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Is the CETA Joint Committee about to Issue Its first Joint Interpretation of the Investment Chapter?

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Recently, the European Commission (EC) and the German Federal Government jointly released **a draft decision** on clarifications to certain provisions in the Investment Chapter (Chapter 8) of the **Comprehensive Economic and Trade Agreement (CETA)**. More specifically, they have agreed upon (1) a more precise scope of circumstances that may give rise to violations of Article 8.10 (fair and equitable treatment, or FET) and Annex 8-A (indirect expropriation) of the CETA; (2) mitigating measures and duties that should be considered by investment tribunals when determining any breach of Chapter 8 and calculating monetary damages in the final award; and (3) the importance of the climate protection objectives in interpreting and implementing the CETA. This post summarises specific clarifications included in the draft decision and highlights important implications of this development.

A More Precise Definition of FET and Indirect Expropriation

While the CETA's Investment Chapter includes a list of measures that may constitute a breach of the FET and indirect expropriation clauses, the draft decision further discusses and specifies each of the listed elements, thereby providing a more precise definition and scope of these two contentious provisions.

(a) Fair and Equitable Treatment

According to **Article 8.10.2 of the CETA**, a state breaches the FET obligation if its regulatory measure is a denial of justice, fundamental breach of due process, manifest arbitrariness, targeted discrimination on manifestly wrongful grounds, and abusive treatment of investors like coercion, duress and harassment. The draft decision clarifies that this list is exhaustive and outlines a more circumstantial description of states' regulatory measures (in terms of the type of states' actions and the level of the seriousness of misconduct) that will or will not constitute a violation of the FET clause.

For instance, the draft decision specifies that a 'denial of justice' in the meaning of Article 8.10.2. does not include an unfavourable outcome in an investor's challenge of an impugned measure in domestic proceedings. To constitute 'manifest arbitrariness', it requires that the concerned measure 'does not contain the reasons', 'is patently not founded on reason or fact', 'is based on

unreasonable discretion, prejudice or personal preference' or 'is taken in wilful disregard of due process and proper procedure'. It further specifies that 'a merely inconsistent or questionable application of a policy or procedure' is excluded from the scope of manifest arbitrariness.

Importantly, this draft decision provides a further explanation of the types of legitimate expectation protected under Article 8.10.4 of the CETA. It specifies that only 'written, specific and unambiguous representations made to an investor by the competent authority of a Party' may be considered by investment tribunals in determining if a legitimate and justifiable expectation has been formed by 'a prudent and informed investor'.

(b) Indirect Expropriation

Similarly, the draft decision provides some detailed interpretations of the concept of indirect expropriation contained in Article 8.12 and Annex 8-A of the CETA. **Paragraph 2 of Annex 8-A** provides that to determine if a measure constitutes an indirect expropriation, the tribunal should engage in a case-by-case analysis. It specifies that necessary considerations include, *inter alia*, a measure's economic impact, duration, character (notably its object, context, and intent) and the measure's relationship with 'distinct, reasonable investment-backed expectations'. The draft decision specifies in respect of a measure's duration that the *permanent* nature of the complained measure is not sufficient alone to establish an indirect expropriation. In respect of the investors' expectations, the draft decision reiterates the requirement for a 'written, specific and unambiguous representation' as also provided for the FET clause.

The draft decision has also interpreted the relationship between indirect expropriations and measures protecting legitimate public welfare objectives. As provided in paragraph 3 of the Annex 8-A, non-discriminatory measures for public interests may constitute an indirect expropriation in exceptionally rare circumstances, when the impact is 'so severe in light of its purpose that it appears manifestly excessive'. The draft decision defines manifestly excessive as 'manifestly disproportionate to its intended policy objectives in that it would be perceived as undeniable unreasonable in light of its purpose'.

Additionally, the draft decision briefly comments on the Russia-Ukraine conflicts in the international investment law context to reaffirm the national security exception embodied in **Article 28.6 of the CETA**. It emphasises that the parties to CETA are entitled to take actions, when necessary, to protect their essential security interests 'in time of war or other emergency in international relations'.

Investors' Mitigating Duties and Contributory Fault

The draft decision also requires investment tribunals to consider the duties of an investor to mitigate damage, and further provides an express role for domestic compensation mechanisms. The draft provides, in particular, that tribunals should assess if any damage prevention and mitigation measures are available to the investor and if the investor has actually accessed, or voluntarily accepted compensation under, any national compensation schemes.

Furthermore, the draft decision adds rules of '**contributory fault**' to Article 38.9 of the CETA. It requires investment tribunals to investigate if there is any unreasonable failure by the investor to reduce the damages arising from a breach and also to assess whether the investor has unreasonably

incurred expenses in conducting its claim. Tribunals are also directed to consider investors' wilful or negligent action(s) or omission(s) which contributes to the claimed injury.

Objectives of Climate Change Protection

Last but not least, the draft decision has again stressed the significance of climate change protection in interpreting and enforcing the CETA, although this objective has been expressly illustrated in a **Joint Interpretative Instrument** adopted at the time of signature.

Given the CETA parties' shared responsibilities to implement the Paris Agreement, the draft decision recalls that investors should expect regulatory measures to be taken by States seeking to combat climate change. It also directs investment tribunals to shape their interpretations of the CETA's Investment Chapter by taking due consideration of host states' climate neutrality objectives and commitments under the Paris Agreement. It further provides that any interpretation should be made so as to allow the CETA parties to 'pursue their respective climate change mitigation and adaptation policies'.

Implications of this Development

There has recently been a proliferation of clauses in investment treaties which expressly allow treaty parties to jointly issue binding interpretative statements (see **here** and **here**). The concepts of FET, most-favoured-nation (MFN) treatment, and expropriation have been the main subjects of existing practice under such clauses (see **here** and **here**). It is thus unsurprising that the draft decision released by the EC and Germany has also touched upon these substantive standards.

The purpose of this draft decision is said to secure the CETA parties' right to regulate on 'climate, energy, and health policies … to achieve legitimate public objectives' and also to prevent 'the misuse of investor to State dispute settlement mechanism by investors' (see **here**). At some level, this is consistent with the primary function of a binding joint investment treaty interpretation, which is aimed at providing **'authentic' clarifications** of treaty provisions to '**avoid and correct any misrepresentation**' of a given agreement. However, one may be skeptical about whether this goal can be effectively and fully achieved by the above clarifications of the CETA's Investment Chapter.

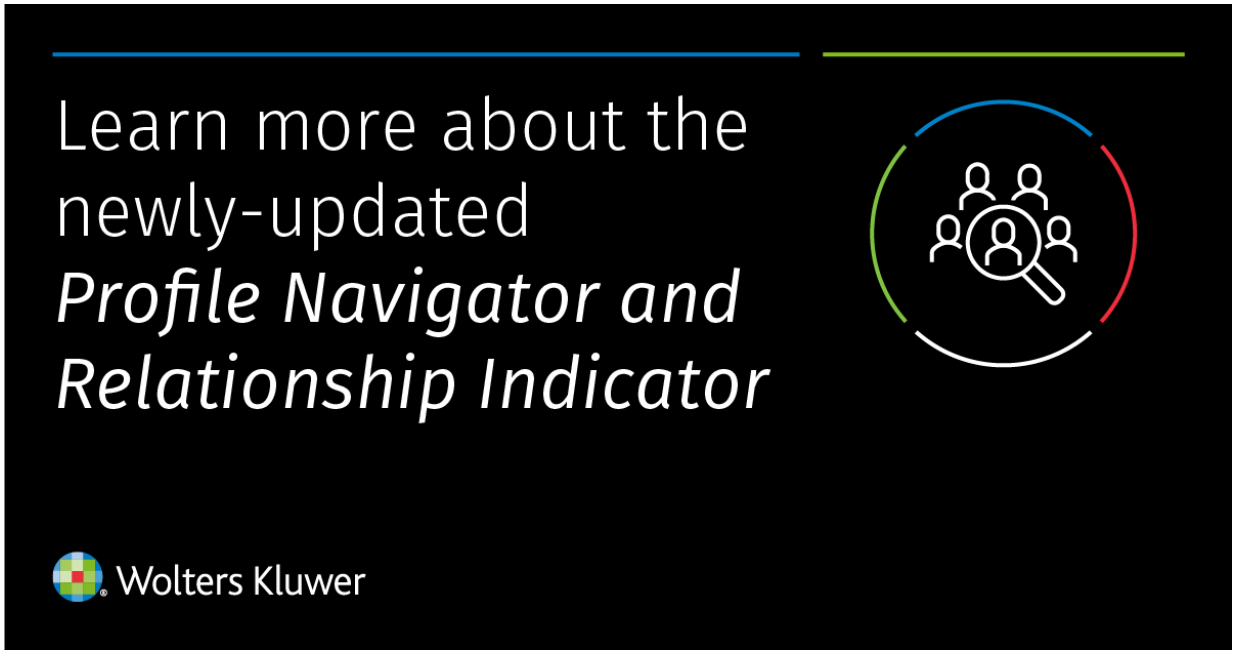
First, the draft decision partially addresses the existing ambiguities and brings in new ones. Some clarifications do provide useful guidance to investment tribunals, for instance, by explicitly limiting the scope of 'manifest arbitrariness' to a handful of circumstances. However, in assessing these circumstances, certain ambiguities remain. What precisely it means for a measure to be 'patently not founded on reason or fact' or 'taken in wilful disregard of due process and proper procedure' is unclear, it being uncertain how serious or gross states' misconduct should be to satisfy the threshold of 'patently' and wilful disregard'. Similarly, although the draft specifies several situations that might constitute a 'blatant miscarriage of justice', it does not explicate if these situations are exhaustive, and the meaning of this concept therefore remain unsettled.

On top of this, the draft decision confirms a large policy space for regulatory measures to combat climate change, which creates a relatively asymmetric effect, particularly from an investor's

perspective. On the one hand, it sets forth a high standard – 'wholly disproportionate' and 'undeniably unreasonable' – for a measure to constitute an indirect expropriation. On the other, investors are asked to expect host states' actions to address the present or future consequences caused by climate change in a broad and general manner, which may lead to an unstable and unpredictable investment climate and cause great difficulties for investors to properly develop their investment strategies.

Moreover, **the timing of joint interpretations** is an important consideration, as it affects when and to whom the statements will become effective. The current draft version does not include this detail, but one may expect that the CETA Joint Committee is likely to decide, in its final version, a specific date of effect, provided that the **procedure** for the adoption of interpretations has allowed it to do so. That being said, considering that these 'interpretations' are significant additions to the original text, concerns may arise as to whether they are more like '**disguised amendments**' of the treaty, with attendance concerns likely to then arise as to their retroactive effects.

If approved, the draft would become the first joint interpretation statement specifically attached to the CETA's Investment Chapter, thereby binding investor-state tribunals established under Chapter 8 of the CETA (see **Article 8.31.3 of the CETA).** Nonetheless, it is worth mentioning that the CETA Joint Committee has already issued a **Joint Interpretative Instrument** at the time of signature of the CETA, which discusses, though briefly, a wider range of aspects, such as public services, investment protection, trade and sustainable development, government procurement, indigenous peoples' rights, among others. A couple of joint declarations respectively on expropriation and intellectual property rights (**Annex 8-D**) and denial of benefits and national security (**Annex 8-E**) have also been annexed to Chapter 8 upon the conclusion of the treaty. Still, this draft statement remains to be discussed by all other European Union Member States, Canada, the CETA Committee on Services and Investment, and ultimately the CETA Joint Committee.



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