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OTTAWA ▪ DECEMBER 2012

The Canada-China Foreign Investment Protection and Promotion Agreement: A Comparative Analysis to Canada's Model FIPA

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Negotiations for a bilateral Foreign Investment Promotion and Protection Agreement ["**FIPA**"] between Canada and China have been ongoing for over a decade. They commenced in 1994, were interrupted pending China's accession to the World Trade Organization ["**WTO**"], and resumed in September 2004. Final talks were held in January 2012 and a Declaration of Intent to conclude negotiations towards a FIPA[2] was signed in February 2012 during Prime Minister Harper's visit to China. The Canada-China FIPA ["**C-C FIPA**" or the "**Agreement**"] was signed on September 9, 2012 in Vladivostok, Russia, on the sidelines of the APEC Leaders' Summit. This agreement represents China's 140th bilateral investment treaty and Canada's 25th. The C-C FIPA was tabled on September 21, 2012 for a 21-day sitting period which expired on November 1, 2012. The next step involves ratification of the Agreement by the Cabinet. Once China has ratified the agreement through its domestic legal procedures, the Agreement will come into force. This could occur as early as December 2012.

A TOOL TO PROTECT INVESTORS' RIGHTS

The main purposes of a FIPA are to establish clear investment rules and measures to protect foreign investors against discriminatory or arbitrary government practices, to provide effective compensation in the event of an expropriation and to enhance the overall predictability of the policy framework governing foreign investments.[3] The existence of a FIPA has proven to be useful in terms of promoting the parties' respective markets as a stable destination for investment with clearly defined and enforceable rules. Foreign investors often look to the existence of a strong investment protection agreement as a key consideration in their decision-making process.

CHINA AND INVESTMENT

China's growth as an economic superpower is significant for global investment and holds particular importance for Canadians.[4] Foreign investment has become an essential corporate strategy for Canadian companies competing in the global economy, allowing them to gain access to foreign markets and acquire new technologies among a panoply of other important benefits.[5] However, the associated risks, including weak legal institutions and uncertain regulatory regimes, must be considered.[6]

China currently ranks as the second largest economy in the world and is the second largest recipient of Foreign Direct Investment ["**FDI**"],[7] receiving US$185 billion in 2010.[8] In terms of outward FDI, China ranks sixth in the world.[9] In 2011, the stock of Canadian FDI in China was valued at nearly CA$4.5 billion.[10] Within that same timeframe, Chinese FDI into Canada was valued at approximately CA$10.9 billion. The

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Canada-China investment numbers have shown an impressive growth trend in the range of roughly 300 percent from 1998 to 2007.[11] In the same period, China-Canada investment numbers showed an increase of about 170 percent.[12] Although the statistics show that inflows of FDI from China are increasing, they remain but a small portion of total FDI inflows to Canada, leaving much potential for expansion.[13] China has recently invested heavily in Canadian resources, buying out Teck Resources, Corriente Resources, and two oil sands properties from Athabasca Oil Sands Corporation.[14] Most recently, the pending acquisition of Nexen Inc. by China National Offshore Oil Corporation (CNOOC Ltd.) for roughly $15.1 billion has received a great deal of public attention. The United Nations Conference on Trade and Development (UNCTAD) Inward FDI Potential Index consistently ranks China as having a high potential for future FDI.[15]

THE CANADIAN MODEL VS. THE C-C FIPA

The C-C FIPA has created a certain amount of debate, including concerns about China's appetite for Canadian resources and the effects of the investor-state provisions on government policy making. The issue of transparency has also been raised in this context. However, perhaps the first step is to review the contents of the Agreement itself and provide some context as to how the text compares to investor-state provisions in Canada's other Free-Trade Agreements (e.g. NAFTA, with its Chapter 11 provisions) and FIPAs.

In 2004, Canada released a new model FIPA [the "**Model**"] to be used as a template in negotiations for bilateral investment agreements, building on the NAFTA Chapter 11 framework. In light of the recent release of the C-C FIPA's text, it is important for Canadian businesses and investors to understand what their respective rights are and how they will be protected under this new agreement. A comparative analysis of the Model and the recent C-C FIPA is useful in this regard. Our analysis will focus on substantive investor elements as follows:

- National Treatment
- Most-Favoured-Nation Treatment
- Minimum Standard of Treatment
- Prohibitions of certain performance requirements
- Provisions governing expropriation

An analysis of the specific investor-state dispute settlement mechanisms in the C-C FIPA is undertaken in Part 2 of this series.

NATIONAL TREATMENT

The national treatment provision ensures that a host state accords to foreign investors and their investments treatment that is "no less favourable" than the best treatment it accords to its domestic investors in "like circumstances". At a minimum, the clause aims to ensure that a party makes no negative differentiation between foreign and national investors when enacting and applying its rules and regulations.[16] This means that a Canadian investor with an investment in China would, in principle, receive the same regulatory advantages their Chinese counterparts enjoy.

As a general principle, awareness of exceptions and "carve outs" is necessary. It is important to note that the C-C FIPA departs from the Model in a significant way with respect to national treatment. Article 6 of the C-C FIPA specifically excludes the terms "establishment" and "acquisition" from its wording. Unlike the Most-Favoured-Nation obligation, which applies both post- and pre-establishment of an investment, the national treatment provision in the C-C FIPA applies only to investments after they come into existence. National treatment is therefore only accorded to investors and covered investments with respect to their "expansion, management, conduct, operation and sale or other disposition…"[17] This omission allows both Parties to preserve their respective right to block new investments in their territory. For instance, Canada will maintain the right to reject proposed investments such as the $15.1 billion Nexen Inc. deal if it is of the opinion that the investment does not represent a "net benefit" for Canada.

The C-C FIPA further restricts national treatment by limiting the application of the concept of "expansion" in Article 6 to "sectors not subject to a prior approval process under the relevant sectoral guidelines and applicable laws, regulations and rules in force at the time of expansion."[18] This preserves the Parties' right to impose certain prescribed formalities and other requirements upon the "expansion" of investments in specified sectors that are subject to a prior approval process.[19] For instance, the C-C FIPA contains an exclusion that "a decision by Canada following a review under the *Investment Canada Act* with respect to whether or not to initially approve an investment that is subject to review; or permit an investment that is subject to national security review shall not be subject to the dispute settlement provisions under the agreement."[20] To obtain approval under the *Investment Canada Act*, investments involving WTO member countries valued at more than $330 million must represent a "net benefit" to Canada. Proposed investments not meeting these criteria can effectively be blocked without being subject to review under the dispute settlement provisions of the C-C FIPA.[21]

MOST-FAVOURED-NATION TREATMENT

Together, the national treatment and most-favoured-nation treatment ["**MFN**"] obligations set out a comparative standard in that they are relative to treatment accorded to other investors and investments. Specifically, Article 5 of the C-C FIPA requires that Canada and China accord investors and covered investments treatment that is "no less favourable" than the treatment accorded, in "like circumstances", to investors and investments of any non-party. The MFN obligation applies to investments at both the pre- and post-establishment stages. Unlike the national treatment provision, MFN applies "…with respect to the establishment, acquisition, expansion, management, conduct, operation and sale…"[22] of investments.

In the context of concerns that have been expressed about Chinese investors "gobbling up" Canadian resources through an aggressive program of acquisitions, the standard of treatment applied to domestic investors is not captured by the C-C FIPA. While Canada retains the right to review prospective investments pursuant to the *Investment Canada Act*, it appears that any pre-establishment advantage given to foreign investors must also be granted to eligible investors under the Agreement. Under both the Model and the C-C FIPA, the MFN obligation is prospective and therefore does not extend to treatment accorded under existing treaties.[23] This is intended to prevent investors from using the clause to "cherry pick" the most favourable selection of rights offered in a foreign government's previous treaties.[24] One notable addition in the C-C FIPA in that respect is the establishment of a fixed date (January 1, 1994) marking the precise point in time before which the MFN obligation will not apply. Interestingly, January 1, 1994 marks the day the North-American Free Trade Agreement ["**NAFTA**"] came into force.

We also note that the Model and the C-C FIPA vary in that the word "treatment" in the latter's MFN provision specifically excludes dispute resolution mechanisms that may be provided for in other international investment treaties or trade agreements. Dispute resolution mechanisms in investment treaties are therefore not subject to the MFN obligation under the C-C FIPA. Nor does the MFN standard apply to "treatment by a Contracting Party pursuant to any existing or future bilateral or multilateral agreement establishing, strengthening or expanding a free trade area or customs union"[25] thus rendering impossible "back-door" access to treatment reserved for parties in agreements like NAFTA.

MINIMUM STANDARD OF TREATMENT

Article 4 of the C-C FIPA calls for a minimum standard of treatment and obliges the Parties to provide covered investments with "fair and equitable treatment and full protection and security, in accordance with international law." This establishes a baseline or floor with an internationally acceptable standard of treatment reflective of the customary international minimum standard and encompassing the concepts of due process and transparency. Article 4 is only slightly different in wording from the Model and includes language that circumscribes its application in a way that makes NAFTA Chapter 11[26] instructive, but may also give Chinese officials some concern with respect to the need to provide adequate transparency and clarity in their decision-making processes.

A breach of the minimum standard of treatment is independent from any other obligation in the Agreement. The following jurisprudence from NAFTA Chapter 11 Tribunals gives further insight into the interpretation of the provision:

- If the State conduct towards a NAFTA investor is found to be arbitrary, grossly unfair, discriminatory, unjust or idiosyncratic, or if it exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety (as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process), such a conduct infringes the minimum standard of treatment. In applying this principle, it is necessary to establish that the investor has reasonably relied on (mis)representations made by the host state.[27] Conversely, the absence of evidence as to any misleading representations made by the host state's officials negates a violation of the standard.[28]
- The conduct will not amount to idiosyncratic, aberrant or arbitrary where domestic content and performance requirements in the challenged governmental policy or decision are common to all three NAFTA Parties.[29]
- The standard does not require that the host state's conduct rise to the level of outrageous, egregious or bad faith.[30]

PROHIBITION OF CERTAIN PERFORMANCE REQUIREMENTS

Article 9 of the C-C FIPA addresses the prohibition of performance requirements. Performance requirements are requirements or obligations which are imposed by a host state through law or regulation as a pre-condition to the establishment and/or maintenance of a foreign investment. These requirements usually require that foreign investors conduct their business in a way that is considered beneficial to the host state's domestic industry. As one might imagine, Canadian investors could be disadvantaged in the context of a competition for investment opportunities based on the need to accommodate the host state's conditions. The Model sets out a list of specific performance requirements that a Party is prohibited from imposing in connection with the investor's investment, including: to export a given level or percentage of goods; to achieve a given level or percentage of domestic content; and to relate the volume or value of imports to the volume or value of exports, or to the amount of foreign exchange inflows associated with the investment, to name a few. Many of these requirements can also be found in the WTO's *Agreement on Trade-Related Investment Measures* ["**TRIMs**"], to which both Canada and China are signatories.

In the Canada-China negotiations, the parties decided to simply reaffirm their obligations under the WTO and to incorporate into the Agreement, Article 2 and the Annex of the TRIMs "as amended from time to time." While this strikes one as a reasonable approach that likely saved negotiating time, it is generally considered that the Model and NAFTA Chapter 11 go well beyond the WTO standard, as reflected in the TRIMs general affirmation (Article 2) and its illustrative list (Annex). For example, the latter does not specifically prohibit technology transfer agreements. For investors who may be affected by performance requirements, there is an added burden of reviewing the WTO rules and the many exceptions and "carve-outs" as well as the uncertainty of a moving target.

PROVISIONS GOVERNING EXPROPRIATION

Just as national laws normally give governments the right to take or expropriate private property, the focus internationally is not to prevent the "taking" of investments or returns, but rather to circumscribe them and provide "prompt, adequate and effective compensation" to investors in the event of expropriation. The expropriation provision in Article 10 of the C-C FIPA prohibits either Party from nationalizing or expropriating covered investments or "returns of investors" and from subjecting them to "measures having an effect equivalent to expropriation or nationalization" except where the measure(s) in question:

- Serve a public purpose;
- Follow principles of domestic due process;
- Are non-discriminatory; and
- Fair market value compensation is provided.[31]

While direct expropriation refers to a direct physical taking of the investment by the host state either through an outright seizure or compulsory transfer of legal title to the government, indirect expropriation refers to government measures that result in "the effective loss of management, use or control, or a significant depreciation of the value of the assets of the foreign investor."[32] In Article 10, indirect expropriation is captured by the phrase "measures having an effect equivalent to expropriation or nationalization." The concept has given rise to certain concerns that foreign investors may attempt to characterize otherwise legitimate government regulations as a form of "indirect expropriation" and consequently, prevent the government from effectively regulating foreign investments in the public interest.[33] However, as in the Model, the Agreement's Annex B.10 sets out an illustrative set of factors that both clarifies and confines the meaning of the term "indirect expropriation". While the final determination is left to a case-by-case review, the Annex does appear to limit the reach of Article 10, particularly with its allowance for measures taken in the interest of health, safety and the environment. In Annex B.10, the C-C FIPA clarifies that the determination of whether a particular measure constitutes an indirect expropriation requires a case-specific fact-based inquiry that considers a list of relevant factors.

In another departure from the Model, the C-C FIPA's expropriation clause includes both "covered investments" and "returns of investors", whereas the Model only speaks to "covered investments". Canada's most recent FIPAs have used both terms in their respective expropriation clauses. This appears to represent a general movement towards a clearer definition of the term expropriation that specifically includes "returns" and therefore affords a broader protection to investors.

Another noteworthy point is that the Model states that compensation is to be based on the value of the expropriated investment on the "date of expropriation", which is the date immediately before the expropriation took place. It further provides that compensation shall not reflect any change in value occurring because the intended expropriation became public knowledge. The C-C FIPA on the other hand, adds a condition to the effect that compensation will either be based on the "date of expropriation", or on the value before the impending expropriation became public knowledge, whichever is earlier. Given the fact that public knowledge of an impending expropriation is likely to negatively affect an investment's value, this new condition represents an important benefit. The Model also speaks to specific valuation criteria for compensation including going concern value and asset value, among others, to determine fair market value. These criteria are not included in C-C FIPA, leaving the determination of fair market value somewhat unclear and unpredictable. This omission seems to be a trend in Canada's most recent FIPAs, whose expropriation provisions are closely in-line with the C-C FIPA.

CONCLUSION

Although differences do exist between the Model and the C-C FIPA, this latest agreement between China and Canada is nonetheless a significant achievement. The C-C FIPA represents the first major economy-wide agreement between Canada and China. Given the protections offered under the Agreement, Canadian businesses will have further impetus to expand their presence in, and partnerships with, China to truly take advantage of the economic possibilities. The Agreement creates a certain degree of security which can only serve to encourage further investment between both countries and help Canadian businesses gain access to the rapidly developing Chinese market. Although it is not a perfect deal for either Party, the C-C FIPA does provide a foundation of rights upon which Canadian investors can rely. Many of these important rights are provided for in the investor-state dispute settlement provisions of the agreement. An analysis of the specific investor-state dispute settlement provisions of the C-C FIPA is undertaken in Part 2 of this series.

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2 *Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments*, C 2012, s 6 <www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=en&view=d>.

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11 Raaj Tiagi, "Canada's Growing Economic Relations with China" (2009) Fraser Institute Studies in Chinese Economic Policy 9.

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14 Michael Hart, "Dragon Fears: China's Impact on Canada-US Trade Relations" (2011) Spring 2011 International LJ.

15 *Ibid.*

16 Rudolf Dolzer & Christoph Schreuer, "Principles of International Investment Law" (2008) Oxford University Press.

17 *Supra* note 1, Article 6.

18 *Ibid.*

19 *Ibid.*

20 *Ibid.* Annex D.34.

21 Investment Canada Act, *An Overview of the Investment Canada Act (FAQs)*, online: Industry Canada <www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html>.

22 *Supra* note 1, Article 5.

23 Andrew Newcombe, "Canada's New Model Foreign Investment Protection Agreement" (2004) University of Victoria Faculty of Law at 4.

24 Luke Eric Peterson, "Evaluating Canada's 2004 Model Foreign Investment Protection Agreement in Light of Civil Society Concerns", Note (2006) CCIC.

25 *Supra* note 1, Article 5.

26 See for example, NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, Part B (Jul. 31, 2001). The FTC Interpretation is binding on the NAFTA Parties by virtue of NAFTA Article 1131(2). This binding character has been confirmed in the post-FTC Interpretation NAFTA case law (see, e.g., *Mondev Int'l, Ltd. V. United States*, ARB(AF)/99/2, Award of 11 October 2002; *ADF Group v. United States*, ARB(AF)/00/1, Final Award of 9 January 2003; *The Loewen Group et al v. United States*, ARB(AF)/98/3, Final Award 26 June 2003; *UPS America v. Canada*, Award on Jurisdiction 22 November 2002).

27 See for example, *Waste Management, Inc. v. Mexico* (Resubmitted Claim; *Waste Management II*), ARB (AF)/00/3, Final Award: 30 April 2004; para. 98.

28 See for example, *ADF Group v. United States*, ARB(AF)/00/1, Final Award of 9 January 2003.

29 *Ibid.* at para. 188.

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