '"Much Ado About Nothing'? An Appraisal of CETA's Investment Chapter" 6:4 *ESIL Reflection* (2017).

[22] The establishment of the multilateral ICS discussed above would of course address this criticism.

[23] From a diplomatic point of view, it is worth emphasizing that to exclude an international dispute settlement mechanism in their relationships, on the basis of the functioning of their respective judiciaries, would have placed the EU and Canada in a difficult position for their future negotiations. In such a scenario, which policy could they have adopted with regard to those States whose judicial system does not meet their standards? Which explanations, diplomatically acceptable for their partners, could they have provided if they had wished to include an international dispute settlement mechanism?