

Canada's New Model Foreign Investment Protection Agreement

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1. Introduction

Canada has released a new model Foreign Investment Protection Agreement (*FIPA*) – the Canadian equivalent of a bilateral investment treaty (*BIT*). The new model FIPA builds on the investment chapter in the North American Free Trade Agreement (*NAFTA*) and Canada's "growing experience" with investment arbitrations under NAFTA.¹ Canada's stated objectives in redrafting its model FIPA were to clarify substantive investment obligations and to maximize transparency and efficiency in the dispute settlement process. This article briefly reviews and comments on the innovations in the new Canadian model FIPA.

2. Canada's investment treaty practice to date

Canada has signed 23 BITs since 1989, when it first began negotiating investment treaties. Five of these BITs were concluded before 1995 and are based on the OECD model. The remaining 18 are based on NAFTA Chapter 11.²

Canada's direct experience with arbitration under investment treaties has been as a respondent in four NAFTA Chapter 11 arbitrations: *Ethyl, Pope & Talbot, S.D. Myers*

¹ *Canada's Foreign Investment Protection and Promotion Agreement (FIPAs) Negotiating Programme*, online: <http://www.dfait-maeci.gc.ca/tna-nac/what_fipa-en.asp#structure> (last modified: 19 May 2004).

² *Ibid.*

and *UPS*.³ *Ethyl* was settled after an award on jurisdiction. The *Pope & Talbot* and *S.D. Myers* arbitrations resulted in awards of damages against Canada. There has been a jurisdictional award in the *UPS* claim, which is now proceeding on its merits. In addition, Canada's application for judicial review of the *S.D. Myers* award was dismissed by the Federal Court in January 2004. Finally, Canada has been an active participant in other NAFTA investment treaty arbitrations against the United States and Mexico by virtue of Article 1128 of NAFTA which allows it to make submissions regarding interpretation of the treaty.

Investment claims under Chapter 11 have been controversial.⁴ A variety of civil society groups and commentators, notably the International Institute for Sustainable Development (*IISD*), have raised concerns regarding the effect of investment obligations on public policy and sustainable development. The critiques have focused on the themes of legitimacy, accountability and transparency.⁵ Concerns continue to be expressed that NAFTA and other investment treaties create a "regulatory chill" that impede public policy innovations. The most recent addition to this debate is the claim that the government of New Brunswick did not to implement public auto insurance because foreign investors could claim that the creation of a public insurance monopoly is a compensable expropriation.⁶

³ A number of other claims have been made but they have not resulted in the establishment of an arbitral tribunal. Information on the investment claims against the NAFTA parties is available online: <http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp> and www.naftaclaims.org (last accessed 30 July 2004). Publicly available awards of all known NAFTA and BIT arbitrations are also available on Investment Treaty Arbitration <http://ita.law.uvic.ca> (last accessed, 1 August 2004). There is also one reported claim under a Canadian FIPA (Canada/Venezuela). See press release dated 9 July 2004, *Vannessa Commences International Arbitration process*, online: <http://www.newswire.ca/en/releases/archive/July2004/09/c2104.html> (last accessed 1 August 2004.)

⁴ Jeffery Atik, "Legitimacy, Transparency and NGO Participation in the NAFTA Chapter 11 Process" in Todd Weiler ed., *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Ardsey: Transnational Publishers, 2004) 135.

⁵ See Howard Mann, Aaron Cosbey, Luke Eric Peterson and Konrad von Moltke. *Investment and Sustainable Development: A Guide to the Use and Potential of International Investment Agreements*. (Winnipeg: IISD, 2004). Online: <http://www.iisd.org/investment/> (last accessed 30 July 2004).

⁶ See press release dated 30 June 2004, *Trade treaty 'chill': New Brunswick abandons public auto insurance in face of trade treaty threats*, online: <http://www.policyalternatives.ca/whatsnew/autoinsurancepr.html> (last accessed 30 July 2004).

The NAFTA parties have responded to concerns about Chapter 11 in a variety of ways. In July 2001, the NAFTA Free Trade Commission (*FTC*) issued an interpretive statement on Chapter 11. Two years later, it issued guidelines on non-disputing party (*amici curiae*) participation in Chapter 11 arbitrations. In 2003, Canada, along with the United States, committed to making NAFTA arbitrations open to the public. Most recently, the NAFTA parties made the draft negotiating texts of NAFTA publicly available.⁷ For its part, Canada established an Ad Hoc Experts Group on Investment Rules, whose members produced papers on expropriation, national treatment and *amici curiae*.⁸ Canada also held multi-stakeholder public consultations on Chapter 11 in 2003.⁹

The concerns expressed by various commentators have focused on a number of substantive and procedural issues, in particular, the scope of expropriation, the minimum standard of treatment, public access to hearings and documents, and non-disputing party submissions. Not surprisingly, the new model treaty addresses many of these concerns. In most respects the new Canadian model closely tracks the new US model, which was also released in early 2004,¹⁰ although, as discussed below, there are some important differences.

3. Innovations in Substantive Obligations

The scope of the new treaty follows the standard investment treaty model: it applies to government measures relating to investors of the other party and their investments. The scope of the treaty is limited by the definitions of “investment” and “investor of a Party”. The only significant change in the definition of “investment” in the new model is the

⁷ Online: <http://www.dfait-maeci.gc.ca/tna-nac/nafta_commission-en.asp> (last accessed 30 July 2004).

⁸ Online: <<http://www.dfait-maeci.gc.ca/tna-nac/background-en.asp>> for the text of the papers (last accessed 30 July 2004).

⁹ Online: <<http://www.dfait-maeci.gc.ca/tna-nac/disp/public-consult-en.asp>> (last accessed 30 July 2004).

¹⁰ See press release dated 5 February 2004, *Update of U.S. Bilateral Investment Treaty*, online: <<http://www.state.gov/e/eb/rls/prsl/2004/28923.htm>> (last accessed, 1 August 2004). For a discussion of innovations in US investment treaty practice see David A. Gantz. "The Evolution of FTA Investment Provisions: From NAFTA to the United States - Chile Free Trade Agreement" (2004) 19:4 *Am. U. Int'l L. Rev.* 679; Noah Rubins. "The Arbitral Innovations of Recent U.S. Free Trade Agreements: Two Steps Forward, One Step Back" (2003):8 *International Business Law Journal*; Mark Kantor. "Investor-State Arbitration Over Investments in Financial Services: Disputes Under New U.S. Investments Treaties" (2004) 121:7 *Banking Law Journal* 579.

exclusion of government issued debt securities. Government issued bonds, like Canada Savings Bonds, would not be covered investments under the new model.

The minimum standard of treatment (*MST*) provision, which provides the “floor” guarantee of internationally acceptable treatment, has been changed to reflect the FTC’s 2001 interpretative statement to the effect that MST means the “customary international law minimum standard of treatment of aliens”. The model thus equates “fair and equitable treatment” with the customary international minimum standard. The MST provision also provides, as did the FTC interpretation, that a breach of another international obligation does not establish a breach of MST. The new FIPA makes no attempt to clarify the content of the MST. Recent investment treaty jurisprudence on the MST, such as *Mondev* and *ADF*,¹¹ confirming that it is an evolutionary standard will thus remain relevant in elaborating the applicable legal standard for government measures.

There are no significant changes to the national and most-favoured nation treatment standards (*NT* and *MFN*). However, two provisions limit their application. First, Annex III provides that MFN does not extend to treatment accorded under existing treaties. The MFN guarantee is therefore prospective. This ensures that foreign investors under the new model cannot reach back and try to obtain the protection afforded by previous treaties. This provision seeks to avoid investment treaty shopping – the argument that MFN applies not only to the actual treatment of other foreign investors but also to the protection guaranteed to other foreign investors in other FIPAs.¹²

Second, unlike NAFTA Chapter 11 and the new US model BIT, the model includes a modified GATT Article XX-like general exceptions provision that applies to all obligations in the model treaty. The general exceptions cover measures to protect human, animal or plant life or health, to ensure compliance with law and for conservation

¹¹ *Mondev International Ltd. v United States*, (2002), 42 I.L.M. 85 (2003), 6 ICSID Reports 192; *ADF Group, Inc. v. United States of America*, (2003), 6 ICSID Reports 470.

¹² See *Maffezini v. The Kingdom of Spain*, (2001), 40 I.L.M. 1129.

purposes. This type of general exceptions provision, while common in trade treaties, has not been used extensively in BITs.¹³

The inclusion of the general exceptions raises a number of interpretative issues. Most notably, the express inclusion of general exceptions in the new model raises the issue of the significance of its omission in earlier treaties. For example, earlier treaties such as NAFTA have a general NT clause which requires non-discrimination between host country and foreign investors where the investments are “in like circumstances”. There is no general health or conservation exception to this obligation. Paradoxically, by trying to protect regulatory powers by including a general exceptions provision, their absence from older treaties becomes more problematic, particularly if tribunals interpret NT provisions in older treaties using GATT NT trade jurisprudence.

The conceptual difficulty with the general exceptions clause is also apparent with respect to expropriation. Under customary international law, if land is expropriated for conservation purposes (such as to establish a national park), compensation must be paid. The general exceptions provide that the agreement does not prevent a party from adopting measures for conservation purposes, provided they are non-discriminatory. Therefore, if both Canadian and foreign investors are expropriated without discrimination based on nationality for a valid conservation objective, a literal reading of Article 10 suggests that no international responsibility arises. One assumes, however, that Canada still intends to be bound by customary international law with respect to takings of property. Another interpretation would be that while Canada is not “prevented” from taking the measure, it must pay compensation for doing so. This would seem to be a very convoluted way of clarifying what is already clear: a tribunal cannot order an offending measure to be removed - its jurisdiction extends only to damages.

With respect to the scope of expropriation, the model FIPA includes an interpretive annex providing guidance on the meaning of indirect expropriation, one of the more hotly

¹³ But note that some of Canada’s newer FIPAs based on the NAFTA model include a general exceptions provision.

contested issues in investment treaty arbitration. The model follows closely (almost word for word in the operative sections) the new US model. The annex states that the determination of an indirect expropriation is a case-by-case, fact-based inquiry that considers, among other factors, the economic impact of the government measure, the extent to which the measure interferes with distinct, reasonable investment-backed expectations and the character of the government measure. This is essentially a codification of the US regulatory takings test as set out in *Penn Central Transportation Co. v. City of New York*.¹⁴ The Annex then states that non-discriminatory measure taken to protect legitimate public welfare objective such as health, safety and the environment will not constitute indirect expropriation, except in rare circumstances. The elaboration of criteria for the determination of the scope of expropriation is to be commended, although, in my view, the criteria are already extant in the existing international expropriation jurisprudence.

4. Procedural innovations

The new model elaborates the investor-state arbitration mechanism to address two major criticisms of the process: public access to hearings and documents, and submissions by non-disputing parties. Article 38 provides that all documents are to be publicly available and arbitral hearings are to be open to the public, subject in both cases to limitations necessary to protect confidential information. The article also provides that a Tribunal cannot require a state to disclose information contrary to the state's laws regarding Cabinet confidences and personal privacy, a provision clearly spawned by Canada's experience in NAFTA arbitrations.¹⁵

Article 39 establishes a process for non-disputing parties to file written submissions with a tribunal, which is essentially identical to the one established in October 2003 by the FTC for NAFTA Chapter 11 arbitrations.

¹⁴ 438 U.S. 104 (1978).

¹⁵ See Gustavo Carvajal Isunza and Feranando Gonzalez Rojas, "Evidentiary Issues in NAFTA Chapter 11 Arbitration: Searching for the Truth Between States and Investors" in Todd Weiler ed., *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Ardley: Transnational Publishers, Inc., 2004).

Like NAFTA, the model provides for the establishment of a commission to supervise the implementation of the treaty. Under the new model, the commission can make rules to supplement the applicable arbitral rules, amend these rules, and make rules relating to expenses incurred by the tribunal. As in NAFTA, the commission's interpretation of a provision of the BIT is binding on the tribunal. The model further clarifies that any award must be consistent with the commission's interpretation. This change addresses the applicability of a commission interpretation to arbitrations commenced before the interpretation is issued, again a contested issue in NAFTA arbitrations.

Other innovations include a requirement that consultations be held in the capital of the state against which a claim is made, provision for a tribunal to decide objections to jurisdiction and admissibility before proceeding to the merits,¹⁶ and specifying criteria for the selection of arbitrations and conduct of arbitrators, including a provision for a code of conduct for arbitrators to be agreed upon between the parties.

5. Comment

Unlike in the case of the new US model BIT,¹⁷ there were no public consultations regarding the draft model FIPA. This is surprising and disappointing given the significant public controversy surrounding investment obligations. Public consultation would have promoted discussion on a number of issues that have not been addressed in the treaty. For example, unlike the US model, the Canadian model does not address the relationship between investment and labour.

Unlike previous FIPAs, the preamble of the new model refers to sustainable development: *“the promotion and the protection of investments ... will be conducive ... to*

¹⁶ The new US model has much stricter and more detailed provisions on preliminary objections. See Art. 28 of the draft US model BIT.

¹⁷ See Report of the Subcommittee on Investment Regarding the Draft Model Bilateral Investment Treaty available at http://www.ciel.org/Publications/BIT_Subcmte_Jan3004.pdf (last accessed 2 August 2004) and letter to Wesley Scholz and James Mendenhall from NGOs regarding deficiencies in draft model BIT dated 16 January 2004 available at http://www.ciel.org/Publications/BIT_Comments_Jan1604.pdf (last accessed 2 August 2004).

the promotion of sustainable development”. Is the new model BIT a better model for sustainable development? Notwithstanding the conceptual and interpretative difficulties surrounding the potential incorporation of GATT Article XX jurisprudence into an investment framework, general exceptions for conservation and health regulation are a positive development.

On the other hand, there are other innovative ways to promote sustainable development that the model does not adopt. To date, BITs have been decidedly one-sided treaties – foreign investors are guaranteed investment protections by the host state, which the foreign investor can enforce through investor-state arbitration. There are no corresponding obligations on foreign investors or the home state of the foreign investor. There is a certain truth in Professor José Alvarez’s critique of Chapter 11 as a “human rights treaty for special interest groups.”¹⁸ If foreign investors have such powerful international rights, it is not unreasonable to seek ways to make them more accountable for breaches of international law, in particular, international human rights and environmental law, through a binding international dispute mechanism. An investment treaty that promotes sustainable development would place international obligations on foreign investors and their home states to ensure that the foreign investment in question is sustainable. Furthermore, it would back up these obligations with a binding international dispute settlement mechanism.

6. Conclusion

BITs practice has evolved since 1959 when the first modern BIT was signed between Germany and Pakistan.¹⁹ The original BITs were short (seven or eight pages) and did not provide for investor-state arbitration. While many short form BITs are still being concluded, the advent of investor-state arbitration has shifted the terrain. Challenges to a wide range of government measures are raising difficult interpretive issues. The disputes

¹⁸José E. Alvarez, “Critical Theory and The North American Free Trade Agreement’s Chapter Eleven”, (1997) 28 U. Miami Inter-Am. L. Rev. 303.

¹⁹ The first modern bilateral investment treaty was concluded between Germany and Pakistan in 1959. Texts of BITs are available on the UNCTAD website: http://www.unctadxi.org/templates/DocSearch_779.aspx (last accessed 2 August 2004).

are increasingly factually and procedurally complex. It is therefore understandable that the legal tools must become more detailed, nuanced and refined to address these issues. The new Canadian and US model BITs now run to 40 some pages.

The evolution of BITs should nevertheless continue. Investment treaties have shown the power of binding international dispute settlement. The problem that now exists is not that BITs go too far, it is in the unwillingness of government to extend international responsibilities to other actors, namely, transnational corporations (*TNCs*) and the foreign investor's home state. At the very least, a new generation of investment treaties could make TNCs accountable for violations of basic international human rights and international environmental law, through a binding and enforceable dispute settlement process. That would be an international legal development to cheer.