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**The Draft Investment Chapter of the Canada-EU Comprehensive Economic and Trade Agreement: A Step Backwards for the EU and Canada?**

Nathalie Bernasconi-Osterwalder – June 26, 2013

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When the Lisbon Treaty granted the European Union jurisdiction over foreign direct investment in December 2009, many thought that a window of opportunity opened for the introduction of new approaches and more systemic changes to investment treaties. The EU’s member states are party to some 1200 bilateral investment treaties (BITs)—over a third of the global total—and so a more progressive and coherent approach to investment treaties by the EU would have profound changes on international investment law. Unfortunately, the trend so far has not fulfilled these expectations.

Also in 2009, Canada and the EU started negotiating a Comprehensive Economic and Trade Agreement (CETA). The agreement was originally confined to trade,[[1]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn1) but in September 2011 the European Council expanded the mandate for the European Commission to negotiate an investment chapter.[[2]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn1) Today, CETA negotiations, including the investment chapter, are at their final stage and the conclusion of the agreement is expected this year.

Getting the investment text ‘right’ is critical; any mistakes will live on for a long time. Even if the Canada or the EU decides at some point to terminate the agreement, the draft CETA states that the agreement’s provisions will continue to be effective for 20 years.

Unfortunately, a recent draft of the CETA investment chapter (dated May 31, 2013) reveals only minor improvements, mainly on procedural matters, over existing EU member state BITs.[[3]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn3) Moreover, the text largely ignores the “major changes” requested by a committee of the European Parliament in a 2011 report on EU investment policy.[[4]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn1) The draft investment chapter is also a step backwards for Canada, which has introduced a number of procedural *and* substantive innovations into its investment agreements over the last decade that would be significantly eroded under the current text.

This brief article describes some important aspects of the draft chapter, as well as commentary on the potential implications should Canada and EU sign on to these provisions. The article also notes proposals that have been made by either the EU or Canada in the draft text—but where they have not yet agreed.

*Definition of investment*

The definition of “investment”is broad, covering “any kind of asset” independent of whether or not investments are associated with an existing or new enterprise in the host state. The definition is crucial since it will determine which investments benefit from the strong protections provided in other parts of the agreement. An exhaustive list of covered investments or an enterprise-based definition would better ensure that the agreement is interpreted to protect selected types of investment, rather than the vast universe.

The draft chapter expands the definition of investor to natural persons or enterprises that “*seek to make, are making*, *or have made an investment.”* This extends the scope of application of the treaty to the pre-establishment phase of an investment (i.e. at the stage when an investor is seeking to invest, but has not yet established an investment).  At the same time, Canada and the EU agreed to limit the scope of the term “investor” by excluding enterprises without substantial business activities in the alleged home state from its definition. This addresses the issue of ‘treaty shopping’ and misuse by ‘mailbox’ investors, and is a welcome outcome.

*Establishment of Investments*

The draft chapter suggests that Canada and the EU agree to extensive market access commitments,which would prohibit a wide range of measures that regulate the entry of foreign investors or their operations. While the extent of liberalization commitments will depend on the carve-outs to the market access commitments, this approach nevertheless risks exposing Canada and the EU to longstanding commitments in areas they did not intend to cover. The risk is heightened due to the use of a negative list approach, which is new for the EU, and amplified even further if these commitments are subject to investor-state arbitration.

Another problematic element is the prohibition of performance requirements.This eliminates countries’ flexibility to use such measures as economic policy tools, thereby significantly reducing their overall scope of policy discretion. While absent from EU treaties so far, Canada has prohibited the use of some performance requirements in its previous treaties, and has already lost an arbitration brought by US oil companies relating to this provision in NAFTA. If included in the CETA, this provision should not be subject to investor-state arbitration, as suggested by the EU. A more flexible approach to resolving disagreements over the use of performance requirements should be considered instead.

*Non-discriminatory Treatment*

The draft chapter couples pre-establishment commitments with obligations to provide national and most-favoured nation treatment (MFN). This means that in addition to prohibitions against limits on market access, Canada and the EU are contemplating *relative* establishment rights incorporated through the national treatment and MFN clause. As a consequence, host states have obligations vis-à-vis prospective investors even before the investment is made. This could significantly limit the ability of Canada and EU member states to regulate certain foreign investments at the entry and pre-entry stage, subject to listed exceptions.

One of the most important shortcomings of the draft relates to the formulation of the MFN provision. The MFN provision**,** as currently drafted, does not limit the possibility for investors to import provisions from other investment treaties. In effect, this would allow foreign investors to cherry pick provisions from other, including older, treaties belonging to the EU and Canada, which risks nullifying any progress made in the CETA to modernize investment law. This would be a serious reversal of Canada’s position in its 2004 Model FIPA, which prevented such cherry picking from older language treaties.

*Investment Protection and Fair and Equitable Treatment*

The draft CETA includes a provision to accord fair and equitable treatment (FET) to investors and investments. Similar provisions have become a ‘catch-all’ obligation invoked by investors, and in many cases has been interpreted by tribunals in inconsistent and far-reaching manners.

According to an earlier draft text, Canada had favored a closed list of situations that amount to a breach of FET (denial of justice, fundamental breach of due process, manifest arbitrariness, targeted discrimination, abusive treatment). The EU on the other hand proposed an open list, making the concept of FET very broad and, as a consequence, highly problematic.

The parties have now agreed on a new approach, which begins with a closed list but incorporates a flexibility mechanism that allows parties to regularly discuss the content of the FET obligation. This is an interesting addition that could also be used in other clauses.

In addition, the parties agreed that there could also be a breach of the FET obligation in other situations that amounted to a breach of customary international law (i.e. where an obligation is “recognized in the general practice of States accepted as law.”)  Unfortunately, this re-introduces uncertainty which was meant to be avoided through the closed list. Defining FET solely through a list of situations that amount to a breach of the obligation would have been preferable.

It is important to note, however, that due to the absence of a proper exceptions clause to the MFN provision (see above), any precision in the formulation of the FET clause could be disregarded by tribunals, since an investor might resort to more vague FET provisions from other treaties when bringing a claim pursuant to the CETA investment chapter.

The EU also proposes the inclusion of the so-called ‘umbrella clause,’ which makes it possible for investors to claim a breach of contract or other agreement as a violation of the treaty itself. Host state commitments are significantly broadened as a result, leaving states all the more exposed to international arbitration claims. Canadian treaties typically do not contain an umbrella clause, and the EU Parliament has expressed concern about their use investment treaties.

*Expropriation*

Earlier in the negotiations Canada and the EU had diverging proposals with respect to indirect expropriation. In line with its longstanding practice, Canada proposed to exclude public welfare measures (i.e. environmental, or health and safety regulations) from the notion of indirect expropriation, which would help limit expansive interpretation by tribunals on whether a government measure amounts to expropriation. The EU, however, suggested that such measures must be subject to both a “necessity” and “proportionality” test in order to determine if they amount to indirect expropriation. The May draft on expropriation builds on language from both proposals but does not incorporate the necessity and proportionality elements. This is a welcome development.

Again, as noted above, since the CETA language on expropriation is different from language used in some EU member state BITs or some older Canadian BITs, the MFN clause, if not qualified properly, could allow investors to import such other expropriation clauses into disputes under the CETA.

*Reservations and Exceptions*

The reservations and exceptions provisions state that selected substantive commitments do not apply to those existing non-conforming measures that are listed in the schedules. This means that states may not maintain pre-existing laws, regulations and other measures that are not in conformity with the commitments in the investment chapter unless explicitly excluded in a schedule. This is risky, as it is very difficult to know with any confidence that all non-conforming measures will be listed in the schedule. A better approach would be to grandfather non-conforming measures across the board, ensuring that *any existing* non-confirming measures may be maintained, unless specifically stated otherwise. Canada sets a precedent for this approach in some of its more recent treaties.

*General exceptions clause*

Canada and the EU have agreed on the architecture of a general exceptions clause in the investment chapter, but have not yet come to an agreement on the content. While Canada appears to want to limit the scope of problemsraises several concernsnd it lauses and, Canada ,  be made subject to ISDS. he most problematic element of the CETA. It permitted measures (‘a party may adopt’) to only three categories of measures (to protect human, animal or plant life or health, to ensure compliance with domestic law, and for the conservation of living or non-living exhaustible natural resources), the EU also wishes to add other categories of measures, including to protect public security, public morals and public order, as well as national treasures of artistic, historic and archaeological value. Both parties wish to subject the exceptions to a so-called ‘necessity’ test, which poses several legal hurdles, as seen in the WTO context.  Exceptions clauses such as the ones proposed will not safeguard government policy space in a satisfactory manner. It is much more important to include clarifications and delimitations to the crucial substantive provisions included in the investor chapter, such as related to fair and equitable treatment, expropriation, MFN, etc. This becomes even clearer since the EU specifically proposes that the exceptions clause should not apply to expropriation and fair and equitable treatment.

*Investor-State Arbitration*

The most worrisome element of the EU-Canada draft with respect to investment is the inclusion of investor-state dispute settlement.[[5]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn5) In light of the well-developed judicial systems in Europe and Canada, allowing investors to bypass national judicial systems in favor of privatized, largely unaccountable tribunals, seems misguided. If maintained, these tribunals should only function as a last resort, after local remedies have been exhausted. Indeed, this is what the European Parliament requested as one of its suggested “major changes”[[6]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/" \l "_ftn6" \o "). In its 6 April 2011 resolution the Parliament stated “that changes must be made to the present dispute settlement regime, in order to include… the obligation to exhaust local judicial remedies where they are reliable enough to guarantee due process….” (paragraph 31).[[7]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftn7) The EU and Canada have entirely ignored this demand.

According to a May 17th table, Canada and the EU have not agreed on the scope of investor-state dispute settlement. It remains to be seen whether market access and establishment issues as well as the prohibition of performance requirements will be subject to investor-state dispute settlement.

In terms of addressing some of the problems inherent to investment arbitration, the main improvement compared to EU member state BITs is the increased transparency at all levels of the arbitration process—something that Canada has long incorporated in its treaties. Further, there is some bracketed language regarding independence of arbitrators.  It states that arbitrators must comply with the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration or a Code of Conduct to be established under the treaty. Introducing a special code of conduct for arbitrators in disputes arising under the treaty is useful and necessary considering the current state of investment arbitration. It is useful insofar as it will trump or complete less adequate standards set in other bodies such as the World Bank’s International Center for Settlement of Investment Disputes (ICSID). However, the parties are considering a formulation where the Code of Conduct will not necessarily apply, as arbitrators have to comply with the Code *or* the IBA Guidelines on Conflicts of Interest. While the IBA Guidelines are a very useful reference, they are general to international arbitration. A code of conduct can be more readily tailored to address specific concerns on arbitrator conflicts in *investment* arbitration. Therefore, the parties should not have a choice between the IBA Rules or a special code but instead the Code should integrate and build on the IBA Rules and bring in investment-specific elements. In particular, the Code of Conduct should clearly state that arbitrators in an investment treaty case may not concurrently act as counsel in other investment treaty arbitrations. Finally, the compromise draft table indicates that the parties may agree to adopt a code of conduct only *after* the adoption of the agreement. This type of postponement should be avoided.

Canada and the EU also appear to agree to create a “Committee on Services and Investment,” which is to oversee the implementation of investor-state dispute settlement provisions. The committee would be tasked with examining “under what conditions, an appellate mechanism could be created.” This is a weak commitment to look into the possibility of an appellate mechanism. Given the fact that there is no urgency to introduce investor-state dispute settlement in the Canada-EU context, the negotiating parties are missing an opportunity to introduce a truly new approach. A preferable option would be to make the introduction of investor-state dispute settlement dependent on the creation of a proper appellate or similar mechanism.

*Conclusion*

The EU and Canada are negotiating an investment chapter that resembles a mix of EU FTA clauses on establishment and market access, Canadian investment treaties and chapters, and EU member state treaties. The May draft does not introduce any major novel changes meant to address the problems that have come to light in investor-state dispute settlement, and appears to disregard the fact that both Canada and EU countries have well-functioning legal frameworks and court systems.

The May 2013 draft of the CETA investment chapter contains timid improvements as compared to EU member state BITs in respect of fair and equitable treatment and expropriation. However, these improvements are made in vain if the MFN clause allows investors to import guarantees under other Canadian or EU member state treaties in case a claim is brought under the CETA investment chapter.

In terms of investment liberalization both parties have agreed to include binding market access commitments and pre-establishment rights. A particularly disconcerting matter in this context is that the EU seems to have been convinced to shift from a positive to a negative list approach to market access, which is less predictable and more difficult to establish. Another important question that still appears to remain open is whether the EU will agree to subject its market access and establishment commitments to investor-state dispute settlement; it has not done so in the past.

As the EU and Canada enter the final stages of negotiation, there is an opportunity to create a truly progressive approach to international investment law, particularly with respect to dispute settlement issues. This opportunity will hopefully be seized.

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[[1]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref1) European Commission, Overview of FTA and other Trade Negotiations, 9 April 2013, available at http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc\_118238.pdf.

[[2]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref2) European Council, Press Release, p. 13, 12 September 2011, available at http://www.consilium.europa.eu/ueDocs/cms\_Data/docs/pressData/EN/genaff/124579.pdf.

[[3]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref3)  The May 31st 2013 text has not been made public by the negotiating parties. However, a February 2013 draft text is available at: http://tradejustice.ca/fr/section/3.

[[4]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref4) See Committee on International Trade (Kader Arif), Report on the future European international investment policy (2010/2203(INI)), 22 March 2011, available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN>.

[[5]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref5) This information is based on a non-public compromise table of the investor-state dispute settlement text of the CETA investment chapter dated May 17, 2013.

[[6]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref6) See Committee on International Trade (Kader Arif), Report on the future European international investment policy (2010/2203(INI)), 22 March 2011, available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN>.

[[7]](http://www.iisd.org/itn/2013/06/26/the-draft-investment-chapter-of-canada-eu-comprehensive-economic-and-trade-agreement-a-step-backwards-for-the-eu-and-canada/#_ftnref7) See also European Parliament resolution of 6 April 2011 on the future European international investment policy (2010/2203(INI)), available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0141+0+DOC+XML+V0//EN>. For a commentary, see Marc Maes, While the EU member states insist on the status quo, the European Parliament calls for a reformed European investment policy, Investment Treaty News, 1 July 2011, available at http://www.iisd.org/itn/2011/07/01/while-the-eu-member-states-insist-on-the-status-quo-the-european-parliament-calls-for-a-reformed-european-investment-policy/.