Trading Away Democracy

How CETA’s investor protection rules could result in a boom of investor claims against Canada and the EU

On September 26, 2014, Canada and the European Union (EU) announced the conclusion of a far-reaching economic integration agreement, the Comprehensive Economic and Trade Agreement (CETA). Following the Canadian general elections and faced with growing and widespread criticism, the agreement was tweaked and finally released on 29th February 2016. It has confirmed many of the concerns raised by independent analysts, which have not been appeased by the revised final version.

This analysis shows how CETA’s investor rights could unleash a corporate litigation boom against Canada, the EU and its member states – including through the Canadian subsidiaries of US multinational corporations. It argues that CETA could dangerously thwart government efforts to protect citizens and the environment, and that states could be forced to pay billions of dollars in compensation to investors for profits “lost” due to regulation in the public interest.

CETA constrains governments in a broad range of areas, including intellectual property, public procurement, public and financial services, and food sovereignty. But for citizens in both the EU and Canada, ironclad “investor rights” protections are the most controversial way that CETA will limit the powers of elected governments.

This brief argues that, contrary to public assurances, the EU and Canada have not tamed these dangerous corporate rights in CETA. It calls on legislators in Canada and the EU to reject the current CETA text which includes investor-state arbitration.

The investment chapter of CETA contains an investor-state dispute settlement (ISDS) mechanism, re-branded as Investment Court System (ICS). ICS grants corporations the special privilege to bypass domestic courts and to instead directly sue states at, in reality, private international tribunals for compensation over health, environmental, financial and other domestic safeguards that they believe undermine their rights. This parallel justice system is available only to foreign, not domestic, investors, let alone ordinary people.

This doesn’t change anything because the standards on the basis of which judgements are rendered remain the same.

Nigel Blackaby, arbitration lawyer with Freshfields on the EU’s ICS proposal

Chevron argues that the mere existence of ISDS is important as it acts as a deterrent.

EU Commission official about a meeting with Chevron on ISDS, 29th April 2014

It’s a lobbying tool in the sense that you can go in and say, ‘Ok, if you do this, we will be suing you for compensation.’ [...] It does change behaviour in certain cases.

Peter Kirby, law firm Fasken Martineau, on investor-state arbitration

Investor-state lawsuits are decided by private commercial arbitrators. The European Commission has re-labelled them members of the different tribunals, but they still lack the independent and financially-disinterest that judges should adhere to. Investment lawyers deciding on CETA cases, will be paid for each case they hear, and so can still be characterised as “for-profit arbitrators”. Globally, investment arbitration is the purview of only a small number of individuals and firms with a revolving door to industry and a clear tendency to interpret the law in favour of the investor.

The number of investor claims against states has exploded in recent years, from a dozen in the mid-1990s to 696 known cases by mid-2016. One policy area after another has come under attack as investors have challenged anti-smoking laws, tax measures, fiscal policies, bans of toxics and mining, requirements for environmental impact assessments and regulations relating to hazardous waste (see Boxes 1 and 2). The amount of taxpayer money that states have been ordered to pay in penalties has also sky-rocketed, often including compensation to investors for the loss of anticipated future profits.

Because the arbitrators can levy monetary penalties against governments, the fear or actual threat of a costly investor-state claim can create a “policy chill” which discourages new government initiatives. Five years after the investor rights in the North American Free Trade Agreement (NAFTA) between the US, Canada and Mexico came into force, a former official of the Canadian government described the effect: “I’ve seen the letters from the New York and D.C. law firms coming up to the Canadian government on virtually every new environmental regulation [...] Virtually all of the initiatives were targeted and most of them never saw the light of day.”

NAFTA lessons bode ill for CETA

Canada’s experience with NAFTA amply illustrates the dangers of investment arbitration. There have been 37 investor-state claims against Canada under NAFTA, and the number continues to grow. So far, Canada has lost or settled eight claims and paid damages to foreign investors totalling over US$171.3 million. Canadian taxpayers have also paid tens of millions of dollars in legal costs defending against these claims.17

Ongoing NAFTA claims challenge a wide range of government measures that allegedly diminish the value of foreign investments, including a moratorium on fracking by the Quebec provincial government, a moratorium on offshore wind projects on Lake Ontario, provisions under the Ontario Green Energy Act to promote renewable energies, and a decision by a Canadian court to invalidate two pharmaceutical patents on the basis that they were not sufficiently innovative or useful (see Box 1). Cumulatively, foreign investors are currently seeking several billions of dollars in damages from the Canadian government.18

EU and Canadian investors are among the main users of investment arbitration. Almost two-thirds (or 463) of all know investor-state disputes globally were brought by investors from the EU and from Canada.

Canadian investors rank fifth among the users of investment arbitration, outnumbered only by investors from the US, the Netherlands, UK and Germany.19
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There is every reason to expect that CETA will pave the way for more such claims against the Canadian government, as well as against the EU and its member states. CETA’s investment chapter arguably grants even greater rights to foreign investors than does in NAFTA (most notably by protecting investors’ “legitimate expectations” under the so-called “fair and equitable treatment” clause and on investor-state disputes with regard to financial services (see Annex 1). CETA would significantly increase the risk of investor-state challenges to Canadian policies given that European investors have initiated 61 per cent of all known disputes (425 cases) as of mid-2016.\textsuperscript{20}

**BOX 2**

**HOW EU CORPORATIONS USE INVESTOR-STATE ARBITRATION**

EU corporations versus environmental protection – Vattenfall vs. Germany I & II: In 2009, Swedish energy multinational Vattenfall sued the German government, seeking US$1.4 billion in compensation for environmental restrictions imposed on one of its coal-fired power plants. The case was settled after Germany agreed to water down the environmental standards. In 2012, Vattenfall launched a second lawsuit seeking US$5.14 billion for lost profits related to two of its nuclear power plants. The legal action came after Germany decided to phase out nuclear energy, following the Fukushima nuclear disaster. The German government has already spent over US$3.54 million to defend the case, and expects a total of US$9.98 million in legal costs.\textsuperscript{21} Both actions were taken under the Energy Charter Treaty.\textsuperscript{22}

A close analysis of the dispute Vattenfall vs. Germany I (over a coal-fired power plant in Hamburg) revealed that it could still be launched under ICS, the investor-state dispute settlement (ISDS) mechanism in the revised investment chapter of CETA.\textsuperscript{23}

EU corporations versus anti-discrimination – Piero Foresti and others vs. South Africa: In 2007, Italian and Luxembourg investors sued South Africa for US$350 million because a new mining law contained anti-discrimination rules from the country’s Black Economic Empowerment Act, which aims to redress some of the injustices of the apartheid regime. The law required mining companies to transfer a portion of their shares into the hands of black investors. The dispute (under South Africa’s investment treaties with Italy and Luxembourg) was closed in 2010, after the investors received new licenses requiring a much lower divestment of shares.\textsuperscript{24}

EU corporations against policies to combat economic crises – Investors vs. Argentina, Cyprus and Greece: When Argentina froze utility rates (energy, water, etc.) and devalued its currency in response to its 2001-2002 financial crisis it was hit by over 40 lawsuits from investors. By January 2014, the country had been ordered to pay a total of US$980 million in compensation. Among the claimants were several EU multinationals, including Suez and Vivendi (France), Anglian Water (UK) and Aguas de Barcelona (Spain). Similar cases have now been brought against Cyprus and Greece.\textsuperscript{25}

Corporations against the minimum wage – Veolia vs. Egypt: Since 2012, the French utility company Veolia has been suing Egypt based on the bilateral investment agreement between France and Egypt for an alleged breach of a contract for waste disposal in the city of Alexandria. The city had refused to make changes to the contract which Veolia wanted in order to meet higher costs – in part due to the introduction of a minimum wage. In addition, according to Veolia, the local police had failed to prevent the massive theft of dustbins by the local population. According to media reports, Veolia is seeking US$90.9 million in compensation.\textsuperscript{26}
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Canada at the mercy of European banks

Investment flows between the EU and Canada are significant and noteworthy in a number of ways. A high volume of investment flows means that a substantive amount of investors will acquire the rights to sue under the trade treaty. Also, the sectors in which investors place their FDI stock is relevant since corporations from certain sectors are more avid users of ISDS than others.

In 2015, European investors invested almost US$200 billion in Canada (FDI stock). A third of this investment was in manufacturing (almost US$67 billion). European investors also invested significantly in the management of companies and enterprises (US$47 billion) and in the finance and insurance sector (US$26 billion).

The finance and insurance sector is of particular significance as this sector will gain greater litigation rights in CETA than exist under NAFTA. This suggests that the risks for Canada of being sued by banks, insurers and holding companies will increase significantly with CETA (see Annex 1). These risks are evident as speculative investors, backed by investment lawyers, are increasingly using investment arbitration to scavenge for profits by suing governments in financial crises.

EU investors are the main users of the ISDS system. Investors from EU member states have initiated 61% of all known ISDS disputes worldwide. In particular, investors from the Netherlands, the UK and Germany “are the most active in terms of bringing ISDS cases” according to the United Nations. Coincidentally, most investment is coming to Canada from exactly those EU countries where investors are notorious claimants in investor-state disputes: the Netherlands and the UK (2nd and 4th biggest investors in Canada respectively in 2015). EU investors have initiated at least 40 investment treaty disputes related to financial and insurance activities involving 25 countries from Burundi to Russia. The reasons for the lawsuits range from restructuring of public debt and default on or amendment of sovereign bonds, capital control in the context of financial crisis, enactment of Emergency Laws and other measures to deal with country’s economic crisis, withdrawal of previous commitments to provide State support to the foreign-owned bank, restructuring of the banking sector, to nationalisation of Banks.

Canadian mining companies: a threat to Europe

In 2015, Canadian investors invested US$174 billion in Europe (FDI stock). A third of this investment was in the finance and insurance sector (US$60 billion). The management of companies and enterprises (US$39 billion) and mining and oil and gas extraction (US$31 billion) were also sectors where Canadians invested the most in Europe.

Transnational corporations in the mining and oil and gas extraction sector are increasingly turning to international arbitration tribunals. In May 2016, one in four cases at the World Bank’s International Centre for Settlement of Investment Disputes (ICSID), where most investor-state disputes are tried, related to oil, mining and gas. It is also the sector in which Canadian companies have gained a reputation as “the worst offenders in environmental, human rights and other abuses around the world.”

Canadian mining companies are already engaged in a number of controversial natural resource projects across the EU (See Image 1 and Box 3). If CETA’s investment chapter goes into effect, Canadian mining companies will be able to threaten and file similar lawsuits against the EU.

Box 3

**A WARNING FOR EUROPE: THE CASE OF ROŞIA MONTANĂ**

Roşia Montană is located in the Romanian Apuseni Mountains and is home of Europe’s largest gold deposit.

In early 2000, Gabriel Resources obtained permits to mine gold in Roşia Montană. The mining project would lead to the destruction of four mountains, displacement of populations and the contamination of the environment through the use of cyanide.

Since its onset, the project was strongly opposed by local communities who challenged the legality of key permits and had them permanently annulled by national courts.

In 2013, Gabriel Resources attempted to pressure Romania’s government into passing a law that would approve the mine through parliament but this triggered national protests. The company is also under investigation in Romania in connection with tax evasion and money laundering.

In July 2015, Gabriel Resources filed a claim against the government of Romania for unfair treatment.
As Dalradian Resources is looking to develop a gold mine at Curraghinalt in Northern Ireland, environmentalists have warned of the potentially destructive impacts of the project, particularly on a nearby nature conservation area, and have questioned the absence of an environmental impact assessment for the project.

In October 2013, following strong community opposition motivated by concerns about environmental destruction, water contamination and loss of livelihoods, the regional government of Galicia, Spain, temporarily halted the development of an open-pit mine in Corcoesto by mining company Edgewater. In October 2015, Edgewater notified Spain of an investor-state dispute under the bilateral investment treaty between Spain and Panama.

Conservationists and indigenous groups have sounded alarm bells about the minerals exploitation boom in Lapland, Finland. Contaminated water and heavy metal waste from projects like First Quantum Minerals’ nickel mine in Sodankylä could bring permanent damage to the ecosystem and negatively impact indigenous communities and the region’s tourist industry.

Citizens are trying to stop open-pit mines developed by Eldorado Gold in the Halkidiki region of Northern Greece (Skouries, Olympias, Stratoni). People fear the clearing of pristine forest, water contamination through cyanide use and loss of livelihoods in the tourism, farming, fishing and beekeeping sectors.

Gabriel Resources is using investment pacts from the 1990s to sue Romania (See Box 3). Community resistance over environmental destruction and the displacement of villagers has put the company’s planned gold and silver mine in Roșia Montană on hold.

Locals and environmentalists in Bulgaria are trying to stop the approval of the Krumovgrad open-pit gold and silver mine developed by Dundee Precious Metals in the Natura 2000 site Ada Tepe. Concerns relate to pollution, strains on limited water resources and threats to the livelihoods of local farmers.
and all of its 28 member states. No wonder mining specialists are celebrating CETA as a “landmark” agreement, which could have “major implications for miners.”

Probably the most significant development in the Comprehensive Economic and Trade Agreement (CETA) for miners on both sides of the Atlantic is the inclusion of an investor-state provision.

Mining publication Mineweb

At the same time as promoting the interests of its mining sector in Europe, the Canadian government also used CETA negotiations as a way to undermine key European legislation on behalf of its oil and gas sector. The Canadian government has worked for years on behalf of oil and gas companies operating in Canada to weaken and subvert the proposed European Fuel Quality Directive, which requires EU fuel suppliers to decrease the carbon intensity of their fuels. This directive was meant to account for the higher greenhouse gas emissions from high carbon fuels such as oil derived from the Canadian tar sands, which requires more energy than conventional oil to be extracted and processed.

After many years of delay, the European Commission has released new measures which recognize that tar sands oil is more carbon intensive, but does not require EU companies to use a higher carbon intensity value if they import it. The result, after intensive lobbying by Canada, is a system that is not going to discourage oil companies from using and investing in the tar sands.

Four out of every five U.S.-owned firms operating in EU member states (41,811 firms) could gain new rights to attack European Union and EU member state policies using CETA’s ISDS mechanism.

CETA: A Trojan horse for US corporations

But CETA will not only allow Canadian businesses to sue EU governments and EU investors to file claims against Canada. Canadian subsidiaries of US-headquartered multinationals (see Image 2) will be also able to use CETA to launch investor-state challenges against European governments – even if the EU eventually excludes or limits investor-state dispute settlement within the Transatlantic

**IMAGE 2**

**SUING THROUGH CETA:** SOME SUBSIDIARIES OF US-BASED COMPANIES WITH ‘SUBSTANTIAL BUSINESS INTERESTS’ IN CANADA
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Trade and Investment Partnership (TTIP) currently under negotiation. EU-based subsidiaries of foreign-owned companies would also have the same power to challenge measures in Canada.

US control of the Canadian economy is of particular concern in the context of CETA because US investors have been the most aggressive users of investment arbitration globally, having filed around a fifth (138 cases) of all known investor-state cases by mid-2016. Statistical evidence suggests that there is a particularly strong tendency among investment arbitrators to adopt investor-friendly interpretations of the law when the claimant is from the US. The legal industry that seeks out every opportunity to sue countries, too, is dominated by US lawyers. Of the top 20 law firms representing claimants and/or defendants in investor-state disputes, 15 are headquartered in the US.

Suing your own government through CETA

Notably, both European and Canadian investors have learned how to sue their own governments as “foreign” investors by registering abroad. Recent examples of this “treaty shopping” include Calgary-based oil and gas company Lone Pine challenging a fracking moratorium and a related revocation of drilling permits in the Canadian province of Quebec (see Box 1) and Spanish conglomerate Abengoa suing Spain under the Energy Charter Treaty’s foreign investor rights via a Luxembourg-registered subsidiary over subsidy cuts in the solar energy sector.

As more and more companies have structured their investments through a dense network of subsidiaries, the EU and Canada can expect similar claims under CETA (see Annex 1). This includes subsidiaries of European corporations with substantial business activities in Canada, including Shell Canada (owned by Royal Dutch Shell), British Petroleum Canada (owned by British Petroleum), Mercedes-Benz Canada (owned by German giant Mercedes-Benz) and Total E. & P. Canada. All will be able to use CETA to sue European governments, provided their investment is structured accordingly. Similarly, aircraft and train manufacturer Bombardier – a Canadian company from Quebec with installations in Ireland – could use CETA to sue the Canadian government.

Moving into propaganda mode in response to public outcry

Opposition to investor-state provisions in CETA is growing on both sides of the Atlantic. Civil society organisations and trade unions in both Canada and Europe have for years raised concerns about CETA and have specifically called for the removal of ISDS from the agreement. But after five years of secret negotiations, widespread citizen opposition and the election of a new government in Canada, CETA has only been cosmetically changed.

CETA, like all recent trade agreements, reduces the space for public policy, and adds constraints for governments striving to provide services or regulate in the public interest.

While we take stock of the improvements that have been made to the investor-state provisions, we find them insufficient. [...] The changes still beg the question of why an ICS or ISDS is needed at all between countries with fully developed and effective court systems.

Joint statement of the Canadian Labour Congress (CLC) & the European Trade Union Confederation (ETUC)

The European Commission and the Canadian government have begun a misleading propaganda drive. Their strategy: to appease the public by diverting attention from the fundamental problems of the system by focusing on cosmetic reforms.

But a closer look at these “reforms” in the final CETA text (See Annex 2) shows that they will not “protect governments’ right to regulate, and ensure that investment disputes will be adjudicated in full accordance with the rule of law”, as the European Commission claims. On the contrary, CETA’s investor rights are arguably even more expansive than those in agreements such as NAFTA – most notably by protecting investors’ “legitimate expectations” under the so-called “fair and equitable treatment” clause and on investor-state disputes with regard to financial services (see Annexes 1 and 2).

Neither the proposed procedure for the appointment of judges of the ICS nor their position meet the international requirements for the independence of courts.

Deutscher Richterbund, Germany’s largest association of judges and public prosecutors.
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Are existing treaties a good reason to negotiate even more?

To justify its approach, the European Commission often refers to the over 3,000 existing investment treaties globally that include investor-state arbitration. The only way to address the loopholes of these agreements and prevent abuse, the Commission claims, is by reforming the current system through new deals that better balance investor rights and the right to regulate. Such changes could subsequently inform other agreements and would directly override some existing ones (such as the eight bilateral treaties between Canada and Eastern European countries which will be replaced through CETA).54

First, CETA shows that there is no genuine attempt to rebalance the investment regime. It offers sweeping rights but demands no obligations for investors (see Annexes 1 and 2). Second, new treaties are not the only reform option; existing deals that have proven dangerous can be ended, allowed to expire or be renegotiated – approaches currently being taken by South Africa, Indonesia, Bolivia, Ecuador and Venezuela, and which are also options for the eight existing bilateral agreements between Canada and EU member states. Third, the Commission is silent on the fact that its approach will significantly expand the scope of investment arbitration – rather than just “reform” what is already in place.

BOX 4
A WARNING FOR EUROPE AND CANADA: CASES STILL POSSIBLE UNDER THE REVISED INVESTMENT CHAPTER OF CETA51

The European Commission has rebranded the investment-state dispute settlement mechanism of CETA, the Investment Court System (ICS). But a close analysis of the most controversial ISDS cases from recent years reveals that those disputes could still be launched and likely prosper under ICS. (See Annexes 1 and 2).

Corporations against climate change and democracy – TransCanada vs. USA: In January 2016, Canadian pipeline developer TransCanada announced its intent to sue the US52 on the basis of the North American Free Trade Agreement (NAFTA) for President Obama’s rejection of the contested Keystone XL oil pipeline from Canada’s tar sand fields to refineries in the US. The project, which, according to critics would have amped up carbon emissions and quickened the pace of global climate change, had faced mounting citizen opposition. TransCanada is demanding a stunning US$15 billion in damages.

Could TransCanada file a similar case on the basis of the EU’s ICS proposal? Yes

Corporations against public health – Philip Morris vs. Uruguay: In February 2010, multinational tobacco company Philip Morris International (PMI) launched an investment arbitration lawsuit against Uruguay, on the basis of the country’s bilateral investment treaty (BIT) with Switzerland.53 PMI claims that the anti-smoking legislation enacted by the Uruguayan government, in particular the ban on selling more than one type of cigarettes under a single brand name (single presentation) and the requirement that graphic warnings about the risks of smoking cover at least 80% of the cigarette pack, “go far beyond any legitimate public health goal” and deprive PMI’s trademark from its commercial value. PMI demands US$25 million in compensation54. In its ruling of July 2016, the Tribunal dismissed all of PMI’s accusations and ordered the company to pay part of Uruguay’s legal costs55. This positive result, however, should not mask the fact that PMI dragged Uruguay for 7 years through a lawsuit that should not have been allowed in the first place. US$ 27 million were spent on lawyers, arbitrators and in administrative costs. This is more than PMI’s compensation demands. Furthermore, this lawsuit has caused major delays in the implementation of more stringent anti-tobacco measures such as plain-tobacco-packaging in Uruguay56.

Could Philip Morris file a similar case on the basis of the EU’s ICS proposal? Yes

Corporations against environmental protection – Bilcon vs. Canada: In March 2015, an arbitration tribunal constituted under the North American Free Trade Agreement (NAFTA) ruled that a Canadian environmental review process violated NAFTA’s investment protection rules. Bilcon, a U.S. company, wanted to build a large quarry and marine terminal in an ecologically sensitive coastal area in Eastern Canada. It planned to mine and crush basalt and then ship it by sea to the U.S. In 2007, after extensive study and public consultation, a government-established environmental assessment panel recommended against the project due to its likely negative environmental impacts. The governments of Nova Scotia and Canada followed the panel’s recommendation and denied approval. Bilcon then sued and won its investor-state dispute under NAFTA. The firm is seeking over US$300 million in damages57.

Could Bilcon win a similar case on the basis of the EU’s ICS proposal? Yes
Currently, 21 out of 28 EU member states – representing well over 95 percent of the EU economy – do not have investor-state arbitration provisions with Canada. More generally, most existing investment agreements of EU member states are with capital importers. CETA and other agreements with capital exporting countries (including the US, Japan and China) will massively expand the scope of investment arbitration, exposing EU member states to unpredictable and unprecedented liability risks.

Canada is likewise increasing the number of trade and investment agreements with capital exporting countries, including most recently the Canada-Korea Free Trade Agreement (CKFTA)\(^59\) and the controversial Canada-China Foreign Investment Promotion and Protection Agreement (FIPA), which entered into force on October, 1st 2014.\(^60\)

### Conclusion

Opposition to the previously unknown investor-state dispute settlement has ballooned in the last years. In CETA, the European Commission and the Canadian government have claimed to reform provisions on investor-state arbitration in a bid to win over public support. However, the minor tweaks and adjustment provide little assurance that the system will not be abused as it has been in the past: as a weapon to limit the powers of elected governments and to fight regulation – particularly in sectors where stricter rules are needed such as finance and mining (see Annexes 1 and 2).

Foreign investment can be risky, but there is no need for the creation of a special legal regime to protect foreign investors, who, like everyone else in society, have access to domestic legal systems to address grievances. Today’s multinationals are amongst the most successful and sophisticated in the world, capable of evaluating risk and the expected returns on that risk. Should the risk be too great, options such as private insurance, public investment guarantee schemes or, indeed, recourse to regular domestic courts are all readily available.

We therefore call on the European Commission, the Canadian government, EU member states and parliamentarians on both sides of the Atlantic to reject the current CETA text which includes investor-state arbitration. It should also be ruled out of all existing and future trade agreements of both Canada and the EU – including the controversial EU-US Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP).

Our societies won’t be able to confront the challenges we are facing – from combating climate change and social inequality to preventing another financial crisis – when they are stuck in a legal straight-jacket, with the constant threat of multi-billion corporate disputes against policy changes. What we need instead are strong regulatory mechanisms to stop abuse by multinational corporations – not a carte blanche for them to trample over democracy, people’s rights and our planet.

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Academics have begun to question whether ISDS delivers the benefits it is supposed to, in the form of increased investment. Foreign investors can protect themselves against egregious governmental abuse by purchasing political-risk insurance […].

*The Economist*\(^61\)