

“The Right to Regulate” in the Trade Agreement between the EU and Canada

– and its implications for the
Agreement with the USA



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Summary and Conclusions

In discussions regarding the contents of a future International Investment Agreement (IIA) between the EU and the USA, a part of the Transatlantic Trade and Investment Partnership (TTIP), certain misgivings were expressed with regard to the risk of such a treaty reducing the state's "right to regulate", i.e., to legislate and adopt administrative acts decisions.

The "right to regulate" in this context refers to the state's ability to legislate and adopt administrative acts *without running the risk of having to pay damages* as the result of a dispute based on an IIA. Such damages can be awarded if the state is found to have acted in a way that constitutes a violation of the IIA insofar as that action has also reduced or destroyed the value of an investment. The "right to regulate" is thus not about de facto limiting the states' possibilities to legislate or adopt administrative acts.

So far no official draft for the investment protection section of TTIP has been made public.¹ Concerns regarding possible limitations of the states' "right to regulate" are instead based on the wording of older IIAs between states, and the agreement between the EU and Canada, the Comprehensive Economic and Trade Agreement (CETA), which was completed in 2014.²

In this report, the Swedish National Board of Trade analyses the wording of two CETA articles that are central to an IIA, which have historically been the most frequently featured in investment disputes, namely the articles on "fair and equitable treatment" and "expropriation". These articles are also the ones with the potentially greatest impact on the state's "right to regulate".

The effect of these articles on the state's "right to regulate" and the level of protection for investors will be analysed. Comparisons will be made with the Swedish legislation, as well as with the Convention for the Protection of Human Rights and Fundamental Freedoms (hereafter the ECHR), in order to ascertain the extent to which these articles offer more far-reaching protection than that granted by Swedish law. The point of departure is that insofar as the provisions do not provide more far-reaching protection than that granted by Swedish law, the provisions do not limit the Swedish state's "right to regulate".

A comparison will then be made between the wording of these two articles in CETA and the corresponding articles in the US Model Bilateral Investment Treaty (hereafter the US Model BIT) for investment

¹ This report was written prior to the draft text presented by the European Commission in September 2015.

² Negotiations on CETA have been completed, but careful legal scrutiny ("legal scrubbing") of the agreement is still underway.

protection.³ The latter constitutes the point of departure in for the United States in negotiations on IIAs. A high level of conformity between CETA and the US Model BIT might give an indication of the possible wording of TTIP.

The following is a brief summary of the analysis' main conclusions with regard to these two articles.

Fair and Equitable Treatment

The article on “fair and equitable treatment” is intended to make the Parties to the agreement ensure that the exercise of public authority and court proceedings maintain a certain quality and that the state does not subject investors to manifestly arbitrary treatment or targeted discrimination. The analysis shows that in CETA, this article contains nothing beyond what is already included in Swedish law and, in several cases, in Swedish constitutional law. Examples include the right to a fair trial, protection against discrimination and protection against arbitrary treatment. As long as these provisions exist, and provided that the state upholds them, the article thus does not limit the Swedish state's “right to regulate”. Since the rules that are relevant to the article hold a unique position within Swedish legislation, it is unlikely that they will change in a way that would limit the state's “right to regulate”. The conclusion is therefore that the article on “fair and equitable treatment” in CETA will not impact on Sweden's “right to regulate”. For foreign investors in Sweden, the article does not provide any additional protection compared to Swedish law, other than guaranteeing a minimum standard of treatment from the state.

The wording of the articles on “fair and equitable treatment” differ in CETA and the US Model BIT. In the latter agreement, there is an illustrative list where the article applies, while CETA contains an exhaustive list. The fact that the list is exhaustive provides a greater level of control over the article's scope, and the article limits the state's “right to regulate” to a lesser extent than the corresponding article in the US Model BIT.

The ground for protection stipulated in the article on “fair and equitable treatment”, also referred to as “legitimate expectations”, has traditionally constituted a factor of uncertainty, as there has been some level of arbitrariness in terms of what arbitration tribunals have deemed to be included in this ground. In CETA, the stipulation regarding “legitimate expectations” has been so greatly limited that, in reality, it offers very little protection for investors.

³ The Canada and the USA are both members of NAFTA and their respective model agreements have the same basic structure. A comparison between CETA and the US Model BIT will therefore give an indication of what the TTIP may come to look like.

In the US Model BIT, there is no explicit mention of “legitimate expectations”; it is, however, still a part of the agreement due to the jurisprudence. In this practice, “legitimate expectations” as grounds for protection is less limited than in CETA.

Expropriation

To a great extent, the expropriation article in the CETA, along with its explanatory annex, is a codification of a sometimes divergent jurisprudence regarding indirect expropriation. These clarifications make the application of the article significantly more predictable than what would have been the case using previous generations of the agreement.

The regulation of direct expropriation (where the state directly nationalises private property) in CETA more or less corresponds to Swedish law. However, the expropriation article's section on indirect expropriation could possibly provide somewhat greater protection than what is granted by Swedish legislation; for example, there are areas covered by the article which are not explicitly included in Swedish law. In addition to the protection against indirect expropriation provided by Swedish law, there is also a certain protection granted by the ECHR. As such, it is already possible, under certain circumstances, for Sweden to become subject to infringement proceedings relating to indirect expropriation, an aspect which must be considered in all decision-making and legislation activities in Sweden.

Due to limited case law relating to indirect expropriation in Swedish courts and the European Court of Human Rights (ECtHR), it is unclear which degree of extended protection the CETA expropriation article provides for foreign investors in Sweden. The case law that does exist indicates that the additional protection provided by the article is very limited. All in all, the article therefore most likely has a limited effect on Sweden's “right to regulate”.

Considering the great similarities between the expropriation articles and the explanatory annexes in the US Model BIT and the CETA agreement, it is not unlikely that the equivalent article in TTIP will be given a similar wording.

Underlying principles in the preamble to CETA

In accordance with the investment protection part of CETA, in the event of a dispute between the state and investors, the arbitration tribunal must consider the underlying principles found in the preamble to the agreement and the other two articles relating to the “right to regulate”. The preamble explains that the parties to the agreement (Canada, the EU and the EU member states) retain the “right to regulate” in areas such as public health, safety, environment, public morals and cultural diversity.

The fact that this is established in the agreement preamble means that the subsequent articles on investment protection shall be interpreted in light thereof. The US Model BIT contains similar principles, but the wording is not identical. In CETA, these principles give the parties a fairly extensive “right to regulate”. Exactly how these principles, which can be characterised as exceptions, will be interpreted by arbitration tribunals is a future question. It is clear that the arbitrators in their interpretation shall take customary international law into consideration, such as the doctrine that gives states an extensive right to make their own decisions without becoming liable for damages.⁴ The two articles in the agreement that explicitly mention “the right to regulate” concerns environmental and labour legislation.

The parties to the investment protection treaty in CETA have given the arbitration tribunals clearer rules than what was the case in previous IIA’s, which reduces the risk of decisions that are contrary to the intentions of the contracting parties. CETA also gives the parties an opportunity to establish binding interpretations of the agreement, which the arbitration tribunals must adhere to. In the long run, this further enhances the parties' “right to regulate”.

⁴ The police power doctrine.

1 Introduction

The purpose of an IIA is to create a stable legal environment to attract investments.⁵ The public debate in Sweden concerning the investment agreement between the EU and the USA, which is intended to constitute a part of the Transatlantic Trade and Investment Partnership (TTIP), has come to revolve around whether the agreement risks leading to Sweden not being able to legislate in areas of particular importance, such as the environment. This is often referred to as Sweden's “right to regulate” potentially being limited.

This report primarily aims to analyse the extent to which the relatively recently negotiated Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada affects Sweden's “right to regulate”. The analysis is conducted by studying the wording of the two articles that have historically most frequently featured in investment disputes, and thereby potentially have the greatest influence on the “right to regulate”. These articles are “fair and equitable treatment” and “protection against expropriation without compensation”.

The analysis will include which level of protection CETA will provide investors with and how the states' “right to regulate” is influenced by the agreement. Comparisons are made with Swedish legislation, including the ECHR. The purpose of these comparisons is to investigate the extent to which the articles offer more far-reaching protection than that conferred by Swedish law and the ECHR.

The point of departure is that in cases where the provisions of CETA provide a more far-reaching level of protection than granted by Swedish law and the ECHR, there is a theoretical risk of the state being found liable for damages in a dispute.⁶

A comparison will also be made between CETA and the US Model BIT. The latter constitutes the USA's point of departure starting-off point for negotiations on IIAs. To the extent that there is a relatively high degree of conformity between these articles in the US Model BIT⁷ and in CETA, it gives an indication of how the corresponding article could be worded in TTIP.

⁵ For an overview of what is included in an IAA, see the Swedish National Board of Trade's memo (2014) “Dispute resolution in a possible future IIA between the EU and the USA – a brief background along with questions and answers”, ref. no. 3.2.4-01078-12. CETA is an agreement based on the negative list approach, which means that the agreement covers all types of direct investments in so far as they are not exempt through sectorial exceptions or specific exceptions.

⁶ The Board starts out from the premise that the aspects analysed in this report will not be influenced by Chapter 2, Section 25 of the Instrument of Government.

⁷ US Model BIT 2012.

Parts of the protection for investors provided by CETA are also included in EU law, and in those cases, Sweden's "right to regulate" is already limited and CETA will have no further effect in these regards.⁸

The method used is a comparative analysis of CETA, the US Model BIT, Swedish legislation and the ECHR. Ph.D. students Love Rönnelid and Joel Dahlquist from the Faculty of Law at Uppsala University have provided valuable commentary for the legal analyses made by the Board in this report. Mathieu Raux, Ph.D. in Law and legal adviser at the French Ministère de l'Économie, des Finances et de l'Industrie has assisted in the legal analysis of CETA.

The report focuses on the possibility for investors to obtain compensation. For this reason, we refrain from comparisons to the supervisory powers of the Parliamentary Ombudsman.

2 IIAs and the "Right to Regulate"

The purpose of IIAs is to create an increased level of foreign direct investment, which in turn hopefully yields positive economic effects. By entering an IIA, a state commits to adhering to the agreement. If the state violates the agreement, it will thus be liable for damages under certain circumstances. The damages shall correspond to the damages suffered by the investor as a consequence of the state's breach of the agreement.

Legislative power lies with the Swedish Parliament (Riksdagen)⁹ and an IIA does not delegate any such legislative power. Nor does an arbitration tribunal dealing with an Investor-State Dispute Settlement (ISDS) have any mandate to reject a country's legislation. On the other hand, the IIA does give the tribunal a mandate to assess whether a country's legislation or decision is in breach of the IIA. Once this has been established, the state may become liable to pay damages.

In this context, the "right to regulate" refers to the extent to which the state can legislate and make decisions without running the risk of being found in violation of the treaty and having to pay damages. Hence, the IIA will not entail the state *renouncing* the right to legislate or regulate. In case the state has a strong wish to break the investment treaty through

⁸ Health, environment and consumer protection are for example protected through the Treaty on the Functioning of the European Union (TFEU), articles 168, 191 and 169. The Charter of Fundamental Rights of the European Union (2010/C 83/02) establishes, in the following articles: the right to property (17), the right to non-discrimination (21), the right to good administration (41) and finally the right to a fair trial (47). However, an investor is only protected by these articles in the implementation of Union law (51).

⁹ Unless the state has transferred some power, for example to the EU.

a law or a decision, the state is free to do so as long as any affected investors are compensated. The term “right to regulate” is thus misleading, but since it is an established concept, the Board has chosen to use it nonetheless.

In cases where the fear of being brought before an arbitration tribunal prompts a state not to introduce a certain piece of legislation or take a certain decision, the state's “right to regulate” is negatively influenced and the state falls into a so-called “regulatory chill”, i.e., it is forced into passivity. The extent to which an IIA actually has this effect remains subject to debate¹⁰, but a review of known disputes would indicate that the phenomenon is rare.¹¹

Up until April 2014, there had only been 14 disputes originating directly from binding legislation – even though there were 3,200 agreements.¹² And one and the same piece of legislation was responsible for several of these disputes.¹³ According to the authors behind these statistics, the absolute majority of disputes instead relate to states subjecting investors to *treatment* they have later found to be arbitrary, and which has also constituted a breach of the IIA. The empirical evidence thus does not indicate that legislation and subsequent binding interpretations constitute a common subject of dispute; instead, arbitrary treatment (which may be the result of legislation) is the most common ground for an investment dispute.

A state can be brought before an arbitration tribunal (regardless of how reasonable the claim is) on the basis of all of the articles in the IIA intended to protect investors/investments. The level of protection in an agreement must thus be balanced so that the state can legislate and make decisions, when necessary, without running the risk of violating the treaty and consequently becoming liable for damages.

¹⁰ The example usually referred to on the subject of “regulatory chill” is that New Zealand is holding off on the implementation of a “plain packaging” law pending the outcome of Philip Morris Asia Limited v. The Commonwealth of Australia

¹¹ Prof. Dr. Christian Tietje et al. (2014) *“The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership”* p. 92f

¹² Caddel, Jeremy, och Jensen, Nathan M., (2014) *“Which host country government actors are most involved in disputes with foreign investors?”*, Columbia FDI Perspectives No. 120. The authors have drawn the line at disputes primarily founded in binding legislation. If for example a state introduces a law forcing the public sector to discriminate an investor, this is a binding legislation and is included in the 14 disputes. Cases where a state, supported by legislation, has the choice to act do not fall within this category and therefore are not part of the selection.

¹³ Jamaica's decision to alter tax levels for aluminium manufacturers led to several disputes, for example. Caddel, Jeremy, and Jensen, Nathan M., (2014) *“Which host country government actors are most involved in disputes with foreign investors?”* Columbia FDI Perspectives No. 120.

3 The “right to regulate” in CETA and in The US Model BIT

Certain IIAs list exceptions in the preamble.¹⁴ The preamble may, for example, state that the treaty shall not be applicable to certain sectors. In other treaties, similar exceptions are introduced directly in the articles. One common such exception is for the protection of investors not to apply in areas of importance to national security. In cases where the state invokes an exception, the burden of proof lies with the state.

In CETA, the “right to regulate” is mentioned in the preamble, which clarifies that the state maintains the “right to regulate” within areas where there are “legitimate policy objectives”.¹⁵ In addition, the “right to regulate” is indirectly regulated by way of the treaty's construction. The underlying principles in the CETA preamble provides five examples of legitimate policy objectives:

“RECOGNIZING that the provisions of this Agreement preserve the right to regulate within their territories and resolving to preserve their flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity; and”¹⁶

The matter of interpreting what constitutes legitimate policy objectives is then up to the arbitration tribunal, but reading legitimate policy objectives as public interest purposes would be reasonable.¹⁷ When the Commission discusses the “right to regulate” in future IIAs, emphasis is placed on the importance of the state being able to “pursue public policy objectives”, i.e. make decisions regarding public interest matters.¹⁸

What constitutes public interest purposes is a related but separate issue, and will not be investigated in any detail here.¹⁹ The principles of the “right to regulate” regarding public health, safety, environment, public morals and cultural diversity are mentioned explicitly, but they are only examples of legitimate policy objectives and do not exclude the

¹⁴ The preamble is the introduction to the agreement, which specifies its purpose. In accordance with article 31(1) of the Vienna Convention, agreements shall be interpreted in their context and the terms of the Treaty in the light of its object and purpose

¹⁵ The “right to regulate” is not absolute in these areas, as is stated in Annex 11(3).

¹⁶ CETA, p. 6 of the consolidated version of 26 September 2014. When the below text refers to CETA, this is the version of the agreement intended. In the preamble to the agreement, there are references to “commitment to sustainable development” and “the right of the Parties to take measures to achieve legitimate public policy objectives”, which includes the promotion of high set environmental norms and labour legislation.

¹⁷ In the public debate on investment protection in TTIP, the Commission provides further examples of what needs to be explicitly specified, such as natural resources, animal life, plants, archaeological and cultural values etc.

¹⁸ Concept Paper from the European Commission (2015) “*Investment in TTIP and beyond – the path for reform*” p. 1.

¹⁹ Inspiration for the general exceptions has been taken from article XX of GATT and article XIV in GATS. For more on this subject, see Titi, Aikaterini (2014) “The Right to Regulate in International Investment Law” p. 99ff

possibility of other legitimate policy objectives.²⁰ The articles on investment protection are then to be interpreted in consideration of the preamble. On 24 April 2015, Commissioner Cecilia Malmström stated before the Standing Committee on Economic Affairs that the above principles will not be included in the preamble to TTIP, but will constitute exceptions in a separate article, which, depending on its wording, could reinforce the principles.

In addition to the preamble, the “right to regulate” is also dealt with in CETA in the chapter “Trade and Labour”, which states that the parties recognise each other's right to determine the level of employee protection and to adopt relevant legislation that is compatible with international agreements. Furthermore, the parties shall strive to improve legislation with the aim of achieving a high level of employee protection.²¹ The “right to regulate” is also regulated in the chapter “Trade and Environment”, in which the parties recognise their mutual right to set their own environmental priorities and domestic levels of environmental protection, as well as to adopt or change relevant legislation in a manner corresponding to multilateral environmental agreements into which the parties have entered. Each party shall strive to reach high environmental protection levels and ensure that relevant legislation is improved.²² Despite both of these articles being found in the substantial agreement text, they rather have the characteristics of a text normally found in the preamble of the agreement.

The OECD noted back in 2004 that legal literature has found that states are entitled to regulate public welfare without becoming liable for damages, as this is one of the state's fundamental functions.²³ The above paragraph in the preamble to CETA clarifies that this interpretation of customary international law, i.e. regarding the principal “right to regulate” for public interest purposes, is part of the treaty. Despite general exceptions being included in different agreements since the late 1990's, no arbitration tribunal has interpreted such an exception.²⁴ Other than introducing the principle of the “right to regulate” for legitimate policy objectives, the individual articles in CETA have been given a more limited content than previous IIAs, limiting the protection for investors compared to what was provided in older agreements.

²⁰ The dispute between Philip Morris and Australia regarding “plain packaging” would most likely be seen as a legitimate policy objective. However, there is no clarification such as the one in CETA written into Australia's 1993 agreement, which is the reason for the dispute.

²¹ Chapter 24 X+1, article 2, p. 342 of CETA.

²² Chapter 25 XX, article 4, p. 391 of CETA.

²³ OECD Working Papers on International Investment 2004/04 “*Indirect Expropriation' and the 'Right to regulate' in International Investment Law*”, p. 6 ff.

²⁴ Tjetje, Christian et al. (2014) “*The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*” p. 55f

In the US Model BIT, the following limitations are set out in the preamble:

“Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labour rights;”

In addition, there are exceptions in the explanatory annex to the article on expropriation:

“Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”²⁵

These provisions in CETA and the US Model BIT are intended to clarify what constitutes the states’ legitimate legislative measures and what constitutes measures where states are instead liable for compensation to investors.

In the following section, we analyse the two central protection articles in CETA, which play the greatest parts in the states’ “right to regulate”, i.e. “fair and equitable treatment” (chapter 4) and “expropriation” (chapter 5). The reason for singling out these two articles is that they have historically most frequently featured in investment disputes and thereby potentially have the greatest influence on the “right to regulate”.

4 Fair and Equitable Treatment

Summary of section 4

In section 4, we compare the article on “fair and equitable treatment” in CETA with the Swedish legislation. The comparison shows that CETA’s provision on “fair and equitable treatment” has been significantly limited compared to how the article is traditionally worded. According to the Board’s analysis, the article in CETA does not provide protection more far-reaching than what is already granted by Swedish legislation. For this reason, Sweden’s “right to regulate” is not affected by the article.

A comparison is also made between the article on “fair and equitable treatment” in CETA and in the US Model BIT. The comparison shows that, due to jurisprudence, the articles have more or less the same content, with the exception that the US Model BIT does not define “fair and equitable treatment” in an exhaustive list as CETA does, but instead provides an illustrative list. Furthermore the protection given by “legitimate expectations” has been neither defined nor delimited in the US Model BIT.

²⁵ Annex B, article 4(b), USA Model BIT 2012.

4.1 What constitutes “fair and equitable treatment”?

The article on “fair and equitable treatment” is the article most frequently cited in investment disputes, and is also the article that states are most often found in violation of. The purpose of the article is to cover a large range of situations where companies may be vulnerable, which are difficult to predict and therefore difficult to regulate by agreement. To make this possible, the article has traditionally been formulated in general and brief terms, which is illustrated below by how the article is worded in certain Swedish BITs.

Each Contracting Party shall at all times ensure fair and equitable treatment of the investments by investors of the other Contracting Party and shall not impair the management, maintenance, use, enjoyment or disposal thereof nor the acquisition of goods and services or the sale of their production, through unreasonable or discriminatory measures.

In the media, it is often said that the TTIP will allow investors to sue states for wrongful treatment. Such fears are primarily grounded in concerns regarding the meaning of the article on “fair and equitable treatment”.²⁶ The concept of “fair and equitable” may give the impression that two separate grounds for protection are involved, when in actual fact they are one and the same.²⁷

However, not all negative treatment that an investor can be subjected to by a state constitutes a violation of the treaty. The following quote from an arbitration award illustrates which type of treatment is usually deemed to be in violation of the article on “fair and equitable treatment”: “acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith”.²⁸ A central aspect of the assessment is thus whether the state has acted in good or bad faith.

The criticism against the article on “fair and equitable treatment” is mainly based on ambiguities in terms of what it covers. No definition of the term “treatment” has earlier been provided in the agreements, which in turn has left it up to the arbitration tribunals to determine whether a certain treatment is subject to the agreement or not. There is a conflicting jurisprudence to consider, which historically has led to a certain level of arbitrariness in the assessment of these grounds for protection. This is also the background for the article on “fair and equitable treatment” being given a very restrictive wording in CETA.

²⁶ In the BIT between Sweden and Madagascar “fair and equitable treatment” has been translated into Swedish as “*rättvis och rimlig behandling*” [fair and reasonable treatment]. However, the French version says “*juste et équitable*”.

²⁷ Dolzer, R., Schreuer C. (2012) “*Principles of International Investment Law*”. p. 133.

²⁸ Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia, *ibid.* p. 142

4.2 Article X.9 in CETA: “Treatment of Investors and of Covered Investments”, (FET)

To provide an overview of the article on “fair and equitable treatment” prior to further analysis, box 1 below contains the full article as it is worded in CETA.²⁹

Box 1, the article “Treatment of Investors and of Covered Investments”, (FET).

1. Each Party shall accord in its territory to covered investments of the other Party and to investors with respect to their covered investments fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 6.
2. A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:
 - 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; or
 - f. A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.
3. The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment.
4. When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party 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.
5. For greater certainty, ‘full protection and security’ refers to the Party’s obligations relating to physical security of investors and covered investments.
6. For greater certainty, a breach of another provision of this Agreement, or of a separate international Agreement, does not establish that there has been a breach of this Article.

What is lacking in CETA but found in the US Model BIT is a clarification regarding the state's treatment of investors/investments having to correspond to customary international law. The US Model BIT specifies that the article on “fair and equitable treatment” shall provide protection corresponding to “customary international law minimum standard of treatment of aliens as the minimum standard of treatment”.³⁰ This means that the USA does not need to provide any more far-reaching standard of treatment than what is stipulated in customary international

²⁹ Article X.9 “Treatment of Investors and of Covered Investments” CETA p. 158.

³⁰ Article 5(2) and (3) of the US Model BIT 2012.

law.³¹ In CETA, the corresponding article contains no similar reference to customary international law, and it is therefore unclear how the TTIP will be worded in this respect. There is an ongoing academic debate on whether the level of protection provided by a clause relating to “fair and equitable treatment” is the same as that provided by customary international law or if this is an independent ground for protection. A resolution from the European Parliament shows that the Parliament considers the protection provided in the article on “fair and equitable treatment” in any IIAs entered by the EU to be the same as the protection obtained from customary international law.³²

4.2.1 Analysis of the article “Treatment of Investors and of Covered Investments” in CETA

The following sections analyses the wording of CETA's article on “fair and equitable treatment” paragraph by paragraph. When appropriate, comparisons are made with Swedish legislation and the US Model BIT.

1. Each Party shall accord in its territory to covered investments of the other Party and to investors with respect to their covered investments fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 6.

“Covered investments” refers to completed investments, which are subject to the treaty.³³ The article does not cover market access, i.e., the possibility/right to make a future investment. The TTIP negotiating mandate from the Council of the European Union to the Commission also states that the agreement shall not provide investors with an opportunity to gain market access through ISDS. The investment section of TTIP will therefore be limited so that ISDS is only applicable to investments which are already completed.

What constitutes “full protection and security” for an investor or an investment is clarified in paragraph 5, which states that the state shall guarantee the physical safety of investors and investments. This statement clarifies that “legal protection” is *not* covered by the agreement. “Legal protection” refers to the state guaranteeing the investor a stable legal environment where laws that vitally affect the investment remain unchanged.³⁴ The fact that “legal protection” is not included in the notion of “fair and equitable treatment” increases the

³¹ In article 1105 of NAFTA a “minimum standard of treatment” is equated to international law

³² European Parliament resolution of 6 April 2011 on the future European international investment policy (2010/2203(INI)) paragraph 19

³³ For a definition of “covered investments” see CETA p. 134

³⁴ Several tribunals have deemed “legal protection” to be included in “full protection and security”, but several other tribunals have reached the opposite conclusion, i.e. that the state has no obligation to preserve its legislation as it was when the investment was made.

states' "right to regulate" as compared to earlier agreements.³⁵ It should however be noted that if there is an individual agreement between a state and an investor containing a "stabilisation clause" (meaning that the state promises not to alter the law within a certain area), this might put things into a different perspective.³⁶

As the US Model BIT contains the same clarification of the concept of "full protection and security", TTIP may come to be worded as CETA in this respect.³⁷

What level of protection is actually provided by the article on "fair and equitable treatment" is developed in paragraph 2 of the article.

2. A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:

This is followed by a number of sub-paragraphs listing the areas covered by paragraph, 2(a–f). This way, the EU and Canada have intended to ensure that the article cannot be misused. However, the agreement allows for the possibility of extending this list in the future, should the parties agree to do so. Paragraph 2 is an attempt to define what the article on "fair and equitable treatment" is intended to protect, by listing the types of government measures included under the article.

In the US Model BIT, the article on "fair and equitable treatment" does not provide an exhaustive list in the way that CETA does. The US Model BIT instead provides an illustrative list.³⁸ However, the jurisprudence shows that the article is still interpreted as encompassing the contents of paragraph 2(a–f) of CETA.³⁹

2(a) Denial of justice in criminal, civil or administrative proceedings;

Paragraph 2(a) regulates "denial of justice". The term "denial of justice" is a concept from Anglo-Saxon law, and in this case it is about the receiving state not being allowed to deny investors access to correct official decisions and due process. An investor invoking "denial of justice" considers itself to have been systematically mistreated by the

³⁵ On 18 March 2015, Commissioner Cecilia Malmström stated before the European Parliament's Committee on International Trade that the TTIP would possibly contain the following wording: "that investment protection rules offer no guarantee for investors that the legal regime under which they have invested will stay the same". The wording is more explicit than that of CETA, but the Board finds that it constitutes no substantial difference.

³⁶ This is for example the case in the noted dispute *Veolia Propreté v. Arab Republic of Egypt*, where Egypt, in the agreement between the parties, had promised that if the minimum wage was raised during the agreement period, Egypt would compensate Veolia for this additional cost.

³⁷ Article 5(2)b of the US Model BIT 2012.

³⁸ US Model BIT 2012, article 5

³⁹ For a comparison with the Swedish version, see the introduction to section 2.

public authorities and courts. In order to successfully initiate infringement proceedings against the state, it is more or less a condition that the investor has exhausted all the domestic legal means available in the host country without having the case tried correctly.⁴⁰ Due process requirements are set with reference to customary international law standards. There are four main groups of claims that may constitute “denial of justice”⁴¹: (1) if a seized court refuses to consider a claim, (2) if the procedure has taken an unreasonably long time, (3) if the procedure has been incorrectly executed (4) if the court has deliberately misapplied the law. The state must thus guarantee an examination that maintains a minimum level, particularly in terms of procedural quality, but also quality in substance.

The protection provided by paragraph 2(a) is also part of the Swedish Instrument of Government. An investor is therefore already eligible for damages in accordance with Swedish law, if the State fails to live up to the standards on which “denial of justice” is based.⁴² This paragraph therefore does not provide more far-reaching protection than Swedish law, and thus it does not influence Sweden's “right to regulate” as specified in paragraph 2(a).

The US Model BIT also includes the wording “denial of justice”, and the corresponding paragraph in TTIP could therefore come to have a similar content to that of 2(a) in CETA.⁴³

2(b) Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.

Paragraph 2(b) is part of the assessment of “denial of justice”⁴⁴. The term “due process” means that the state must live up to certain fundamental legal principles. The term is related to “minimum standard under customary international law”, which means that the state's treatment of an investor must maintain a minimum level set by customary international law. The actual assessment in each individual case must be in accordance

⁴⁰ In accordance with Article X.21 of CETA, the investor is not required to have exhausted all domestic legal means before they can bring the dispute to an arbitration tribunal, but in practice all domestic legal means have to be exhausted (since this is the subject of dispute) for the investor to successfully cite a “denial of justice”. See *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, final decision 18 of August 2008.

⁴¹ Dolzer, Rudolf and Schreuer, Christoph. (2012). *Principles of International Investment Law* p. 179.

⁴² Such damages could be based on Chapter 3, Section 2 of the Swedish Tort Liability Act (1972:207), or on Article 6 of the ECHR, unless the right to compensation is especially regulated in another act.

⁴³ Article 5(2)a of the US Model BIT 2012.

⁴⁴ According to Dolzer, Rudolf and Schreuer, Christoph. (2012). *Principles of International Investment Law* p. 178, “denial of justice” and “due process” are included in a “fair and equitable treatment” even when they are not explicitly mentioned, which they are in CETA and the US Model BIT.

with the rule of law (fair treatment). The paragraph emphasises that only fundamental breaches of the legal principles will constitute its violation. According to jurisprudence, an arbitration tribunal shall only in exceptional cases assess whether a national authority or court has made a decision in violation of an IIA. An exceptional case is when the line between an incorrect judgement and a manifest error in judgement is crossed.⁴⁵ It is therefore not enough for the investor to convince the arbitration tribunal that the national court has made a fundamental error, but the error in itself must also constitute a violation of the IIA.⁴⁶

The protection provided by paragraph 2(b) is highly reminiscent of the protection provided by Chapter 2, Section 11 of the Instrument of Government and Article 6 of the ECHR, i.e. the right to a fair trial.

The Swedish rules on open access⁴⁷, which guide Swedish authorities and courts, generally exceed the level required by customary international law.

The Swedish system contains the possibility of requesting a higher court to quash a grossly⁴⁸ erroneous decision.⁴⁹ In addition, investors in Sweden claiming damages from the state corresponding to the value of the loss have a chance to be awarded such damages, if there has been a manifest error in judgement.⁵⁰ However, to be awarded damages for incorrect legal treatment, there is no requirement for the handling to have been grossly erroneous. Paragraph 2(b) is an additional example where CETA does not provide a higher level of protection than what is already provided by Swedish legislation, and the state's "right to regulate" is therefore unaffected by the paragraph.

The US Model BIT contains similar provisions to CETA in regard to "due process".⁵¹

2(c) Manifest arbitrariness;

⁴⁵ Dolzer, Rudolf and Schreuer, Christoph. (2012). "*Principles of International Investment Law*" p. 182

⁴⁶ Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States, decision of October 1999, ICSID CASE No. ARB(AF)/97/2

⁴⁷ The Swedish Freedom of the Press Ordinance, and the Public Access to Information and Secrecy Act (2009:400)

⁴⁸ It is of course also possible in Sweden to appeal decisions that are not grossly erroneous, but this is irrelevant in a comparison to CETA.

⁴⁹ In addition, there is the possibility of utilising the extraordinary legal measure of petitioning for a new trial, in accordance with Section 37b of the Swedish Administrative Court Procedure Act (1971:291) "A new trial may be granted in a case or matter if, due to particular circumstances, there are extraordinary reasons to review the matter." There is, however, no requirement for altered circumstances specified in CETA, which is the principal condition for being granted a new trial in Sweden.

⁵⁰ Such damages could be based on Chapter 3, Section 2 of the Swedish Tort Liability Act (1972:207), or on Article 6 of the ECHR, unless the right to compensation is specifically regulated in a different act.

⁵¹ Article 5(2)a of the US Model BIT 2012.

This paragraph deals with protection against manifestly arbitrary treatment. According to the jurisprudence, the article on “fair and equitable treatment” contains protection against arbitrary treatment even when it is not explicitly specified in the agreement text. However, in CETA, the parties still chose to limit the possibilities of bringing a state before an arbitration tribunal on these grounds by adding the “manifest” prerequisite. The wording of CETA leads to the state being prohibited from treating investors with in a manner of “manifest arbitrariness”, if this in turn leads to the reduction or destruction of the investment value.

In Sweden, investors are protected from arbitrary conduct by Swedish authorities through the Instrument of Government, which guarantees freedom of trade.⁵² Furthermore, the principle of legality outlined in the Instrument of Government requires that all public authorities have legal grounds for their decisions, and the objectivity principle ensures the public authorities' obligation to consider everyone's equality before the law.⁵³ However, in Sweden, the authorities'/state's treatment is not required to be *manifestly* arbitrary in order to constitute a violation of constitutional law. The Board therefore finds that paragraph 2(c) will most likely not lead to a more far-reaching protection than provided by Swedish law.

No corresponding paragraph is explicitly included in the US Model BIT, but can be found in the jurisprudence.

2(d) Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;

Paragraph 2(d) protects the investor against *targeted* discrimination on *manifestly wrongful grounds*. The examples of discrimination mentioned in the paragraph do not constitute an exhaustive list, as they are preceded by the phrase “such as”. For the investor to win a dispute the discrimination must have resulted in the reduction or destruction of the value of the investment. However, this is not explicitly expressed in agreement text as the articles are traditionally worded, but it is still included in IIAs due to established jurisprudence. Compare for example the model BITs of the USA and Sweden.

The prerequisites “targeted” and “manifest” are additions to what has traditionally been included under “fair and equitable treatment” in older agreements. These prerequisites have been added to raise the bar for which type of discrimination may lead to liability in case of a dispute.

The grounds for discrimination listed in 2(d) are also included in Swedish law. However, the latter does not require the discrimination to be targeted

⁵² Chapter 2, Section 17 of the Instrument of Government.

⁵³ Chapter 1, Sections 1 and 9 of the Instrument of Government.

and committed on manifestly wrongful grounds in order to constitute a violation of the law.⁵⁴ Article 14 of the ECHR also provides protection against discrimination. All in all, paragraph 2(d) most likely will not lead to more far-reaching protection than provided by Swedish law, including the ECHR, and in all likelihood, paragraph 2(d) will thus have no effect on Sweden's “right to regulate”.

Since protection against discrimination is included in the US Model BIT through jurisprudence, it is not unlikely that TTIP may come to include a clarification that discrimination may constitute a breach of the article on “fair and equitable treatment”. Just as in paragraph 2(c) above, the question of what position the USA will take on the introduction of relatively high-set prerequisites, such as “manifest”, remains open.

2(e) Abusive treatment of investors, such as coercion, duress and harassment; or

Paragraph 2(e) is intended to protect investors or investments from coercion or harassment by the state, or from the state not protecting them from such treatment.⁵⁵ This protection is normally only included in the notion of “fair and equitable treatment” via jurisprudence.

Coercion and harassment by individual officials constitutes professional misconduct in Sweden, even if such actions are sanctioned by authority or government representatives.⁵⁶ In accordance with the Swedish Penal Code, gross professional misconduct can result in up to six years' imprisonment.⁵⁷ If such treatment by an official results in property loss for an investor, it is possible to sue the state for damages, pursuant to the Swedish Tort Liability Act. Article 3 of the ECHR may also come to be invoked, due to its protection against degrading treatment. All in all, paragraph 2(e) will most likely not lead to any protection more far-reaching than that provided by Swedish law, and thus it does not affect Sweden's “right to regulate”.

In the US Model BIT, the protection against coercion and harassment is not explicitly specified, but it is still applied in the jurisprudence.

⁵⁴ It is most likely easier to be awarded compensation pursuant to Chapter 5, Section 1 of the Swedish Discrimination Act than pursuant to Article 9(2)d of CETA.

⁵⁵ The type of coercion and harassment that is referred to is illustrated by *Pope & Talbot v. The Government of Canada*, decision of 10 April 2001; *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, decision of 29 May 2003; *Total S.A. v. The Argentine Republic*, decision of 27 December 2010; and finally *Desert Line Projects LLC v. The Republic of Yemen*, decision of 8 February 2008.

⁵⁶ In cases where the harassment is inflicted through legislation, the situation becomes more complicated.

⁵⁷ Chapter 20, Section 1 of the Swedish Penal Code (1962:700).

2(f) A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.

3. The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The Committee on Services and Investment may develop recommendations in this regard and submit them to the Trade Committee for decision.

Paragraph 2(f), together with the following paragraph 3, opens up the possibility for the EU and Canada to – if they reach an agreement in this regard – add items to the list under paragraph 2(a–f) applying to the contents of the article on “fair and equitable treatment”. The benefit of an exhaustive list, as the one provided in CETA (as opposed to an illustrative list) is clarity and predictability. The downside is a risk of the list leaving something out that the parties failed to consider when entering the agreement, and which therefore falls outside the protection of the agreement. Paragraph 3 constitutes a compromise between a fully exhaustive list and an illustrative list.⁵⁸

4. When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party 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.

A common interpretation of what may constitute “legitimate expectations” for an investor is that they shall be based on the state's existing laws and regulations⁵⁹ (as they were when the investment was made), as well as any implicit or explicit commitments made by the host country to attract an investment. In the US Model BIT, as in the Swedish BITs, there is no explicit mention of the article on “fair and equitable treatment” providing protection by means of “legitimate expectations”. However, through jurisprudence, the article has been given this type of content. If a state treats a company in a way that violates the company's “legitimate expectations”, and this treatment leads to the loss or devaluation of the investment, this can lead to the state being found liable in a dispute. What constitutes “legitimate expectations” has been the core issue in a number of different investment disputes⁶⁰ and certain

⁵⁸ Amending the treaty requires a new ratification procedure. However, an amendment to paragraph 2 can be made by the investment group consisting of the EU and Canada. In order for this group to make an amendment, it must be given permission to do so through a Council decision.

⁵⁹ Bearing in mind the Police Power doctrine.

⁶⁰ See, for example, *National Grid plc v. The Argentine Republic*, decision of 3 November 2008; *S.D. Myers, Inc. v. Government of Canada*, partial award of 21 October 2002; *Marvin Roy Feldman Karpa v. United Mexican States*, decision of 16 December 2002; *Mondev International Ltd. v. United States of America*, decision of 12 October 2002; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, decision of 1 July 2004; *CMS Gas Transmission Company v. The Republic of Argentina*, decision of 12 May 2005; *Eureko B.V. v. Republic of Poland*, decision of 19 August 2005.

interpretations are responsible for much of the criticism against ISDS in general and against the article on “fair and equitable treatment” in particular.

What to include in the article on “legitimate expectations” can be defined in the agreement text (as in CETA) or be an implicit part of the article through the jurisprudence (as in the US Model BIT). “Legitimate expectations” have traditionally been a stand-alone segment of the article on “fair and equitable treatment”. This has meant that the states' actions, regardless of area, could create a “legitimate expectation” in investors, which in turn has led to an investment dispute and by extension to the state becoming liable for damages. The parties to CETA have dealt with this.

In CETA, the parties have chosen to significantly limit which areas are included in “legitimate expectations”, in that only the items on the list specifying the article's scope are covered, i.e. paragraph 2(a–f). Through the formulation “When applying the above...” in the latter paragraph 4, the parties have ensured that “legitimate expectations” do not constitute independent grounds for protection under the article on “fair and equitable treatment”. Instead, the investor's possible “legitimate expectations” shall be weighed into the assessment of whether a violation of paragraph 2(a–f) has been committed. This means that, should the investor cite a violation against one of the items in paragraph 2(a–f), and should an arbitration tribunal deem that it is a borderline case, then the tribunal shall also consider whether the investor has had “legitimate expectations” regarding the item in question. If the tribunal finds that the investor has indeed had “legitimate expectations”, the requirements regarding what constitutes a violation of one of the items in paragraph 2(a–f) are lowered somewhat. Against the background of how the article has been worded, a relaxation of the requirements should however only marginally affect the overall assessment.

CETA also limits what may be considered “legitimate expectations” in that such expectations can only be based on active actions from the state (“specific representation”). The scope of what is included in “legitimate expectations” is thereby significantly limited, which allows the states to retain the greater part of their “right to regulate”. To our knowledge, there is no corresponding limitation in other IIAs. When weighing the need for a clear “right to regulate” against the need to maintain a high level of protection, the parties of CETA have thus chosen to emphasise the former.

The limitation of “legitimate expectations” made in paragraph 4 of the article on “fair and equitable treatment” is so significant, in comparison to jurisprudence, that the paragraph does not entail any more far-reaching

protection for investors than what is already provided by Swedish legislation. This means that if the jurisprudence develops in accordance with this analysis, the part of the article on “fair and equitable treatment” that has been considered so problematic in the debate will be fully neutralised.

As mentioned above, reference to “legitimate expectations” is not explicitly made in the US Model BIT, and the agreements differ in this regard. However, this does not mean that “legitimate expectations” are excluded from the US Model BIT; on the contrary, it is included in the jurisprudence, where it has – for obvious reasons – not been limited as in CETA.

5. For greater certainty, ‘full protection and security’ refers to the Party’s obligations relating to physical security of investors and covered investments.

See the comment on paragraph 1 above.

6. For greater certainty, a breach of another provision of this Agreement, or of a separate international Agreement, does not establish that there has been a breach of this Article.

Paragraph 6 is a standard formulation to ensure that violations against other articles in the IIA or against other agreements do not automatically entail a breach of the article on “fair and equitable treatment”.⁶¹

4.3 Summary

The above analysis shows that the article on “fair and equitable treatment” in CETA consists of elements already found in Swedish law, and in several cases they are found in Swedish constitutional law. The article on “fair and equitable treatment” is a guarantee for the exercise of public authority and the conduct of court proceedings to maintain a certain quality and for the state not to subject investors to manifestly arbitrary treatment or targeted discrimination. What the article does *not* do, is provide “legal protection”, meaning that the state does not commit to placing legislation that is crucial to investment on hold. Furthermore, the concept of “legitimate expectations” has been so watered-down that it does not provide any more far-reaching protection than Swedish law. Nor does the article as a whole entail more far-reaching protection than provided by Swedish law.

As has been reported above, the article on “fair and equitable treatment” in CETA reflects the Swedish law to a significant degree, as it includes the right to a fair trial, protection against discrimination, protection

⁶¹ Corresponds to Article 5(3) in the US Model BIT 2012. The background for the paragraph is that some tribunals have extended the protection given by the article “fair and equitable treatment” to apply to breaches of other articles in the same agreement.

against arbitrary treatment, etc. As long as Sweden maintains these laws of fundamental societal importance, and provided that the state adheres to them, the article on “fair and equitable treatment” in CETA constitutes no limitation of the Swedish “right to regulate”.

In the US Model BIT, the article on “fair and equitable treatment” lacks an exhaustive list indicating what falls within the scope of the article, as is the case in paragraph 2(a–f) in CETA. Despite this, all of these points have been covered by established jurisprudence, and they are thereby already a part of the US Model BIT. A central part of the negotiations on TTIP will most likely be the question of whether a possible list in the article on “fair and equitable treatment” shall be exhaustive or illustrative.

5 The expropriation article in CETA

Summary of section 5

In section 5, the expropriation article in CETA is compared to Swedish legislation, including the ECHR. The comparison shows that, especially when it comes to indirect expropriation, CETA provides a somewhat higher level of protection than does Swedish law.

Through the ECHR, which is incorporated in Swedish legislation and therefore directly applicable in Sweden, investors have a certain protection against indirect expropriation. This means that the effect of CETA – and a future investment chapter in TTIP – on Sweden's already pre-existing “right to regulate” is smaller than what it would appear at first glance.

For indirect expropriation to result in the state becoming liable for damages pursuant to CETA, the investor will either have to have lost control of the investment, or the investment must have become more or less worthless.

The respective expropriation articles and their explanatory annexes in CETA and the US Model BIT are relatively similar.

5.1 Expropriation and the “right to regulate”

The importance of protection against expropriation is illustrated by the right to property being classified as a human right⁶² which is also

⁶² This is admittedly one of the more controversial parts of the ECHR. Several states have chosen not to ratify this annex.

protected by the Swedish constitutional law.⁶³ In customary international law, property consists of both physical property and intellectual property rights, but can also consist of market shares, etc.⁶⁴ The problem with the expropriation article in an IIA is finding the limit between what constitutes legitimate government control and what is unlawful interference in the right to property.

This article of an IIA is not about prohibiting expropriation, but about *how* to carry out a possible expropriation and what happens if this is not done correctly. The article does not deal with the protection of property, but only with the right to compensation in the event of an expropriation.⁶⁵ In this context, the article's possible influence on the state's "right to regulate" is thus limited to when and how it is possible to legislate or make decisions leading to the expropriation of an investment *without* the state becoming liable for damages.

5.2 Article X.11 in CETA: Expropriation

To provide an overview of the expropriation article prior to further analysis, box 2 below contains the full article (Article X.11) as worded in CETA.⁶⁶

Box 2, Article X.11 in CETA

1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation"), except:
 - (a) for a public purpose;
 - (b) under due process of law;
 - (c) in a non-discriminatory manner; and
 - (d) against payment of prompt, adequate and effective compensation.
 For greater certainty, this paragraph shall be interpreted in accordance with Annex X.9.1 on the clarification of expropriation.
2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible determine fair market value.
3. The compensation shall also include interest at a normal commercial rate from the date of expropriation until the date of payment and shall, in order to be effective for the investor, be paid and made transferable, without delay, to the country designated by the investor and in the currency of the country of

⁶³ Protocol 1, Article 1 of the ECHR and Chapter 2, Section 15 of the Instrument of Government.

⁶⁴ OECD Working Papers on International Investment 2004/04 "*Indirect Expropriation' and the 'Right to regulate' in International Investment Law*", p. 3ff.

⁶⁵ Many treaties allow arbitration tribunals to order states to return property, but if the state so wishes, it can choose to pay out compensation instead.

⁶⁶ Page 159 in CETA.

which the investor is a national or in any freely convertible currency accepted by the investor.

4. The investor affected shall have a right, under the law of the expropriating Party, to prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party, in accordance with the principles set out in this Article.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ('TRIPS Agreement').

6. For greater certainty, the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS and Chapter X (Intellectual Property) of this Agreement, do not constitute expropriation. Moreover, a determination that these actions are inconsistent with the TRIPS Agreement or Chapter X (Intellectual Property) of this Agreement does not establish that there has been an expropriation.

5.2.1 Analysis of the expropriation article in CETA

In CETA, the parties have chosen to include an explanatory annex (X.11, see below), which applies as part of the agreement. The explanatory annex deals more or less exclusively with what is to be considered in the assessment of what constitutes indirect expropriation (such as the purpose of the measure). Below, we analyse the expropriation article (Article X.11) and the annex (annex X.11) in CETA, and we then compare them to the US Model BIT and Swedish legislation, including the ECHR.

1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as “expropriation”), except:

- (a) for a public purpose;*
- (b) under due process of law;*
- (c) in a non-discriminatory manner; and*
- (d) against payment of prompt, adequate and effective compensation.*

For greater certainty, this paragraph shall be interpreted in accordance with Annex X.11 on the clarification of expropriation.

The exceptions listed in 1(a–d) are part of customary international law, and corresponding text is found in most IIAs, as well as in the US Model BIT.⁶⁷ This paragraph regulates the conditions for a state to carry out an expropriation without violating the treaty, i.e. if it is done in the public interest, if it is correctly implemented⁶⁸, if it is non-discriminatory and if

⁶⁷ Article 6(1) US Model BIT 2012 is more explicit than the corresponding article in CETA, but “due process of law” is limited through the reference to “minimum standard of treatment”, which aims to reduce the level of protection.

⁶⁸ For a closer definition of “due process” see article 2(b) in section 4.2.1 above.

it is done in exchange for immediate compensation.⁶⁹ The appropriate level of compensation (“adequate and effective”) is elaborated in the subsequent paragraph.

Not all cases of expropriation entail entitlement to compensation. Whether the state is obligated to pay compensation is determined on a case-to-case basis; however, in the jurisprudence, great emphasis has been placed on whether the measure is non-discriminatory, proportional, if it promotes a legitimate purpose and to which extent it affects the right to property.

Direct expropriation

Direct expropriation can be equated to nationalisation, and entails the seizure of private property by the state. In national legislation, direct expropriation is generally well-regulated, and the possibility for compensation in direct expropriation is nearly the same in CETA as it is under Swedish legislation, which means that the investor is entitled to market value compensation.⁷⁰ When comparing what is covered by CETA and by Swedish legislation, consideration must be paid to any incidence of differences in what constitutes expropriation in accordance with Swedish law and what is considered direct expropriation according to customary international law. For this reason, CETA may in some cases offer protection more far-reaching than Swedish legislation.

Indirect expropriation in Swedish legislation and the ECHR

Along with the article on “fair and equitable treatment”, the article on indirect expropriation is the part of an IIA that is most often criticised. An example of indirect expropriation may be when a permit necessary for the production of a product or service is revoked. It may also be a government initiative results in the value of the investment being maintained, but the investor losing control of the investment.

As mentioned above, annex X.11 to the investment part of CETA provides details on how to interpret the article concerning indirect expropriation (Article X.11). An analysis of what protection level for

⁶⁹ The Hull formula: “prompt, adequate and effective” has been featured in international law since the 1930s.

⁷⁰ Direct expropriation is regulated in Sweden through Chapter 2, Section 18 of the Instrument of Government (RF) and by the Swedish Expropriation Act (1972:719). Chapter 4, Section 1 of the Expropriation Act states that compensation shall be equivalent to the market value of the expropriated object. Most countries have similar legislation. However, the Swedish law does not guarantee full compensation, as the provision in RF does not guarantee the compensation of “expectation values”. See Bengtsson Bertil, (2007) *Speciell fastighetsrätt, Miljöbalken* (Specialised property law, Environmental Code), ninth edition, Iustus Förlag AB, p. 111 and 127f.

indirect expropriation is obtained through the treaty, and its possible effect on the state's "right to regulate" is therefore further developed in conjunction to the analysis of the annex (in section 5.3 below). This section goes further into how the right to compensation in the event of indirect expropriation is regulated in Swedish legislation, including the ECHR.

In 2014, the Swedish Supreme Court clarified that it is in practice possible to successfully sue the Swedish state in the direct basis of Chapter 2, Section 15 of the Instrument of Government (RF), which pertains to property protection.⁷¹ The case in question related to the possibility of compensation for restrictions on the right of disposition of land or buildings. As there is a possibility to sue the state with reference to Chapter 2, Section 15 of RF, there is a possibility that compensation will be paid for indirect expropriation. However, the extent of this right to compensation remains unclear.

In addition, Swedish investors have a certain amount of protection against indirect expropriation through the ECHR, which is directly applicable in Sweden.⁷² The European Court of Human Rights (hereafter ECtHR) has found that the Convention protects contract rights, company shares, company goodwill, fishing rights, patents and building permits, among other things.⁷³ Withdrawals of licences to serve alcohol are also subject to the convention, as illustrated by the dispute *Tre Traktörer Aktiebolag v. Sweden*.⁷⁴

In accordance with the Instrument of Government, no Swedish legislation or other regulation may be adopted in violation of the ECHR.⁷⁵ Since the ECtHR's interpretation of the convention sets a precedence also for domestic courts and authorities, Swedish laws or decisions may retrospectively be deemed to be in breach of the convention, even if the Riksdag or the adopting authority has not made this assessment when adopting the law or making the decision in question.

⁷¹ P.D et al. v. the Swedish State represented by the Office of the Chancellor of Justice, judgement by the Supreme Court (case no. T 5628-12) of 23 April 2014. The judgement shows that if the measure is motivated by health or environmental protection or for safety reasons, the Swedish state is as a main rule not liable for compensation, unless it is unreasonable for the individual to take on the full cost. The assessment shall include the expectations the individual had at the time of procuring the property. In the aforementioned judgement, the court found that the state was liable for compensation due to the estoppel principle.

⁷² The Act (1994:1219) on the European Convention for the Protection of Human Rights and Fundamental Freedoms establishes that the convention is applicable as Swedish law.

⁷³ Escarcena, Sebastián L. (2014), "*Indirect Expropriation in International Law*", p. 18.

⁷⁴ Eur. Court HR, Series A No. 159, Judgment, 7 July 1989

⁷⁵ Chapter 2, Section 19 of the Instrument of Government.

One example where Sweden has been found to be in breach of the ECHR is the case of *Sporrong and Lönnroth v. Sweden*⁷⁶, in which the ECtHR found that Sweden was guilty of indirect expropriation, as the state had not sufficiently considered the interests of the private individuals over the years and had failed to pay out compensation.⁷⁷ In accordance with ECtHR case law however, investors are only guaranteed damages which are "...reasonably related with the property taken."⁷⁸ The investor is thus not guaranteed full compensation, pursuant to the ECHR, but only the level of compensation that is deemed reasonable in relation to the expropriated property. This is a slightly smaller right to compensation compared to the expropriation article in CETA.

Swedish law may also contain special legislation, which further reduces the gap between the protection afforded by Swedish constitutional law and the protection afforded by CETA. The Act on Nuclear Power Phase-Out (1997:1320), for example, afforded the right to compensation from the state for indirect expropriation at the time that the right to operate the reactor at Barsebäck expired.⁷⁹ The compensation was provided in accordance with the principles of expropriation law.⁸⁰

Through Swedish law and the ECHR, investors in Sweden have a certain level of protection against indirect expropriation. The Swedish state must therefore already today consider whether a law or a decision could constitute indirect expropriation and thereby a breach of the ECHR. Just as through the investment section in CETA, the state can become liable for damages if a measure in practice leads to indirect expropriation of an investment. For this reason, the text in CETA that relates to indirect expropriation does not automatically have a negative impact on Sweden's "right to regulate".

2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

⁷⁶ The dispute *Sporrong and Lönnroth v. Sweden* (case no. 7151/75, judgement of 23 September 1982 in ECtHR) concerned long-term expropriation permits (23 and 8 years respectively), which gave the municipality the right to expropriate the properties in the future, should the municipality wish to do so. *Sporrong and Lönnroth* argued that this made it impossible to sell the properties. Another example is the case of *Hellborg v. Sweden*, judgement of 28 February 2006, in which it was found that the failure to implement a preliminary notice for a building permit constituted an Article 1 violation.

⁷⁷ OECD Working Papers on International Investment 2004/04 "*Indirect Expropriation and the 'Right to regulate' in International Investment Law*", p. 13 and p. 18.

⁷⁸ Escarcena, Sebastián L. (2014), "*Indirect Expropriation in International Law*", p. 2.

⁷⁹ As the matter of compensation has now been settled, the act has been repealed.

⁸⁰ For more information on how compensation was regulated at the decommissioning of Barsebäck, see Govt. bill 1999/2000:63.

Paragraph 2 and 3 deal with how to calculate the value of an investment. The level of compensation determines how expensive it will be for the state to violate the treaty. The corresponding paragraph in the US Model BIT is paragraph 6(2), and it is unlikely that the USA will object to a similar formulation in TTIP.

As stated in paragraph 2, compensation shall correspond to the market value of the investment immediately prior to when the expropriation became known.⁸¹ The paragraph also provides certain guidance on how to calculate that value.⁸² Considering the unclear jurisprudence when it comes to evaluating an investment⁸³, it would be desirable to have more detailed instructions for how to secure a greater level of predictability.⁸⁴ Above all, there should be regulations on whether, and if so how, compensation for loss of profit is to be calculated.⁸⁵ The level of compensation is currently regulated by customary international law, which leads to a certain level of insecurity. Direct regulation in the treaty increases predictability when it comes to the level of compensation for violations of the expropriation article.⁸⁶

3. The compensation shall also include interest at a normal commercial rate from the date of expropriation until the date of payment and shall, in order to be effective for the investor, be paid and made transferable, without delay, to the country designated by the investor and in the currency of the country of which the investor is a national or in any freely convertible currency accepted by the investor.

In accordance with paragraph 3, an investor is entitled to interest on any damages that an arbitration tribunal may award. One of the reasons for this is that a dispute may continue for several years.

⁸¹ This corresponds to the fundamental tort law principle of *restitutio in integrum* (restoration to the original or pre-contractual position), which means that damages shall compensate a loss.

⁸² The most common manner of calculating the value of an investment is to use the methods discounted cash flow and estimated future cash flows. Dolzer, Rudolf and Schreuer, Christoph (2012). “*Principles of International Investment Law*” p. 297.

⁸³ For example *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*, decision of 16 December 2003; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, decision of 25 May 2004, *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, decision of 2 October 2006, and *Siemens A.G. v. The Argentine Republic*, decision of 6 February 2007.

⁸⁴ However, the jurisprudence provides more guidance than the Swedish agreements, which do not regulate how the evaluation is to be conducted. Nor is there a description in Swedish constitutional law of how the calculation is to be done or which level of compensation is to be paid out in the event of expropriation. It only states that compensation shall be paid on the grounds established in law, which provides no guarantee that the loss will be fully compensated.

⁸⁵ Also see Article X.36 “Final award” in CETA.

⁸⁶ The dispute *Chorzów Factory (Claim for Indemnity) (Merits), Germany v. Poland*, P.C.I.J. Series A., No. 17 (1928) is often referred to when deciding the level of compensation payable, as it establishes that the compensation shall be such that it erases the negative consequences incurred by the investor as a result of the measure. See, e.g., *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16 paragraph 479ff.

What constitutes “normal commercial rate” is not entirely clear in CETA; why it would be desirable to have clarification in this respect. It would, for example, be preferable if the treaty directly provided clarification as to whether the amount is subject to flat-rate interest or compound interest. In later years, the use of compound interest has become increasingly common.⁸⁷ Since the financial difference between flat-rate interest and compound interest can be substantial when the dispute has lasted a few years, it should be determined in the treaty what type of interest rate shall be applied. Based on the unclear jurisprudence, the interest can differ from what it would have been when a private individual obtains compensation from the Swedish government.⁸⁸

4. The investor affected shall have a right, under the law of the expropriating Party, to prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party, in accordance with the principles set out in this Article.

Paragraph 4 ensures the investor's right to have their claim examined and have the investment valued by a court of law or independent valuating body.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ('TRIPS Agreement').

See comment to paragraph 6 below.

6. For greater certainty, the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS and Chapter X (Intellectual Property) of this Agreement do not constitute expropriation. Moreover, a determination that these actions are inconsistent with the TRIPS Agreement or Chapter X (Intellectual Property) of this Agreement does not establish that there has been an expropriation.

Paragraphs 5 and 6 concern the relationship between CETA and the TRIPS treaty in WTO, which regulates intellectual property rights.⁸⁹ Paragraph 6 clarifies that the treaty cannot be used to challenge measures taken in accordance with TRIPS. The US Model BIT contains similar exceptions.⁹⁰

5.3 Explanatory Annex X.11: Expropriation

As previously mentioned, CETA contains an explanatory annex⁹¹ (annex

⁸⁷ Dolzer, Rudolf and Schreuer, Christoph. (2012). “*Principles of International Investment Law*” p. 298.

⁸⁸ See Section 4 of the Swedish Interest Act (1975:635).

⁸⁹ The full title of the TRIPS agreement is *Agreement on Trade-Related Aspects of Intellectual Property Rights* in Annex 1C of the WTO agreement.

⁹⁰ US Model BIT 2012, Article 6(5).

⁹¹ Page 184 in CETA.

X.11), which is applicable as part of the treaty and primarily intended to define what constitutes indirect expropriation. To provide an overview box 3 below contains the full annex as it is worded in CETA.

Box 3, Annex X.11 on how to interpret Article X.11

The Parties confirm their shared understanding that:

1. Expropriation may be either direct or indirect:
 - a) direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and
 - b) indirect expropriation occurs where a measure or series of measures by a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.
2. The determination of whether a measure or series of measures by a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-base series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
 - a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
 - b) the duration of the measure or series of measures by a Party;
 - c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and
 - d) the character of the measure or series of measures, notably their object, context and intent.
3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

5.3.1 Analysis of Annex X.11

The analysis of Annex X.11 is conducted in order to identify the way in which the article could affect Sweden's "right to regulate", but also in order to identify similarities to the US Model BIT, which also contains an explanatory annex on indirect expropriation.⁹²

The Parties confirm their shared understanding that:

1. *Expropriation may be either direct or indirect:*

⁹² US Model BIT 2012, annex B.

- (a) *direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and*
- (b) *indirect expropriation occurs where a measure or series of measures of a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.*

According to the wording of the annex, an indirect expropriation is a measure that has an effect equivalent to direct expropriation. The assessment of whether this is the case, is entirely essential for Article X.11, and is settled by determining whether the effect “...substantially deprives the investor of the fundamental attributes of property...” The concept of “fundamental attributes of property” most likely refers to the investor's possibility of utilising the “benefits and revenues of the investment”.⁹³ “Benefits and revenues” include being able to withdraw profits and being able to lease or sell the investment.⁹⁴ By extension, these are characteristics that influence the “value” of the investment, which is the term used here. When determining whether an expropriation has occurred, consideration must also be given to whether the investor has lost control of the investment. Scholars disagree about the extent to which the text of the annex opens up a possibility to read in other characteristics, in addition to value and control. This question will have to be answered by future jurisprudence. However, if the Parties to the agreement should find that the jurisprudence is contrary to the paragraph’s intended purpose, they have the option of jointly deciding on a binding interpretation for the future.⁹⁵

According to jurisprudence, an indirect expropriation occurs if the value of an investment has been “substantially” diminished. The use of the term “substantially” means that the decrease in value must have been very great, and more or less total, for the measure to be considered an indirect expropriation: “[m]ost tribunals seem to agree that expropriation can only occur where diminution in value is very close to 100 per cent.”⁹⁶ Even if the decrease in value is not as drastic, it is an instance of indirect expropriation if control of the investment has been taken away from the investor. According to jurisprudence the assessment of whether an

⁹³ OECD Working Papers on International Investment 2004/04 “*Indirect Expropriation and the ‘Right to regulate’ in International Investment Law*”, p. 15

⁹⁴ The commission also employs the expression “...the right to use, enjoy and dispose of the investment”. Commission Concept Paper (2015) “*Investment in TTIP and beyond – the path for reform*”, p. 6.

⁹⁵ Article X.27 in CETA.

⁹⁶ Happ, Richard and Rubins, Noah. (2009). “*Digest of ICSID awards and decisions 2003–2007*”.

expropriation has occurred must take into consideration whether the measure was proportionate. There must be a reasonable balance between public interests and the investor's interest in keeping their property.⁹⁷ This assessment is based on the facts in the individual dispute and the extensive jurisprudence/case law that is available in terms of proportionality assessments.

It is thus only possible, pursuant to jurisprudence, for an investor to be successful in a dispute on indirect expropriation if the investment has become worthless or nearly worthless, or if the investor has lost control of the investment. Paragraph 1(b) of the annex clarifies that an indirect expropriation occurs when it has an “effect equivalent to direct expropriation...”, which places emphasis on the fact that a diminished value is not alone to be equated with indirect expropriation.

2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:

- (a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;*
- (b) the duration of the measure or series of measures by a Party;*
- (c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and*
- (d) the character of the measure or series of measures, notably their object, context and intent.*

Paragraph 2 of the annex deals with the considerations that an arbitration tribunal shall make when determining whether or not an indirect expropriation has taken place. The arbitration tribunal shall make an overall assessment that includes paragraph 2(a–d), which constitutes a formalisation of what the OECD, as early as in 2004, found to constitute the core of the jurisprudence in regard to the assessment of whether or not an indirect expropriation has taken place.⁹⁸ The paragraph emphasises the importance of basing the assessment on the individual circumstances, stating that the tribunal shall conduct a case-by-case examination. Paragraph 2(a–d) has perhaps most likely been inspired by the US Model BIT, which was given similar content in 2004.⁹⁹

⁹⁷ OECD Working Papers on International Investment 2004/04 “‘Indirect Expropriation’ and the ‘Right to regulate’ in International Investment Law”, p. 17f.

⁹⁸ OECD Working Papers on International Investment 2004/04 “‘Indirect Expropriation’ and the ‘Right to regulate’ in International Investment Law”, p. 10ff.

⁹⁹ The US Model BIT, Annex B, paragraph 4(a).

Paragraph 2(a) is intended as an aid for interpreting paragraph 1(b). The “adverse effect” of a measure on the economic value of an investment alone does not mean that the measure is to be considered an expropriation. The intention here is most likely to codify and clarify the jurisprudence regarding “substantially” (see paragraph 1(b) above). Paragraph 2(a) thus means that if a state only diminishes the value of an investment, it does not in and of itself constitute an indirect expropriation, unless the value is reduced to zero or near zero (and if the exceptions in paragraph 3 below do not apply).¹⁰⁰ In addition, the paragraph emphasises that the doctrine of “the sole effect” is not applicable, which is further developed below, in paragraph 2(d). It is possible that the parties to CETA found the inspiration for paragraph 2(a) in the US Model BIT, which contains a more or less identical paragraph.¹⁰¹

Paragraph 2(b) also constitutes a codification of the current jurisprudence and clarifies that the length of the measure plays a role in the assessment. A ban or a confiscation during a shorter period means that the measure is *not* to be considered an indirect expropriation.¹⁰²

The paragraph 2(c) is a codification of jurisprudence, which establishes that consideration shall be given to whether the measure matched the investor's expectations. The investor's expectation shall be both clear and reasonable. The fact that the expectation must be reasonable means, among other things, that the investor must count on certain normal legal changes.¹⁰³ This type of expectation cannot lead to the state becoming liable for damages. The burden of proof, with regard to the investment being based on an expectation that was not met, lies with the investor. This paragraph can also be found in the US Model BIT.¹⁰⁴

Paragraph 2(d), which is also part of the US Model BIT, deals with the character of the measure.¹⁰⁵ Particular emphasis is placed here on “character”, “context” and “intent”. The paragraph is intended to ensure that arbitration tribunals do not utilise the “sole effect doctrine”, only considering the effect of a measure and not its purpose.¹⁰⁶ Stating that

¹⁰⁰ In its interpretation of paragraph 1(b) and 2(a), the Board has consulted PhD students Güneş Ünüvar and Love Rönnelid from the respective faculties of law at the University of Copenhagen and Uppsala University.

¹⁰¹ US Model BIT 2012, annex B, paragraph 4(a)i.

¹⁰² In the dispute *Hauer v. Land Rheinland-Pfalz*, it was established that a ban lasting more than three years did not constitute an expropriation. See OECD Working Papers on International Investment 2004/04 “*Indirect Expropriation*” and the “*Right to regulate*” in *International Investment Law*, p. 14

¹⁰³ Tjetje, Christian et al. (2014) “*The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*” p. 55.

¹⁰⁴ US Model BIT 2012, annex B, paragraph 4(a)ii.

¹⁰⁵ US Model BIT 2012, annex B, paragraph 4(a)iii.

¹⁰⁶ Examples of disputes where the “sole effect doctrine” has been implemented are *Tippets v. Iran* (1984) and *Metalclad Corporation v. The United Mexican States*, decision of 30 August 2000.

character shall be taken into consideration means that emphasis is to be placed on the format of the measure. This should, for example, be proportional to the purpose. The tribunal shall also consider the context in which the measure was implemented. Finally, they shall consider the intention behind the measure. If the purpose of a measure is to make improvements in the public interest, it can mean that the state is not liable for damages, even though the measure as such has an effect that is tantamount to expropriation.¹⁰⁷ All in all, this raises the bar for what constitutes expropriation and allows the state to retain a certain “right to regulate”.

The above is comparable to Swedish legislation on damages for erroneous decisions on expropriation or revoked licences. Unless the law contains special provisions, the general rule¹⁰⁸ is that the injured party must be able to prove that the authority has caused the injury through error or neglect in order to be awarded damages.¹⁰⁹ The Chancellor of Justice has stated that it is not enough for an authority or court to have made an incorrect assessment of a legal or evidentiary matter: only pure omissions of provisions or manifestly incorrect assessments are considered as an error or neglect in the sense referred to in the Swedish Tort Liability Act.¹¹⁰

Jurisprudence relating to IIAs does not contain the requisite of the error being manifest and may instead entail a right to compensation if an erroneous assessment results in the expropriation of an investment. In these cases, CETA affords foreign investors a more extensive protection than what the Swedish legislation does. As customary international law requires the injured party to have suffered “substantial” injury or lost control of the investment, it is unclear how extensive this additional protection is.

3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

Paragraph 3 confirms the principle stated in the introduction on states' “right to regulate”, but is also intended to ensure that states cannot misuse the principles concerning public interest measures.¹¹¹ States shall

¹⁰⁷ OECD Working Papers on International Investment 2004/04 “*Indirect Expropriation and the ‘Right to regulate’ in International Investment Law*”, p. 16.

¹⁰⁸ Chapter 3, Section 2 of the Swedish Tort Liability Act (1972:207).

¹⁰⁹ Indirect damages, i.e. third party damages, are not generally compensated.

¹¹⁰ For more on this subject, see, e.g. the Chancellor of Justice, decision of 27 March 2014, ref. no. 6727- 12-40 regarding Custodia.

¹¹¹ According to Titi, Aikaterini (2014.) “The Right to Regulate in International Investment Law” p. 153, the version of CETA of 7 February 2013 is differently

not be able to take or destroy any investment they choose (without compensation) with the motivation that it is done in the public interest. For this reason, a measure that is manifestly exaggerated, and which results in a direct or indirect expropriation, would constitute a violation of CETA even if its stated purpose was in the public interest. In other words, a state is entitled to take measures in the public interest without that measure being considered an expropriation, as long as it does not appear to be manifestly exaggerated or discriminatory. The parties of CETA have most likely found inspiration also for this paragraph in the US Model BIT, which includes exceptions for public interest measures in the explanatory annex to the article on expropriation.¹¹² It is not unlikely that a similar paragraph will be included in TTIP.

5.3.2 How to implement the expropriation article

In the Swedish debate, there is a discussion about the possibility of TTIP providing American investors the opportunity to win a dispute against Sweden, in the event of a future ban on profits in the welfare sector. The outcome of a dispute is of course dependent on how such a ban would be worded and on how the actual treaty is designed.¹¹³ In the following, the considerations which an arbitration tribunal should make in the application of the expropriation article in CETA will be examined.

It should initially be established whether the ban on profits has had an effect on the investment which is equivalent to indirect expropriation. When making this assessment, two questions should be asked:

- Has the measure led to the value of the investment dropping to zero or close to zero?
- Has the measure denied the investor control of the investment?

When determining these matters, the arbitration tribunal shall consider the following factors:

- Is the measure set to last, i.e., not to be considered short-term?

constructed and the paragraph is based on the state's actions having to be proportional and non-discriminatory. This would also correspond better with ECtHR case law. It is therefore possible that the EU would wish to see similar wording in the article in TTIP.

¹¹² US Model BIT 2012, Annex B.4(a)b.

¹¹³ The analysis showed that “fair and equitable treatment” in CETA led to certain procedural protections, which are already part of Swedish legislation, but other than that, the article affords no additional protection to foreign investors. In case the “fair and equitable treatment” article in TTIP is worded the same way, it would therefore be unlikely to have any impact on a possible future dispute regarding a ban on profits in the welfare sector.

- Could the investor reasonably have expected the measure before the investment was made?
- What is the purpose of the measure?

Even if one or both of the general questions receive a positive answer, the tribunal must consider the above factors, and place special emphasis in the assessment on the investor's expectations and the purpose of the measure. If the tribunal, despite this, still finds that an indirect expropriation has taken place, it must consider in the next step whether the reasons for implementing the measures have a legitimate political purpose. If the answer to this question is “yes”, then the state may avoid damage liability *even if* the measure is equivalent to direct expropriation given that the measure was necessary. The arbitration tribunal shall base their assessments on customary international law.

In case Sweden introduces a profit ceiling instead of a ban, or if the investors were to be compensated in the same way as at the closing of Barsebäck, this would be unlikely to result in the Swedish state being found guilty in a dispute.

5.4 Summary of the expropriation article and the “right to regulate”

The expropriation article in CETA affords a somewhat higher level of protection for investors than Swedish law, as it does not require the state to have made blatant omissions of a provision or a manifestly erroneous assessment. To be found guilty of violating the expropriation article in an investment dispute (direct or indirect expropriation), it is sufficient for the state to have committed an error. However, according to jurisprudence, the investor must show that this error has had such an effect on the investment that it has been rendered worthless, or nearly worthless, or that the investor has lost control of the investment. In addition to the above, the regulation of direct expropriation and compensation in CETA essentially corresponds to Swedish law. In the below section, we therefore focus on the differences that exist in respect of indirect expropriation (for example in reference to the revocation of licences to produce goods or services).

It is difficult to formulate the expropriation article so that it results in predictable interpretations, and both CETA and the US Model BIT therefore have explanatory annexes. A comparison between the two annexes shows that CETA has been inspired by the US Model BIT. The contents of the explanatory annexes are to a great extent a codification of a sometimes divergent practice. The codification leads to a greater predictability in terms of the article's implementation and to the

maintenance of a greater “right to regulate” for the states, as compared to older IIAs.

Swedish law does not provide the same explicit protection as CETA against indirect expropriation. Despite this, there is already a certain level of this type of protection written into the ECHR. It is thus already possible, under certain circumstances, for Sweden to be sued in a Swedish court for infringements relating to indirect expropriation. The article on indirect expropriation in CETA will thus not have such a great real effect on Sweden's existing “right to regulate” as may be assumed at first glance.

In case of a dispute, the arbitration tribunal must consider the fundamental principles relating to the “right to regulate” for legitimate political purposes, which are included in CETA. These are broad principles which guarantee the state a relatively extensive “right to regulate”. Exactly how these principles will be interpreted by arbitration tribunals is a question for the future. In addition, another level of protection for the states' “right to regulate” has been built into CETA, as the Parties to the agreement are allowed to provide arbitration tribunals with binding interpretations of the treaty text. In case a tribunal arrives at an interpretation of the treaty that is not in line with the parties' intentions, they can provide a binding interpretation at a later date, which the tribunals will be obligated to adhere to. NAFTA contains this possibility for binding interpretations, which thus enhances the “right to regulate” compared to Sweden's earlier BITs.

CETA should more clearly explain how to calculate the value of an investment. This because it should be as clear as possible to a state what a future violation of CETA could cost.

An arbitration tribunal's assessment of whether an expropriation violates CETA should consider the “police power” included in the doctrine of customary international law¹¹⁴, which means that the state has a fundamental right to expropriate, with certain restrictions.¹¹⁵ In its verdicts, the ECtHR emphasises that the assessment must take into consideration

¹¹⁴ The revocation of a licence to sell alcohol in Iran after the revolution in 1979 was, for example, not considered to constitute an indirect expropriation, as it was a bona fide (taken in good faith) and non-discriminatory measure OECD Working Papers on International Investment 2004/04 “*Indirect Expropriation*’ and the *Right to regulate*’ in *International Investment Law*”, p. 19.

¹¹⁵ The police power doctrine can be exemplified by the Iran-USA Claims Tribunals: “A State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price...” *Too v. Greater Modesto Insurance Associates* (Award of 29 December 1989), 23 Iran-United States Cl. Trib. Rep. p. 378.

whether an expropriation is conducted in the public interest, and whether it is proportional to its purpose.¹¹⁶

¹¹⁶ Tjetje, Christian. et al. (2014) *“The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership”* p. 50.