CETA and the Investment Court System

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<u>Key Points</u>

- There is no plausible economic argument for Investor-State Dispute Settlement (ISDS) / Investment Court System (ICS) in CETA. Reforms in CETA may address some problems but do not change the fact that there are no good arguments for this system.
- By ratifying CETA, Ireland becomes subject to an international arbitral system that accords privileged rights to international investors, and whose decisions are unreviewable in any Irish or European court.
- Rights conferred on investors in CETA impose binding constraints on national policy choices, including over environment, public health, housing and financial regulation.
- The threat of investor claims under similar treaties has been shown to slow or prevent the adoption of legitimate public policies that are opposed by investors.
- While procedural and substantive innovations go some way to address the pervasive uncertainties of existing international investment protections, significant doubts remain about the scope of the rights being given to investors.
- The CJEU have confirmed that only member states, not the EU, have the power to create ISDS mechanisms of this kind. The EU can (and does) make trade agreements without including ISDS.
- While the CJEU has found CETA's ICS legally compatible with European Union law, this does not mean that it is politically or socially desirable, for Ireland or the EU.
- The CJEU's finding that the agreement is compatible with states' freedom to pursue legitimate public policies rests on an optimistic interpretation of its provisions, which will not be binding on, and may not be followed by, the CETA Tribunal/Appellate Tribunal.
- Once ratified, Ireland will have no power to unilaterally vary or withdraw from these commitments. If concerns cannot be addressed now, there is little reason to expect they will be in the future.

<u>1. There is no plausible economic argument for ISDS/ICS.</u>

ISDS is usually advocated as a tool to help states attract investment by reassuring investors (signalling) and reducing political risk (binding). However empirical studies of the link between Bilateral Investment Treaties (BITs) and investment flows are inconclusive – some find a positive effect, but others find none, or indeed a negative one. (Bonnitcha et al 2017, Ch. 6) Further, those studies focus on developing countries where political risk is most plausibly an impediment to investment – the argument is substantially weaker for countries with positive international reputations, stable regulatory environments and strong rule of law. Ireland has successfully attracted substantial foreign investment without reliance on BITs or ISDS. There is no need to give these additional privileges to foreign investors to attract investment, and investors themselves have more efficient tools available to address political risk where necessary.

<u>2. ISDS / Investment Court System are Unequal and Unreviewable.</u>

The ICS allows foreign investors to sue host states (including Ireland) in international tribunals (the "CETA Tribunal" / "Appellate Tribunal"). This is highly unusual in international law, which predominantly relies on state-to-state enforcement and dispute settlement. It accords rights to investors that are not accorded to any other individuals or groups that may be affected by the decisions and policies that are challenged.

Despite chapters on sustainable development, labour and the environment in CETA, enforcement mechanisms are much weaker than those for investors, and ultimately depend on voluntary compliance. (e.g. Art 23.10.12 on Trade and Labour disputes)

ICS decisions are not reviewable in any Irish or European Court. Under the *ICSID Convention* and the *Arbitration Act 2010*, a decision of the ICS is enforceable in the same way as a court order. Unlike other arbitration systems, the courts cannot review these decisions on public policy grounds.

<u>3. Investor rights constitute binding constraints on national policy choices.</u>

While CETA guarantees the 'right to regulate', that right is subject to the rights of investors set out in Chapter 8. The mere fact, without more, that a measure pursues a legitimate public policy, will not provide a defence to a complaint of discrimination, indirect expropriation or breach of fair and equitable treatment (FET). ISDS complaints under other treaties have been used to challenge *inter alia* public health, environmental (including climate change), public services and financial stability policies. Arbitration law firms actively market their ISDS services to oppose environmental regulations that might hurt investors' profits. Examples of prominent policies that Ireland has adopted, or considered, which might be challenged under these rules include:

- <u>2008 Bank Guarantee</u> – guaranteed Irish but not foreign-owned banks. *[Investor could argue breach of (i) Non-discrimination and (ii) Fair and Equitable Treatment (manifest arbitrariness). Compare* Saluka v Czech Republic*]*
- <u>Housing Reform</u> – proposals for rent controls and secure tenure *[Investor could argue (i) indirect expropriation; (ii) Discrimination / Fair and Equitable Treatment (manifest arbitrariness) if include exemptions for smaller landlords; (iii) FET (legitimate*

expectations) if assurances provided to investors re future regulatory environment. Compare Blake v AG 1981; CMS Gas v Argentina*]*

- Healthcare reform – establishing a single-tier public health service *[Investor in health insurance business could argue indirect expropriation and FET as closure of private healthcare eliminates insurance market – compare* UP and CD v Hungary *re regulatory changes making business uncompetitive]*
- Covid 19 Measures *[Investors could argue indirect expropriation of closed businesses; FET (manifest arbitrariness) where particular lockdown decisions / distinctions between businesses / risks not evidence-based]* (Benedetelli 2020)
- Tobacco Plain Packaging [indirect expropriation / FET – challenged in *Philip Morris v Australia, Uruguay*)
- Moratorium on Oil and Gas Exploration *[Investor could argue indirect expropriation / FET wrt existing license-holders. Compare* Rockhopper v Italy*]*
- Climate Change including de-carbonisation and promotion of renewables *[Investors in carbon assets could argue indirect expropriation / FET – compare* RWE v Netherlands *re coal-fired power plants,* Vattenfall v Germany *re nuclear, Spanish solar claims re adjusting feed-in tariffs]*

For practical purposes, the size of potential financial claims (14 known awards exceed US$1billion) means constraints are analogous to those in the Irish Constitution, with the provisos that (i) constitutional constraints are interpreted by the Irish courts and (ii) constitutional constraints can be revised by referendum. Once ratified, there is nothing an Irish government or electorate can do to change the rules in CETA.

4. ISDS has a chilling effect on legislation.

Quantitative and qualitative studies have identified a deterrent effect from potential investor claims. (Moehlecke 2020) This operates through a number of mechanisms: *internalisation*, whereby regulators and policy-makers themselves consider ISDS risks in policy-making; *threat*, whereby affected industries threaten or initiate ISDS complaints as part of broader efforts to influence policy-making; and *cross-border*, whereby ISDS complaints in one country deter policy-making in other countries. (Tienhaara 2017) Litigation firms market their abilities to use ISDS threats to lobby against regulatory change. (see e.g. Steptoe 2014) The scale of awards, and high costs of cases (total costs average around US$12 million per case: Titi et al 2019) means governments have strong incentives to avoid or settle cases, even if they think they could win in the end. Criticism of recent Irish governments for undue caution in the face of constitutional uncertainties suggest CETA's investment chapter would be further barrier to legislative action. (e.g. Walsh 2020)

5. Reforms address some uncertainties, but others remain.

Implementing a standing panel of adjudicators and an appeal mechanism may reduce the risk of divergent interpretations in the future, but it tells us little in advance about how these provisions will be interpreted. Similar mechanisms in the WTO have provided consistent interpretation, but on a number of points those interpretations have diverged significantly from those expected at the time the WTO agreements were concluded.

CETA specifies key standards, including “indirect expropriation” and “fair and equitable treatment” in more detail than many existing agreements. However continuing uncertainty about how key terms will be interpreted (e.g. “manifest arbitrariness”, “legitimate expectations”, “manifestly excessive”, “less favourable treatment”, “like situations”) make it impossible to say with confidence what these standards will mean in practice.

The possibility of the parties to the agreement providing political guidance on interpretation to adjudicators may be of limited practical value, given the need for agreement before this can be done.

6. Only member states have the power to create ISDS/ICS mechanisms of this kind.

The Court of Justice of the European Union (CJEU) in *Opinion 2/15* (on the EU-Singapore FTA) confirmed that the EU lacks competence to establish an investor-state dispute settlement system, such as the ICS, which allows investors to sue member-states outside the court system. Such a mechanism cannot be regarded as ancillary to the Union’s competence over foreign direct investment. It is for member states’ parliaments, not the EU, to judge the desirability of such mechanisms.

As a result, the EU’s FTAs with Singapore and Vietnam have been split into separate trade (EU only) and investment (EU plus member states) agreements. More recent agreements with Japan, China and Mercosur do not include ISDS.

CETA’s trade chapters (where the main economic benefits are) have been ‘provisionally applied’ without the investment chapter for the past three years. There is no practical limit on how long this can continue, or reason to think the agreement could not be readily renegotiated to remove the investment chapter.

7. The CJEU said CETA was legal, not that it was good.

The CJEU, in *Opinion 1/17*, held that CETA’s ICS was compatible with the autonomy of the EU legal order, with the general principle of equal treatment, and (with some qualification) with the right of access to an independent tribunal. That opinion applied formal legal tests in EU law, which do not necessarily reflect the public and political concerns about these issues.

In relation to the autonomy of EU law, for example, it emphasised the formal right to regulate in CETA, without considering how its rules might impede that right in practice. It emphasised the CJEU’s continuing authority to determine the correct interpretation of EU law, accepting the ICS’s unreviewable authority to decide whether EU law was compatible with CETA’s investor rights. In relation to equality, it considered equality between different categories of investors, whereas the public concern is overwhelmingly about inequality between the rights of investors and of other groups and individuals.

8. The CJEU's views on the right to regulate are highly optimistic, and may not reflect how the agreement will actually be interpreted.

The CJEU's opinion reflects the CJEU's interpretation of the agreement. However, as the CJEU there acknowledges, it lacks jurisdiction in this regard: the CETA Tribunal and Appellate Tribunal will have the final word on how these provisions are interpreted and applied in claims by investors, and will not be bound by the CJEU's views.

On key provisions, the CJEU's interpretation is open to question. The CJEU assumes that the CETA tribunal cannot review the level of protection chosen by a state in a given area, yet the language of "manifestly excessive" seems to invite such judgments. The CJEU says CETA restricts means, not goals, but in practice these may amount to the same thing, where alternative means are practically, economically or politically unsustainable. The CJEU relies on the general exceptions in Art 28.3.2 of CETA, but these (i) do not apply to the key investment provisions and (ii) adopt language from WTO law which in that context has proved extremely difficult for states to use to justify their policies. The CJEU relies on references to regulation and the right to regulate to pursue legitimate policy objectives in Article 8.9.1 and 2 of CETA, yet neither provision creates a defence or exception from the relevant rules: the right protected is the right to do what those rules allow, and no more.

9. Ireland is free to accept or reject CETA now. Once ratified, there is no practical way back.

If CETA is terminated, the ISDS provisions of CETA will remain in force for a further twenty years as regards existing investments. (Art 30.9.2) Commentators have identified these kinds of long sunset clauses as an impediment to treaty reform, as they make threats to terminate a treaty less credible. Further, CETA can only be terminated by either Canada or the European Union. Ireland cannot withdraw from the agreement on its own – termination is an action of the EU as a whole. Ireland will be asked to ratify at least two further EU Investment Agreements with ISDS provisions (*EU-Singapore* and *EU-Vietnam*) in the short term. The more of these agreements we approve, the harder it is to change.

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