# Investment Arbitration and National Interest

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Zoltán Víg[*] & Gábor Hajdu[**]

# INVESTMENT PROTECTION UNDER CETA: A NEW PARADIGM?


## Abstract

*Investment protection is a central element of many free trade agreements. However, this subject is provoking heated discussion in every corner of the world. There is a widely shared theory that provisions related to investment protection only serve the interests of the investors and not those of the citizens. The European Union-Canada Comprehensive Economic and Trade Agreement (CETA) has an exceptional importance for the European Union, as its provisions on the protection of investment can potentially reshape not only the environmental protection system of the European Union but its whole legislation. It is possible that the European Union would be reluctant to take socially and environmentally justified measures, because foreign investors would sue them if such measures harm their interests. Besides, large United States companies could "crawl" into the European Union through Canada and have the same advantages as Canadian companies. Therefore, it is important to scrutinize and interpret the investment protection system of the CETA, its potential future effects, and to make suggestions how to solve problematic issues.*


## I. Introduction

The European Union-Canada Comprehensive Economic and Trade Agreement (CETA) was the result of long negotiations between the European Union and Canada. There were plans for a comprehensive trade agreement between the parties already in 2002.[1] As an antecedent to the negotiation process, the Commission submitted to the Council of the European Union a proposal to entitle the Commission to start formal negotiations on an economic integration agreement with Canada. This was granted in 2009 and was amended in 2011 when the Commission received a mandate to negotiate on detailed investment protection issues and an investment related dispute settlement procedure. Both directives became partially public on December 15, 2015 with the decision of the Council.[2] The amendment of 2011 is of crucial importance for this work as it made it

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[1] Panagiotis Delimatsis, TTIP, CETA, TiSA Behind Closed Doors: Transparency in the EU Trade Policy 11 (Tilburg Law and Economics Center, 2016).

[2] http://www.consilium.europa.eu/en/press/press-releases/2015/12/15-eu-canada-trade-negotiating-mandate-made-public/, accessed on May 12, 2018.

possible for the CETA to contain comprehensive investment protection rules. However, leaked information showed that the CETA draft already contained a chapter on investment protection in 2010. This chapter showed the influence of NAFTA, as it equated "fair and equal treatment" with the "minimum standard" of treatment of foreigners in international customary law. The term "like circumstances" used by NAFTA was also taken over in the provisions on national treatment and most favored nation treatment.[3] This influence of NAFTA and its concepts might be the result of Canada's influence and the Commissions' limited authority. Thus, the draft of the CETA received serious criticism from European Union-based interest groups because of the application of NAFTA's solutions, who were unwilling to accept such a system of protection. Because of this, the Commission partly changed its standpoint regarding the investment protection chapter in 2013 and tried to guarantee better protection for European investors' foreign investment abroad. However, these were only minor changes. Nevertheless, according to some opinions, the investment protection chapter of the CETA still shows the influence of the NAFTA.[4] The change of the Commission's position can be explained by the 2011 amendment, which gave a free hand to the Commission to negotiate investment protection issues related to the CETA. Furthermore, the 2008 economic crisis might have affected its position, as the European Union needed capital and the easiest way was to get it from North American investors. However, these investors wanted to have an investment protection system familiar to them, like that of NAFTA. The next step of the CETA's development was on October 18, 2013 when the President of the European Commission, José Manuel Barroso and Stephen Harper, Prime Minister of Canada, reached consensus regarding the most important parts of the CETA. However, working out of details still had to be resolved.[5] The Committee on International Trade of the European Parliament (INTA) received the text of the agreement as a classified document in August 2014.[6] The negotiations on the content of the agreement were closed in the same month. The next important step happened only two years later in July 2016 when the Commission made a formal proposal to the Council for signing the CETA.

Here the case of Belgium should be mentioned as the Vallon Regional Parliament was in the position to force Belgium to block the ratification of the CETA. This could have frustrated the conclusion of the agreement. In the end, Belgium and the European Union managed to handle the issue.[7] Thus, each member state gave consent on October 28, 2016 and the agreement was signed on October 30, 2016.[8] Subject to the decision of the Council, the CETA can be provisionally applicable. However, for it to enter into full force, the Council's decision, the European Parliament's consent and carrying out the

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3 Filippo Fontanelli & Giuseppe Bianco, *Converging Towards NAFTA: An Analysis of FTA Investment Chapters in the European Union and the United States*, 50(2) Stanford Journal of International Law 231 (2014).

4 *Id*. at 232.

5 *Id*.

6 Panagiotis Delimatsis, TTIP, CETA, TiSA Behind Closed Doors: Transparency in the EU Trade Policy 12 (Tilburg Law and Economics Center, 2016).

7 http://www.bbc.com/news/world-europe-37731955, accessed May 13, 2018.

8 http://www.bbc.com/news/world-europe-37814884, accessed May 13, 2018.

ratification procedure in each member state is necessary.[9] Thus, the adoption of the CETA, on the side of the European Union, will be the result of a complex procedure, which is still not finished.

All in all, the CETA is the result of a long negotiation process and is a milestone of the new trade and investment policy of the European Union. However, national parliaments of the European Union still must approve the CETA before it can take full effect.

## II. Investment Protection Standards of the CETA

Contracting parties tried to avoid ambiguity regarding definitions and tried to close loopholes that were present in some of the previous international investment protection treaties. Here, only the most important standards of the CETA will be analyzed.

The first standard that should be discussed is the already mentioned "fair and equitable treatment". The first section of article 8.10 of the Agreement explicitly states that contracting parties guarantee for the investors of the other party fair and equitable treatment and full protection and security.[10] Section 5 of the same article says "full protection and security" means the physical security of investors and covered investments.[11] Accordingly, "fair and equitable treatment" is dealt with in other sections of the agreement. Thus, Section 2 lists the measures that breach "fair and equitable treatment" requirement. These are

(a) denial of justice in criminal, civil or administrative proceedings;
(b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings;
(c) manifest arbitrariness;
(d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
(e) abusive treatment of investors, such as coercion, duress and harassment;
(f) a breach of any further elements of the "fair and equitable treatment" obligation adopted by the Parties in accordance with paragraph 3 of article 8.10.[12]

Item (f) is discussed in section 3 of the Agreement, which states that the parties to the Agreement shall regularly, or upon request of a party, review the content of the obligation to provide fair and equitable treatment. According to the same section, the Committee on Services and Investment may propose recommendations regarding such issues to the CETA Joint Committee which makes the final decision.[13]

Section 2 contains a seemingly exclusive list but its last item and section 3 of the same article makes it possible to extend the cases of breach of "fair and equitable treatment". It is important to emphasize that item (f) of section 2 together with section 3 allow

[9] http://ec.europa.eu/trade/policy/in-focus/ceta/, accessed May 14, 2018.

[10] CETA Section 1, Article 8.10.

[11] CETA Section 5, Article 8.10.

[12] CETA Section 2, Article 8.10.

[13] CETA Section 3, Article 8.10.

only extension, meaning that measures from items (a) to (e) cannot be excluded from applying this mechanism.

It is interesting to mention that in February 2013, the draft of the Agreement did not contain such an exhaustive list but relied on the application of general clauses. Finally, the parties diverged from the draft, with the aim to make the content of "fair and equitable treatment" clearer.[14] Instead of the general definition, the above analyzed combined solution – an extendable list – was applied. This is beneficial for North American investors, as treatment standards can be further extended.

Section 4 of article 8.10 is the next section which is worth examining regarding the analysis of "fair and equitable treatment". This section states that in case of dispute settlement, the Tribunal (the first instance investment protection court examined in the next part of this work) related to this treatment can take into account whether a party to the Agreement made a specific representation to an investor to induce a covered investment that created a legitimate expectation and upon which the investor relied in deciding to make or maintain the covered investment, but that the party subsequently frustrated.[15] Thus, CETA empowers the Tribunal to take into account potential bad faith conduct of the parties to the Agreement, like luring in foreign investors with certain benefits and later revoking such, causing damages to these investors. An excellent but extreme example is the *Veolia Propreté v. Egypt* case.[16]

Sections 6 and 7 should be mentioned in relation to article 8.10. Section 6 provides that a breach of another provision of CETA, or of a separate international agreement does not establish a breach of article 8.10.[17] Section 7 states that a measure that breaches domestic law does not, in and of itself, establish a breach of article 8.10.[18] These provisions aim to preclude avoidance of the application of rules stated in previous sections. Namely, if the Agreement made it possible to breach this article merely by the breach of another international agreement, or by the breach of other provisions of CETA, or by the breach of domestic law, the application of detailed rules laid down in section 1 could be avoided.

Related to the above-mentioned section 4 of article 8.10, article 8.9 of CETA should be discussed. Section 1 of this article states that the contracting parties keep their right to regulate to achieve legitimate policy objectives, such as the protection of public health; safety; the environment or public morals; social or consumer protection or the promotion and protection of cultural diversity.[19] Theoretically, this guarantees the right to regulate when it is needed for a public purpose, however, certain doubts might arise in comparison

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[14] Günes Ünüvar, The Vague Meaning of Fair and Equitable Treatment Principle in Investment Arbitration and New Generation Clarifications 18–19 (OUP, 2016).

[15] CETA Section 4, Article 8.10.

[16] https://icsid.worldbank.org/apps/ICSIDWEB/cases/pages/casedetail.aspx?CaseNo=ARB/12/15, accessed May 14, 2018. Veola had entered into a 15 year contract for waste collection with the Governorate of Alexandria. It argued that the host country had breached legitimate expectations of the investior by refusing a re-negotiation of the terms of the contract after the adoption of new and burdensome labor legislation and the devaluation of the Egyptian currency.

[17] CETA Section 6, Article 8.10.

[18] CETA Section 7, Article 8.10.

[19] CETA Section 1, Article 8.9.

with section 4 of article 8.10. Sections 2 and 3 of article 8.9 further strengthens the right of states to regulate. Section 2 provides that the mere fact that a party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under CETA.[20] Section 3 states that not issuing, renewing or maintaining a subsidy is not a breach, provided there was no specific commitment under law or contract to issue, renew, or maintain that subsidy or to the terms or conditions attached to the issuance, renewal or maintenance of the subsidy.[21] These provisions basically function as a counterbalance to section 4 of article 8.10, which tries to protect the investors against bad faith conduct of states while these try to protect the public interest-based legislation of states.

Three further elements should also be discussed which are important innovations of CETA. The first is that article 8.1 exactly determines who can be considered investor: A party to the Agreement; a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an investment in the territory of the other party.

CETA also defines what constitutes an enterprise of a Party. There is a requirement for it to be constituted or organized under the laws of that Party CETA also demands that it has have substantial business activities in the territories of that Party. This clause was evidently designed to exclude shell corporations and enterprises from the provisions of CETA. However, CETA also recognizes enterprises that are constituted or organized under the laws of that Party and are either directly or indirectly controlled or owned by a natural person of that Party or by an enterprise fitting within the other category mentioned above. This second category is more troubling, because it omits the "substantial business activity" clause and only requires the enterprise to be owned or controlled by a natural person of that Party or an enterprise fitting the previous definition.[22]

The next element which should be dealt with is article 8.7. This article lays down the Most-Favored-Nation (MFN) principle – if any party to the Agreement concludes an agreement with a third party and this agreement provides for more favorable treatment to the investors of this third party, such treatment should be granted to the other CETA party as well.[23]

According to the opinion of the authors, section 4 of the same article is also important. It states that substantive obligations in other international investment treaties and other trade agreements do not in themselves constitute treatment and thus cannot give rise to a breach of CETA.[24] Hence, in theory, this precludes investors to invoke more advantageous substantial provisions from other international treaties during the dispute settlement procedure.

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20 CETA Section 2, Article 8.9.

21 CETA Section 3, Article 8.9.

22 CETA Article 8.1.

23 OECD, Most-Favoured-Nation Treatment in International Investment Law, 2004/02 OECD Working Papers on International Investment 2 (OECD Publishing, 2004).

24 CETA Section 4, Article 8.7.

According to this section, an investor of a Party may submit a claim to the Tribunal that the other Party has breached an obligation under either Chapter 8 (chapter on investments) Section C (provisions on non-discriminatory treatment) of CETA or Section D (provisions on investment protection) if the investor suffered loss or damage as a result of the alleged breach.[25] This means that the breach of other provisions of CETA does not constitute standing for a dispute settlement procedure.

All in all, it can be said that CETA's chapter on investment is quite precise. It contains detailed, exact terms and standards. There is a clear aspiration to close up loopholes. At the same time, it should be noted, especially relating to section 4 of article 8.10, that considerable discretion was left to the Tribunal.

## III. Procedural Provisions of the CETA

The other relevant part of the CETA is the investment dispute settlement procedure. This is the biggest innovation of the CETA as it establishes a permanent international tribunal for the settlement of investment disputes instead of *ad hoc* arbitration. The dispute settlement system established by the CETA is called Investment Court System (ICS), contrary to the Investor State Dispute Settlement (ISDS) system used for similar disputes before.[26] The competence and organization of the two tribunals and the procedure will be discussed. However, before this discussion, it should be mentioned that the CETA also contains two alternative disputes settlement methods: Consultation, provided for in article 8.19, and mediation, discussed in article 8.20. The parties to the dispute can resort to any of these at any time during the dispute, even during arbitral proceedings.[27] Presumably, these articles aim to help the parties to find a solution to their dispute effectively, in the least costly manner, and to reduce the load of the tribunals set up under the CETA.

According to article 8.18, an investor of a party may submit to a tribunal constituted under the CETA a claim only in cases where an obligation under section C or D of chapter 8 has been breached and where the investor has suffered loss or damage as a result of the alleged breach.[28] This excludes claims based on the breach other provisions of the CETA, in which cases typically the contracting parties should act in the dispute settlement instead of the investors.

The constitution of the first instance tribunal, "the Tribunal", is regulated in article 8.27. Section 2 states that the CETA Joint Committee shall, upon the entry into force of the Agreement, appoint fifteen members of the Tribunal, from which five are nationals of a member state of the European Union, five are nationals of Canada and five are nationals of third countries.[29] According to section 3, the Joint Committee may increase

[25] CETA Section 1, Article 8.18.

[26] http://ec.europa.eu/commission/2014-2019/malmstrom/blog/proposing-investment-court-system_en, accessed May 14, 2018.

[27] CETA Article 8.19, Article 8.20.

[28] CETA Article 8.18.

[29] CETA Section 2, Article 8.27.

or decrease this number, however, only with numbers divisible by three and on the same basis as provided for in paragraph 2.[30] Pursuant to these two sections, the Tribunal should always have the same number of EU, Canadian and third country members, to guarantee the neutrality and impartiality of the Tribunal. According to section 5 of the Agreement, seven arbitrators appointed immediately after the entry into force of the CETA will serve for 6 years. Otherwise, arbitrators are chosen for a 5 year term and this term can only be renewed once. Vacancies are filled as they arise. A person appointed to replace an arbitrator of the Tribunal whose term of office has not expired holds office for the remainder of the predecessor's term. A member of the Tribunal serving on a division of the Tribunal when their term expires may continue to serve on the division until a final award is issued.[31] This latter element was inserted to the Agreement to prevent interruption of procedures because of the expiry of the term of an arbitrator.

The service requirements for the members of the Tribunal according to section 4 of article 8.27 are as follows. The arbitrators have to possess the qualifications required in their respective countries for appointment to judicial office, or be jurists of recognized competence. They should have demonstrated expertise in public international law. It is desirable that they have expertise, in particular, in international investment law, in international trade law, and in the resolution of disputes arising under international investment or international trade agreements.[32] Article 8.30 imposes additional requirements: They have to be independent and not affiliated with any government; they shall not take instructions from any organization, or government with regard to matters related to the dispute; they shall not participate in the consideration of any disputes that would create a direct or indirect conflict of interest. In addition, upon appointment, they shall refrain from acting as counsel or as party-appointed expert or witness in any pending or new investment dispute, irrespective whether it is under the CETA or another international treaty.[33] Conflict of interest rules are laid down in detail in article 8.30.

The President and Vice-President of the Tribunal shall be responsible for organizational issues and will be appointed for a two-year term and will be selected by lot from among the Members of the Tribunal who are nationals of third countries. They shall serve on the basis of a rotation drawn by lot by the Chair of the CETA Joint Committee. The Vice-President shall replace the President when the President is unavailable. The Tribunal may draw up its own working procedures.[34] The reason for the selection of these office holders from third countries can be that the Agreement tries to strengthen with this the impartiality of the Tribunal, as these arbitrators are responsible for operational tasks.

The other tribunal established by the CETA is the second instance – the Appellate Tribunal. The CETA itself does not provide for the number of its members, composition

[30] CETA Section 3, Article 8.27.

[31] CETA Section 5, Article 8.27.

[32] CETA Section 4, Article 8.27.

[33] CETA Section 1, Article 8.30.

[34] CETA Section 8 and 10, Article 8.27.

and similar issues. Instead, section 3 of article 8.28 states that these issues, as well as the appointment of its members, are decided by the CETA Joint Committee.[35]

At the same time, the CETA stipulates some basic organizational issues, like conditions of appointment mentioned in article 8.27. The ethical and conflict of interest rules from 8.30 also apply to Appellate Tribunal arbitrators as well.[36] We suppose that the parties did not find the issue of the organization of the Appellate Tribunal as important as the first instance tribunal and this is the reason that they referred the majority of these issues to the competence of the Joint Committee, instead of regulating these issues in the Agreement.

Another provision that should be highlighted related to the Appellate Tribunal, is that the earlier mentioned Committee on Services and Investment periodically reviews its functioning according to the Agreement. It can make recommendations to the Joint Committee, which can revise its decisions related to the functioning, composition, etc. of the Appellate Tribunal.[37] Thus, two committees can be linked to the functioning of the Appellate Tribunal.

The next element that should be discussed after organizational issues is the procedure of these two tribunals. First of all, the course of the procedure in front of the Tribunal should be examined, highlighting the most relevant elements. One of these is that the foreign investor can submit the claim not only on its own behalf but also on behalf of a locally established enterprise which it owns or controls directly or indirectly.[38]

The next issue are (f) and (g) items of section 1, article 8.22, according to which the investor cannot have an ongoing proceeding before a national or international tribunal or a court related to the same claim and waives its right to initiate a proceeding related to the same issue in the future if he or she wants to submit a claim to the ICS system.[39] This provision is aimed at eliminating concurrent procedures.

Another important provision of CETA explicitly prohibits an investor from submitting a claim if the investment has been made through fraudulent misrepresentation, concealment, or corruption.[40] This might have dissuasive power against proceedings in bad faith during the course of an investment.

The CETA provides the possibility for the Tribunal to dismiss a claim if the respondent files an objection about how a claim is manifestly without legal merit. Furthermore, the Tribunal may address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim or any part thereof, is not a claim for which an award in favor of the claimant may be made under CETA, even if the facts alleged were assumed to be true.[41] These two articles are aimed at making the Tribunal's work more efficient and quicker.

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[35] CETA Section 7, Article 8.28.

[36] CETA Section 4, Article 8.28.

[37] CETA Section 8, Article 8.28.

[38] CETA Section 1, Article 8.23.

[39] CETA items (f) and (g), Section 1, Article 8.22.

[40] CETA Section 3, Article 8.18.

[41] CETA Article 8.32 and 8.33.

Returning to the main elements of the procedure, it should be stated that the Tribunal hears cases in divisions consisting of three members, one of whom is a national of a Member State of the European Union, one a national of Canada, and one a national of a third country. The national of the third country chairs the tribunal. At the same time, the parties may agree that a case should be heard by a sole arbitrator appointed at random from the third country nationals. Such a request shall be made before the constitution of the division of the Tribunal.[42] This strengthens CETA's idea of ensuring impartiality of the tribunals through third country members and makes the procedure more cost efficient as well.

Tribunals cannot oblige states to amend or to revoke their legislative acts. Instead, they can be obliged to pay monetary compensation. Such compensation cannot exceed the damage suffered by the investor. The Agreement explicitly forbids punitive damages as used in the United States. The CETA also states that costs related to the proceedings shall be borne by the unsuccessful disputing party.[43] These provisions are primarily in the interest of states: preserving their right to legislate and putting the burden of paying for the costs on the losing party.

Finally, special procedural rules related to the Appellate Tribunal are highlighted. Similarly to organizational issues, the Joint Committee decides on procedural issues as well.[44] The most important provision related to the Appellate Tribunal is that it may uphold, modify or reverse a Tribunal's award based on:

(a) errors in the application or interpretation of applicable law;
(b) manifest errors in the appreciation of the facts, including the appreciation of relevant domestic law;
(c) the grounds set out in Article 52(1) (a) through (e) of the ICSID Convention, in so far as they are not covered by paragraphs (a) and (b).[45]

Thus, the Appellate Tribunal can examine factual as well legal issues.

The Appellate Tribunal is also constituted of three members, who are elected randomly. Regarding the award, the same rules apply as to the first instance tribunal.[46] The issue of transparency is also very important. The CETA essentially took over the UNCITRAL rules on transparency with certain digressions. For example, section 5 of article 8.36 states that hearings are open to the public. The reason for this might be that potential compensations are paid from public funds. At the same time, the CETA makes it possible to have a private hearing if the Tribunal determines that there is a need to protect confidential or protected information.[47]

Regarding the future of ICS, article 8.29 should be mentioned, according to which Canada and the European Union will aspire to establish a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes with their other trading partners. Once it is set up, the CETA Joint Committee will decide how to fit the

42 CETA Section 6 and 9, Article 8.27.

43 CETA Article 8.39.

44 CETA Section 7, Article 8.28.

45 CETA Section 2, Article 8.28.

46 CETA Section 5 and 6, Article 8.28.

47 CETA Article 8.36.

"current" rules into that system.[48] This definitely represents the goals of the European Union in establishing a single international tribunal for investment dispute issues, based on the ICS in the CETA.

On the whole, it can be said that the CETA has introduced a new form of investment dispute settlement procedure. Instead of the earlier *ad hoc* ISDS, it has introduced the new ICS system, which is intended to be more stable and predictable.[49]

## IV. "Regulatory Chill" and the Future of Investment Protection Arbitration

There are several issues related to investment protection arbitration, both in economic and societal aspects. This part of the paper deals with the issue of "regulatory chill" and its potential effects on the future of investment protection arbitration.

Legal disputes between foreign investors, who are usually multinational companies, and host states, are often decided by international arbitration panels due to provisions in international investment agreements. Critics fear that these arbitration panels favor multinational companies as they have the incentive – more cases, more fees. This would make governments reluctant to adopt appropriate policies. Reluctance to adopt socially desirable legislation due to such fear is called regulatory chill. In a wider sense, regulatory chill means that the given state's lawmaker will avoid making laws that might have negative effects on foreign investors and, in a narrower sense, it means that they will avoid making specific laws for certain investments.

There are a number of cases related to this issue: *Philip Morris v. Australia*[50]; *Philip Morris v. Uruguay*[51] (regulation related to public health); *Vattenfall v. Germany (*regulation related to environment) [52] and *Veolia v. Egypt* (regulation related to minimum wage)[53]. In order to highlight the controversies arising around ISDS and its supposed regulatory chill effects, the two *Vattenfall* cases mentioned above will be discussed. These cases significantly influenced German public opinion about investment arbitration and thus merit a deeper examination.

The first *Vattenfall* case[54] concerned a planned power plant in Hamburg in 2009. This power plant was to be coal-powered and was to be constructed by an investor named Vattenfall, a 100% government-owned Swedish utility company. However, problems arose where the local Hamburg government changed and the issuance of administrative permits related to emission controls, water quality and water usage were allegedly delayed by the new local government. Furthermore, Vattenfall also argued that the content of the permits themselves were not consistent with what was agreed upon with the previous local government. Thus, Vattenfall claimed that the local Hamburg

[48] CETA Article 8.29.

[49] http://europa.eu/rapid/press-release_IP-15-5651_en.htm, accessed May 15, 2018.

[50] UNCITRAL, PCA Case no. 2012-12.

[51] ICSID Case no. ARB/10/7.

[52] *See* the next section, below.

[53] ICSID Case no. ARB/12/15.

[54] ICSID Case no. ARB/09/6.

government and, by extension Germany, were in violation of the Energy Charter Treaty, specifically articles 10 (1) (fair and equitable treatment) and 13 (expropriation without compensation). Interestingly, the case never went before an arbitration tribunal as Germany instead decided to settle the case with Vattenfall. Unfortunately, the contents of this settlement were not revealed to the public and thus the agreement is unknown.[55]

This case, while it never went before an arbitration tribunal, still showcased the potential for conflict between international investment law and domestic regulation, environmental regulation in this particular case – currently one of the most sensitive legal topics. If the case had gone before an arbitration tribunal, the arbitrators would have had to decide whether the domestic environmental regulations were consistent with international investment law, specifically the Energy Charter Treaty. In this hypothetical scenario, the effects of regulatory chill could have potentially been observed, as Germany could have been essentially penalized, if it had lost, for adopting environmental regulation that was detrimental to a foreign investor. Furthermore, the first Vattenfall v. Germany case also highlights that regulatory chill is not restricted to national legislation. In this particular case, the primary problem lay with the conduct and decisions of the local Hamburg government, which means that regulatory chill can even affect local-level legislation or regulation.

The second *Vattenfall* case[56] also deals with conflict between the interests of a foreign investor and environmental regulation. However, the situation is fundamentally different as in this case German federal legislation was at the center of the proceedings. The case is still pending at the moment and could have significant implications on the future of German anti-nuclear legislation and thus environmental regulation. The background of this case lies with the Fukushima incident. In 2011, a tsunami caused significant damage to the Fukushima nuclear power plant, disabling its power supply and the cooling system of its reactors. This event led to the meltdown of the reactors and thus triggered a serious radioactive release.[57] While the event was caused by unforeseen complications with the power supply of the nuclear power plant, international public opinion sharply turned against the usage of nuclear power in general. This created the situation in Germany. Seeing the devastation of the Fukushima nuclear accident, the German parliament decided to amend the country's Nuclear Energy Act. The amendment ordered a more rapid phasing out of nuclear power in Germany and the scheduled deadline for the completion of this procedure was brought forward to 2022. Besides this element, the amendment also proscribed the immediate shut-down of the oldest nuclear reactors in Germany. Vattenfall, the same Swedish company, owns and operates two of these affected nuclear reactors: the Krümmel and Brunsbüttel nuclear power plants.[58] The initial situation

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55 Markus Krajewski, *The Impact of International Investment Agreements on Energy Regulation, in* European Yearbook of International Economic Law, 2013 19 (Christoph Herrmann, Markus Krajewski, Jörg Philipp Terhechte eds., Springer, 2013).

56 ICSID Case no. ARB/12/12.

57 http://www.world-nuclear.org/information-library/safety-and-security/safety-of-plants/fukushima-accident.aspx, accessed May 14, 2018.

58 Nathalie Bernasconi-Osterwalder, Martin Dietrich Brauch, The State of Play in Vattenfall v. Germany II: Leaving the German public in the Dark 2 (International Institute for Sustainable Development, 2014).

in this case shows exactly how environment-minded legislation, or environmental policy, can conflict with the interests of foreign investors. Vattenfall alleged that this amendment and especially the immediate shut-down of two of its nuclear reactors, caused it a significant loss of profits. Thus, Vattenfall initiated arbitration proceedings against Germany within the International Centre for Settlement of Investment Disputes and also filed a lawsuit before the Federal Constitutional Court of Germany. The basis of these claims was the Energy Charter Treaty, under which Vattenfall was considered a foreign investor.[59] The compensation claimed by Vattenfall as a foreign investor is currently at 5.140 million USD.[60] It can be seen in this situation that environmental regulation harmful to a foreign investor's interests immediately prompted a reaction, namely a reference to international investment arbitration. While the case is still pending, it is undeniable that for Germany, the second Vattenfall case has been a troubling and tiresome exercise, with significant associated legal fees, which will remain even if the state wins the case. If Germany loses against Vattenfall, the economic fallout will be significant, even for the relatively large federal budget of Germany.

As mentioned above, while Germany is not particularly threatened by the damages awarded to foreign investors, its less wealthy counterparts are much more imperiled. A developing country might be more reluctant to introduce environmental legislation that might conflict with the interests of foreign investors, fearing costly arbitration. The regulatory chill effect is very likely to loom over such cases. A host country acting in the public interest is thus coming under threat.

This can be an issue with the CETA as well. Moreover, the definition of investor in the Agreement is too broad and almost every large US corporation has a Canadian subsidiary. They can try to challenge EU environmental and other standards which are generally higher than US standards via Canada, .

Article 8.9 of the CETA reaffirms the right of the parties to regulate "within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity." Theoretically, investors without such provisions would have the right to sue their host state if the latter increases the minimal wages, creates more severe environmental protection rules, or just ceases granting earlier preferences, resulting in the investor suffering damages. Thus, it should be examined whether article 8.9 is suitable to preclude the above-mentioned issues from dispute settlement procedures. The answer to this question is not obvious. Section 1 of article 8.9 enumerates certain legitimate policy objectives. However, it does not define the concept neither in this article, nor in article 8.1 which deals with definitions. Therefore, it can be said that the determination of the content of this concept is entrusted to the courts established in the ICS system. This causes uncertainty and there are no precedents.

The "necessity test" could be the solution – the Tribunal should examine whether such measures are "necessary". However, the Agreement does not define this concept either and, thus, this causes more uncertainty for host states.

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[59] *Id.*

[60] http://investmentpolicyhub.unctad.org/ISDS/Details/467, accessed May 14, 2018.

The second section of the same article tries to be specific by stating that the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under the CETA. However, it is the Authors' opinion that this is not sufficient. The motivation behind the fact might amount to the breach of an obligation under the CETA and such motivation will be examined by the Tribunal, again an uncertainty factor. This might deter states in some cases from legislating, because the necessity of the legislation will be decided by the Tribunal. In addition, in the beginning there will be no precedents, which makes their decisions even more unforeseeable. Thus, this might lead to "regulatory chill"– states will avoid legislating in certain fields, being afraid of potential law suits and losses.

Article 8.10 deals with fair and equitable treatment, which is also related to the issue of regulatory chill. This principle is open, enumerated cases can be extended by the Joint Committee, and section 4 practically gives free hands to the Tribunal when applying the principle. Thus, this principle in fact strengthens the position of potential investors, that is to say, it can contribute directly to "regulatory chill".

Related to "regulatory chill", it is worth to deal with the issue of compensation. Although CETA prohibits punitive damages,[61] this is not enough to protect states. In the case of major investments, compensation for the loss suffered can be a considerable amount. This can be a serious issue for Member States of the European Union with scarce resources, for which even a compensation which has to be paid for a loss suffered can be a serious amount of money. This is enhanced by the fact that usually these are the states where there is need for new legislation in the social and environmental fields. Therefore, regulatory chill would cause the biggest harm to the most vulnerable countries.

This also leads to issues of fundamental rights, because, regulatory chill would potentially prevent the enforcement of second and third generation fundamental rights. These are, among others, related to the right to work, or from third generation rights, the right to a healthy environment, or the right to natural resources. Without legislation in these fields, the before-mentioned rights would be endangered. At the same time, there are two fundamental rights which would be presumably furthered by the CETA: The right to property as investment, strongly protected by the Agreement, is at the same time property. That is to say, protecting investment is also protecting private property and the right to economic development. There was a tremendous increase in the significance of foreign investment during the last few decades, especially in less developed countries. New foreign investment can strengthen the development of these EU Member Countries.

The definition of "'investors" may be problematic as defined in article 8.1. Although CETA excludes the possibility of establishing shell companies, the text, in our view, is not precise enough to exclude companies from non-contracting states having established a subsidiary in a contracting state. At the same time, smaller domestic enterprises are disadvantaged, in the sense that they do not have the means to use the above mentioned back door via establishment of a foreign subsidiary. Another problem might be that

[61] CETA Section 4,Article 8.39.

the procedure is asymmetrical. Only investors can initiate proceedings in front of the tribunal. However, states might also have justified claims against investors.

Overall, it can be said that CETA applies mostly American solutions, based on investment treaties (and the NAFTA) concluded by the United States, for investment arbitration and the main problem is the issue of regulatory chill.

## V. Conclusions

In this paper, we have tried to find solutions to the issues raised by the wording and content of CETA.

Article 8.9 should be changed as it gives the right to the parties to regulate. CETA should define exactly what should be understood under "legitimate policy objectives". The current solution with examples is adequate. However, there should also be a general definition for this concept. Furthermore, it would be wise to add a concrete and unambiguous provision that the Tribunal is bound by this article. Thus, if an act of a state complies with the notion of "legitimate policy objectives", irrespective of the motivation, the Tribunal should not be able to establish a breach of CETA related to this issue. Such amendments could significantly improve upon the lack of balance between the investor and the host state. As a result, the host states would not only formally, but also factually, be guaranteed the right to enact necessary legislation.

An amendment is also advisable for article 8.10. The notion of "fair and equitable treatment" is far too broad and should be narrowed down. We would advise to replace the current open list with an exhaustive list. The provision which allows the CETA Joint Committee to extend the list should also be redacted, as well as the wide discretion given to the Tribunal in section 4 of the same article. Such actions would serve three goals: The end of confusion related to the notion of "fair and equitable treatment"; the currently too investor friendly interpretable principle would become more balanced and neutral and it would create stability and legal certainty both for the investors and the host states, as the investors would know exactly what to expect, while the states would be made aware of what legislation does and does not violate this principle.

It is also recommended to insert a general clause into this chapter of the CETA, which squarely states that investment protection cannot result in violation of basic rights. In addition to this, it would be necessary to regulate exactly the violation of which basic rights should be avoided. It should be made clear that the states would have the right to rely on these provisions during dispute settlement procedure and that the Tribunal would be obliged to take them into consideration. This clause would insure, beside the amended article 8.9, that the Tribunal will not undermine basic rights with its awards.

Thus, these measures could guarantee the avoidance of regulatory chill. Article 8.9 would reinforce the right to legislate and article 8.10 would precisely define the notion of "fair and equitable treatment". This would bring stability to both sides and strengthen the view that public interest is not harmed by investment protection.

With the intention to improve the balance between states and investors, there is also the possibility of introducing the initiation of legal action for states against foreign investors under the CETA. However, our opinion is that this would not be an ideal solution, as the primary function of the dispute settlement procedure is to protect investors and not host states against investors. Therefore, the above said changes would be enough to protect the interests of states during dispute settlements.

At the same time, we would suggest the amendment of article 8.1. The definition of the term investor is not exact and lacks precision. This might provide an opportunity to misuse the Agreement. Therefore, it would be reasonable to expressly exclude subsidiaries which are under the control of third country investors or enterprises, or in which the majority owners are third country natural or legal persons. This might seem like a quite strict measure, but in our opinion, it is necessary to avoid the above-mentioned circumventions.

Similarly, it is necessary to solve the problem of domestic investors. Economically stronger investors can find ways to be treated as foreign investors under CETA. However, smaller domestic investors are at a disadvantage, because they do not have the means to use these loopholes. Therefore, we would suggest to make the CETA dispute resolution procedure accessible for domestic investors as well. In this case, there would be a need for special provisions. It would be particularly important to provide such possibility to domestic investors only as *ultima ratio*. That is to say, they should first exhaust domestic legal remedies before appealing to the Tribunal. This would presumably mitigate their disadvantageous situation. Furthermore, such a solution would fit into the concept of a multilateral investment protection court, an idea which is supported both by Canada and the European Union.

In conclusion, we can say that there is a need for certain amendments to the text of the CETA, in order to solve these issues. Although, in many respects the CETA is more advanced and more detailed than older BITs or other trade agreements, it also has certain imperfections and needs revision.