CANADA-EUROPE TRANSATLANTIC DIALOGUE:
SEEKING TRANSNATIONAL SOLUTIONS TO 21ST CENTURY PROBLEMS

canada-europe-dialogue.ca
CETA Policy Briefs Series
October 2013

The Investment Provisions of the CETA

Armand de Mestral[1] and Stephanie Mullen*

Introduction

The investment rules proposed in the Canada-EU Comprehensive Economic and Trade agreement (CETA) are hotly debated. They have the potential to open new doors for investment between Canada and the European Union (EU) but they are viewed with concern in certain quarters. Until the final text is approved and made public it will be impossible to make more than an educated, if not speculative, guess as to the contents and implications of CETA. The final version has not been made public and at time of writing in September 2013 is still under negotiation. If the draft investment chapter is adopted, its purpose will be to expand market access and increase protection for investors on both sides. The EU has sought greater access to provincial services and public procurement markets. Canada has similar ambitions within the European market, which is estimated to be the largest in the world.[1] The EU, having acquired competence over direct foreign investment in 2009 is now in a position to negotiate in this area.

While much can be said of a positive nature, CETA has nevertheless become a

[1] Emeritus Professor of Law, McGill University; *LLB candidate, Cambridge University. The views expressed herein are attributable only to the authors in a personal capacity and not to any institution with which they are associated.

cause of concern for some Canadian and European civil society groups, who fear that their governments may lose regulatory control over the provision of public services and the capacity to protect certain key Canadian and European industries.[2] Many of these fears focus on the investment chapter. Most prominent is the fear that the CETA—and specifically its proposed investment rules—will limit the regulatory powers of municipal and provincial governments in Canada, especially over natural resources and environmental regulations, while expanding the rights of foreign investors. Similar fears have been voiced by members of the European Parliament with respect to foreign investment in Europe. These fears can be put to rest. While CETA will surely increase the scope of protection for investors, negotiators on both sides have reportedly proposed various methods, including rules of interpretation and broad exceptions to the investor-state arbitration provisions and the investment protection rules, to ensure that CETA will not adversely affect implementation of many current and future governmental measures.

The following is a short analysis of the implications of CETA on investment in Canada and the EU, based on leaked drafts, some of which date from well over a year ago, of the investment chapter and investor-state dispute settlement provisions.[3] Not everything is public and much is still a matter of conjecture. It is evident from the drafts that both the EU and Canada have sought to overcome some of the challenges faced in the application of the North American Free Trade Agreement (NAFTA) and various other bilateral trade agreements, particularly those arising in the context of investor-state arbitration.

Investment protection rules

There are few investment rules under GATT, as revealed by the *Canada-FIRA* case.[4] The Agreement on Trade-Related Investment Measures (TRIMs) essentially confirmed this situation. The General Agreement on Trade in Services (GATS) goes further in that it covers investment rules through the regulation of services such as banking, insurance or brokerage etc., but only on the basis of a "positive list" approach which requires that covered rights must be specified. Thus, the WTO provides only limited investment protections. The parties have proposed similar non-discriminatory obligations in CETA, but reportedly they have chosen to go further than the GATT /

GATS approach by adopting a formula similar to the "negative list" approach of NAFTA, which requires the specific exclusion of measures which are not covered.[5] CETA will primarily expand liberalization of investments in particular services industries, as well as rights of investors, subject to proposed reservations by either party.[6] In legal terms, the proposed reservations will be of great importance, limiting the scope of the agreement by reference to specific (and significant) policy areas. This process, however, has been in part driven by the presence of the Canadian Provinces at the negotiating table. The involvement of the provinces was deemed necessary by the EU, as many of the key issues for the negotiations fall under provincial jurisdiction, including public procurement, services and many environmental issues.[7] The same applies for the EU member states, as they too retain significant jurisdiction over many significant policy sectors.

Due to the various political factors involved, the reservations to the investment chapter proposed by Provinces and European member states vary in scope and detail, and as a result, one can only speculate as to what the final agreement will include. For example, agriculture has been acknowledged as a main negotiating issue by both parties.[8] Canada's dairy and poultry supply management systems, moreover, have also been the subject of WTO complaints dating back to 1996.[9] Several provinces have proposed Annex I reservations to protect their supply management systems for agriculture (including dairy and poultry).[10] Exemptions for these industries will not only continue to limit market access to European producers, but also deny access to export markets for Canadian producers. Unsurprisingly, the EU is also protecting its producer subsidies under its Common Agricultural Policy through several Annex I reservations.[11] There has reportedly been strong resistance to expanding the right of access of Canadian beef to Europe and of European cheese to Canada.

It is evident from the drafts that the EU and Canada have taken slightly different approaches to increasing access to investment in their public procurement markets. In some sectors, Canada and the EU have proposed similar reservations, and in others there is no reciprocity. For example, the EU has proposed a *Market Access* and *National Treatment* reservation for the collection, purification and distribution of water services. It is not yet clear how Canada has chosen to deal with this important issue, but it can be assumed that Canada will take the same reservation and will remove any lingering doubt

that bulk water may be a tradable commodity. Another example can be found for the varying approaches taken for investment in the energy sector. The EU has proposed both an Annex II reservation contained in the CETA leaked draft exempting measures limiting the market for the extraction and manufacture of refined petroleum and gas, as well as the distribution of electricity.[12] Also relevant is the EU's proposal for inclusion of a broad Annex II reservation covering public utilities at both a national and local level. The Canadian Provinces have also proposed various reservations to protect their regulatory powers over the provision of public utilities.[13]

It is reported that the European side has requested broad exemption of European investments from Investment Canada review and, even more controversially in light of recent EU banking history, the European Commission has reportedly requested exemption of EU banks from many Canadian restrictive investment and regulatory provisions. It is unlikely that Canada will accede to these requests.

It is also worth noting that both parties have proposed a general public policy exception to the investment chapter in the various leaked drafts.[14] Both proposals are modeled on GATT Article XX, yet each differs in scope. In addition, any measure would also have to comply with the chapeau of GATT Article XX. Each of the proposed reservations include a variation on the chapeau, which prohibits the exemption of trade measures that involve arbitrary or unjustifiable discrimination or disguised restrictions on international trade or investment. By including a general policy exceptions clause, CETA negotiators have offered both parties an additional way to protect their policy autonomy.[15]

Investor-state arbitration

The investment protection rules are subject to an investor-state arbitration (ISA) clause and a dispute settlement chapter, which together will provide a system similar to NAFTA. It is reported that the investment chapter establishes a mechanism for resolving investor-state disputes through arbitration. This is by no means unusual - the inclusion of ISA provisions is common in bilateral investment treaties (BIT) and other trade agreements with investment protection chapters, most relevantly (for present purposes) in NAFTA. However, the inclusion of ISA provisions in trade agreements has proven to be

controversial, especially between developed nations. Australia's recent decision not to include ISA provisions in its bilateral agreement trade agreement with the United States has contributed to the ongoing debate over the advantages and disadvantages of ISA as a form of dispute resolution. Negotiators from Canada and the EU are committed to including ISA provisions in CETA, as their exclusion would have been seen as limiting the efficacy of the resolution of investment disputes between host states and foreign investors under CETA, and because on both sides there remains lingering concern that their investors may suffer economic harm, particularly from certain EU member states.[16] Canada has also proposed to exempt any investment reviews under the *Investment Canada Act* from ISA.

Dispute Settlement Chapter

The general dispute settlement procedure will be similar to Chapter 20 of NAFTA. The state parties may have recourse to CETA's interstate dispute settlement procedure for any alleged violation or any dispute over the interpretation and application of the agreement.[17] With the existence of investor-state arbitration, it is unlikely that many investment disputes will go to the general interstate procedure.

Secondly, the parties have sought to resolve several complications that have arisen in its experience with NAFTA, particularly the appointing of panelists. In several NAFTA disputes, parties have refused to appoint NAFTA panelists to hear cases, freezing the dispute in question.[18] The 2013 CETA Draft provides for alternate mechanisms to appoint panelists on the refusing party's behalf. The chair of the arbitration panel, or the chair's delegate, may draw by lot the members of the panel from a list established by the state parties.[19] This procedure should effectively resolve the issues encountered with the establishment of NAFTA panels.

Finally, the 2013 Draft also provides parties with the option of selecting the forum in which they may raise their disputes—either party can bring a claim under the dispute settlement chapter or under the WTO Dispute Settlement Understanding if the claim is "equivalent in substance." CETA, however, has addressed the issues Canada faced in the *Softwood Lumber* dispute with the United States, in which aspects of the dispute were litigated under both the WTO DSU, NAFTA Chapter 19 and indirectly Chapter 11,

resulting in potentially conflicting outcomes. Under CETA, once a party initiates dispute settlement in its chosen forum, a claim may not be brought for the same breach in the other forum, 'unless the forum selected fails, for procedural or jurisdictional reasons, to make findings on that claim.' This is a significant change which seeks to avoid the possible jurisdictional overlap which has arisen in the context of several regional trade agreements.[20] Whether it will succeed in trumping access to the WTO dispute settlement system is a matter of considerable legal uncertainty.

Conclusions

Until a final text is issued by both parties one can only speculate on the contents of the agreement. However there is little doubt that it will encourage trade between firms in Canada and the EU. It is to be hoped that this will be but the first of a series of long-awaited agreements with our major trading partners apart from the United States.

---

[1] For more information, see the 2009 joint study released by the European Commission and the Government of Canada. 'Assessing the costs and benefits of a closer EU-Canada economic partnership.'

[2] See e.g. Open Civil Society Declaration on a proposed Comprehensive Economic and Trade Agreement between Canada and the European Union, signed by a number of organizations, available at <http://tradejustice.ca/en/section/22>. See also Canadian Union of Public Employees at <http://cupe.ca/ceta/legal-opinion-urges-provinces/brakes>, and Canadian Centre for Policy Alternatives at <www.policyalternatives.ca/newsroom/news-releases/canada-eu-free-trade- deal-could-cost-150000-canadian-jobs-study>.

[3] Available at http://tradejustice.ca/fr/section/3; see also: http://www.laquadrature.net/en/CETA

[4] The WTO Panel decision was based on Article III (National Treatment) and Article XI (General Elimination of Quantative Restrictions) of GATT, which are two of the non-discriminatory obligations for member states. See *Canada-Administration of the Foreign Investment Review Act (FIRA)*, Report of the Panel adopted 7 February 1984. L/5504 – BISD 30S/140. It should be noted that the Panel's interpretation of GATT largely influenced the WTO Agreement on Trade-Related Investment Measures (TRIMs).

[5] Documents outlining the Federal and Provincial Annex I and II reservations were made public by the Quebec Network on Continental Integration and the Trade Justice Network (October 2011) at <http://tradejustice.ca/en/section/3>. The EU's Annex I and II reservations are not yet in the public domain.

[6] The latter is discussed below in greater detail.

[7] The EU insisted that the provinces be directly involved in CETA negotiations, after the difficulties experienced in negotiations for a trade and investment enhancement agreement launched at the Canada-EU Summit in 2002. For more on Canada and the EU's economic relationship, see Viju, Crina & Kerr, William. 2011. *Agriculture in the Canada-EU economic and trade agreement.* International Journal.

[8] "Assessing the costs and benefits of a closer EU-Canada economic partnership," www.international.gc.ca. Other studies published since have shown similar results. See Patrick Leblond and Magdalena Andreea Strachinescu-Olteanu, "Le libre-échange avec l'Europe: quel est l'intérêt pour le Canada?" Canadian Foreign Policy/La politique étrangère du Canada 15, no. 1 (2009): 60-76.

[9] E.g. *Canada – Dairy*, WTO Doc WT/DS103/AB/R, 13 October 1999.; *Canada – Dairy (21.5 II)*, WTO Doc WT/DS103/AB/RW2, 20 December 2002.; *Canada-Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WTO Doc/DS276/R, 6 April 2004.

[10] Quebec, Nova Scotia, Newfoundland and Manitoba have all proposed Annex I reservations to exempt the supply management of dairy, eggs and poultry products.

[11] For a summary of this position, see Findlay, Martha Hall. 2011. "Supply Management: Problems, Politics and Possibilites." *The School of Public Policy Research Papers* 5(19). Accessed July 15, 2013. http://www.policyschool.ca.

[12] Conflict has arisen over the possible implementation of the European Fuel Quality Directive. See Bartels, Lorand & Henkels, Caroline. 2011. "Investment and the Canada-EU Comprehensive Economic and Trade Agreement: the oil sands controversy." Canada-Europe Transatlantic Dialogue.

[13] Ontario however is the only Canadian province to propose an Annex II reservation for renewable energy. This is likely a consequence of its efforts to protect its *Green Energy Act* from NAFTA and WTO rules. Following the recent *Canada—Feed-in Tariff Program* decision by the WTO Appellate Body, Canada is under an independent obligation to amend the discriminatory aspects of Ontario's FIT program.

[14] As noted in an earlier CETD publication, the inclusion of this clause is uncommon in investment treaties and is not included in NAFTA. See Bartels, Lorand & Henkels, Caroline, *supra* note 12.

[15] Canada has also proposed two additional exceptions to the investment protection rules: (i) government procurement and subsidization by a Party and (ii) denial of benefits to investors if the Party's measure is related to maintenance of international peace and security of protection of human rights or is to prohibit transactions with that enterprise or would be violated if benefits this Chapter were accorded to that enterprise.

[16] See European Commission, Proposal for Regulation of the European Parliament and of the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries, COM(2010)344 final. Brussels. 7 July 2010.

[17] 2013 Draft, p 273 < http://www.laquadrature.net/en/CETA >. Draft in possession of the author.

[18] The United States and Mexico have both refused to appoint NAFTA panelists in different disputes, instead choosing to commence dispute settlement proceedings at the WTO. Appellate Body Report, *Mexico—Soft Drinks*, WT/DS308/AB/R, (24 March 2006); Report of the Panel, *US—Tuna II*, WT/DDS381/R, (circulated 15 Sept 2011). See also Office of the United States Trade Representative, "United States initiates NAFTA Dispute with Mexico over Mexico's Failure to Move Its Tuna-Dolphin Dispute from the WTO to the NAFTA", November 2009. <http://www.ustr.gav/about-us/press-office/press-releases/2009/november/united- states-initiates-nafta-dispute-mexico-over>.

[19] Pursuant to the treaty's entry into force, the CETA members would establish a list of arbitrators at its first meeting. Each party is obligated to propose at least 5 individuals, for a minimum of 15 possible arbitrators listed in total. In the event the Parties are unable to agree on the composition of the arbitration panel within 10 working days of the request for a panel, one member will be drawn from the sub-lists of individuals proposed by the responding Party, the complaining Party and the Parties acting as chairperson. 2013 Draft, p 276.

[20] Joost Pauwelyn, "The U.S.-Canada Softwood Lumber Dispute Reaches a Climax" ASIL Insights, 30 November 2005. Accessed April 17, 2013. http://www.asil.org/insights051129.cfm.