EVALUATING CANADA’S 2004 MODEL FOREIGN INVESTMENT PROTECTION AGREEMENT IN LIGHT OF CIVIL SOCIETY CONCERNS

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The Canadian Council for International Co-operation (CCIC) is a coalition of Canadian voluntary sector organizations working globally to achieve sustainable human development. CCIC seeks to end global poverty, and to promote social justice and human dignity for all.

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EXECUTIVE SUMMARY

For more than fifteen years, Canada has negotiated foreign investment protection agreements (FIPAs) with other governments. These treaties provide high levels of international legal protection to foreign investors and investments. A series of investor-state lawsuits launched under NAFTA served to highlight the potentially broad impact of these agreements upon public policy and the right of governments to regulate inward foreign investment. Recently, Canada undertook a review of its negotiating template and in 2004 adopted a revised model FIPA. This briefing note provides a review of the changes in the new FIPA model, and assesses their implications in light of longstanding development and human rights concerns voiced by civil society organizations (CSOs).

The recent revisions to the Canadian FIPA address some of the concerns of CSOs, and in some respects Canadian FIPAs outclass those promoted by other developed countries. Canada’s revised 2004 model introduces welcome improvements to the process by which investment disputes are to be arbitrated, with arbitration hearings and documents now open to the public. The new FIPA also pays greater attention to preserving the right of governments to regulate in the public interest.

However, the basic structure of the model remains unchanged in key respects, leaving many CSO concerns untouched and introducing new ones. As such the new Canadian FIPA is more constraining to a developing country than a typical OECD investment treaty, and imposes restrictions on developing countries that did not apply to developed countries in the course of their own economic development. The new FIPA follows the long-standing Canadian practice of requiring developing countries to liberalize their foreign investment climate, and to treat foreign (Canadian) investment on the same terms as domestic investment once foreign investors enter the market or acquire existing businesses. Governments can place limits on such across-the-board liberalization by designating specific sectors for exemption, however developing countries have protested that this approach confronts them with the difficult (and largely irrevocable) task of determining which sectors should be sheltered for future needs.

The new FIPA also introduces additional restrictions on the use of certain performance requirements, thus removing from government discretion the use of certain policy tools which might be valuable in selected circumstances, and which might have been utilized by developed countries at earlier junctures in their own economic development. These disciplines on performance requirements and national treatment have far-reaching implications for the policy space of developing countries.

At the more basic level, questions might be asked about the propriety of offering foreign investors international legal protections that permit foreign investors to exit local legal systems and to pursue international arbitration against states. Concerns have been raised by some social scientists and CSOs that investment treaties – and their grant of international dispute settlement – may detract from broader efforts to promote good governance, rule of law and human rights protection in developing country legal systems. More generally, calls from CSOs for an international investment policy model that provides greater balance between the rights and responsibilities of investors, and the interests of host states, continue to go unheeded.
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1.0 INTRODUCTION

For more than fifteen years now, Canada has negotiated foreign investment protection agreements (FIPAs) with other governments in an effort to provide enhanced levels of legal protection for Canadian businesspersons or corporations investing abroad. In this period, three different negotiating templates have been used: an early design modeled on the typical bilateral investment treaty (BIT) in OECD countries; a post-NAFTA model which follows the design of Chapter 11 of the North American Free Trade Agreement; and a new model FIPA released in 2004. It is the last of these three templates that is examined in this memo. Civil society concerns about investment protection agreements are varied and long-standing; a number of these concerns are canvassed in the following paragraphs so as to provide a backdrop for analysis of the new FIPA template.

As a matter of foreign policy, commentators have questioned whether it is appropriate to negotiate unbalanced investment treaties that set forth a slate of international law protections for foreign investors – with no explicit countervailing duties or obligations – and to empower those investors to invoke their rights under a special fast-track international investor-state arbitration mechanism.1 A narrow focus on property-rights, coupled with a waiver of the requirement for claimants to pursue all remedies available under domestic law before turning to international adjudication, are at odds with established practice in other areas of international relations, including human rights law. Also, civil society organizations (CSOs) have questioned whether these agreements are instruments of good governance if they bypass local judicial bodies in order to permit disputes to be resolved in international arbitration.2

In terms of the substance of such agreements, concerns have been raised as to the development-compatibility of provisions on national treatment and performance requirements. By mandating that foreign investors be treated on an equal plane with domestic investors, critics argue that developing countries are deprived of potential policy tools which require some differentiation between locally-owned and foreign-owned investments, for example, the use of subsidies or special incentives to promote infant industries, or the use of local content rules so as to encourage linkages between foreign investors and the domestic economy.3 There are also long-standing concerns that investment treaties may permit foreign investors to characterize legitimate government regulation as a form of “indirect expropriation,” which could constrain a government’s ability to regulate the activities of foreign investments in the public interest.4

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Investment treaties pursued by Canada and the United States with other parties raise an additional concern. In contrast with most BITs, Canadian and U.S. treaties oblige the signatory governments to treat foreign investors on a level playing field with local companies even at the entry phase of an investment. By liberalizing the rules of entry for foreign investors these treaties oblige developing countries to take difficult (and largely irrevocable) decisions as to which sectors should be sheltered – via a so-called negative list or opt-out – in the interests of future needs. Where societies are fragmented or prone to serious income inequality, economic dominance by foreign investors could have negative social repercussions and contribute to conflict and strife.  

Because investment agreements may lock in market openings for foreign investors, they appear to offer little flexibility for governments in this regard.

In relation to controversial foreign investment projects, concerns have been raised that community protests may be stifled – ostensibly to ensure investor rights are respected – or that the success of protest initiatives may trigger treaty lawsuits by thwarted foreign investors. Critics have also noted the open-ended obligation for governments to provide “fair and equitable treatment”, and raised questions as to what this demands of governments – and whether disparities in host state development and capacity can be taken into account when interpreting this obligation.

In addition to the basic propriety of allowing foreign investors to leap-frog over domestic courts, various concerns have been raised with respect to the operation of the investor-state dispute settlement mechanism included in these treaties. Under most BITs, there are no requirements to disclose the existence of investor-state disputes, much less open the proceedings of the arbitration to public scrutiny. Documents and pleadings in a case may be kept secret, even where the existence of the claim has become a matter of public knowledge. Arbitral rulings, to the extent that they are released by the parties, are subject to limited review by domestic courts, which tend to give deference to arbitral rulings on account of their supposed consensual and commercial nature. This posture of deference may not take sufficient account of the extent to which such arbitrations are now touching upon matters of public interest.

2.0 THE NEW 2004 CANADIAN FIPA

In 2002-03 the government of Canada updated its FIPA model in response to concerns raised about the NAFTA Chapter 11, and experience gathered from the operation of that agreement to date. The revised agreement was released to the public in 2004. The revision exercise corresponded with a similar effort undertaken by the US Government. However, in notable contrast with the US effort, the Canadian review did not submit the proposed new template for public comment.

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6 Ibid. and APG full brief on CAFTA.

7 See CIEL, et. al. Letter to James Mendenhall and Wesley Scholz, op.cit.

8 For background and a copy of the text see: http://www.dfait-maeci.gc.ca/tna-nac/what_fipa-en.asp#structure

The final changes included:

- A limited reference to “sustainable development” in the agreement’s preamble;10
- A more narrow definition of investment, with Canadian government bonds now removed from the list of covered investments;
- Expansion of the list of performance requirements or obligations which may not be imposed on foreign investors;
- Clarification that the so-called minimum standard of treatment for investors is that prescribed by customary international legal practice, rather than the wider constellation of laws or treaties to which governments might adhere;
- Restriction of Most-Favored Nation Treatment so that it does not permit foreign investors to claim rights accorded to other foreign investors under earlier investment treaties signed by a host country;
- Clarification to the expropriation clause so as to provide greater shelter for legitimate, non-discriminatory public interest regulation;
- Procedural changes so as to provide for disclosure of all investor-state arbitrations, disclosure of documents and pleadings, as well as opening of hearings to public participation; express provisions for intervention by amicus-curiae in investor-state arbitrations.11

3.0 ANALYSIS OF THE NEW FIPA IN LIGHT OF CIVIL SOCIETY CONCERNS

At the outset, it must be stressed that all changes to the FIPA template are relevant to future agreements, but do not address problems which may plague existing agreements. Since 1990, Canada has concluded 22 FIPAs, as well as investment provisions in free trade agreements with Chile, Mexico and the United States. Given that these agreements are in force, closer review and analysis may be warranted so as to bring these earlier agreements into line with the new model FIPA. The following analysis is limited to the terms of the 2004 model FIPA, and is not meant to provide an overview of the strengths and weaknesses of pre-existing investment agreements.

3.1 Expropriation and Regulation

Of the changes to Canada’s FIPA template, perhaps the most high-profile has been a decision to include interpretive guidance that clarifies the meaning of “indirect” expropriation. This guidance outlines several factors that will be relevant to a tribunal’s determination as to whether a government measure (for example, a regulation or administrative act) constitutes a form of “indirect expropriation.” These factors include the “character” of the measures, their “economic impact” on the investment, and whether the measures interfere with “distinct, reasonable investment-backed expectations.”12

10 The preamble does not specify sustainable development as a treaty objective in a straightforward manner. Rather, the preamble argues that the promotion and protection of investment will be conducive to the promotion of sustainable development.
One upshot of this clarification is to ensure that tribunals may not declare “indirect” expropriations to have occurred merely based on the impact of those measures on a foreign investment – as had been the approach in one early controversial NAFTA case, Metalclad v. Mexico. Henceforth, tribunals must take account of the purpose or character of the government measures, for example its pursuit of a health or environmental objective. Furthermore, the new FIPA template makes explicit that measures whose purpose is a legitimate public welfare objective will rarely be characterized as “indirect expropriation.”

Viewed in light of civil society concerns, this new language helps assuage fears that tribunals might hold legitimate health, environmental or other public interest regulation to constitute an “indirect expropriation”. Until, such language is tested in arbitration proceedings, however, its concrete force remains unclear; in particular, tribunals may harbour differing opinions as to those “rare circumstances” where a public welfare regulation does cross the line to become a form of indirect expropriation.

In a related vein, since the new FIPA template was drafted, at least two arbitral tribunals have issued interpretations of existing agreements (the NAFTA and a Dutch-Czech BIT) that carve out more space for legitimate public interest regulation. However, reviews of these rulings are mixed. One environmental lawyer has wondered whether the Methanex v. United States arbitral ruling may provide even more policy space than has been offered by the new Canadian model FIPA; occasioning concerns that the new model FIPA may not go far enough. Another commentator, who represents business interests in NAFTA arbitrations, has criticized the Methanex decision for offering too much shelter for public welfare measures, and stressed that future tribunals might not be so generous towards governments. Indeed, in an ongoing arbitration against the United States Government, Glamis Gold Ltd. has filed legal briefs alleging that the Methanex ruling is at odds with the established state of international law.

Given that tribunals will continue to be called upon to make judgment calls as to the line between regulation and expropriation, efforts to shed greater light on the work of these tribunals will continue to be important. For this reason, the reforms to the dispute settlement mechanism of Canada’s BITs, discussed in the next section, should be particularly welcome.

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13 Finally, it should be noted that Article 10 of the new FIPA incorporates a general exception which appears to have been modeled on a similar exception found in the General Agreement on Trade and Tariffs (GATT), and which is found in some earlier Canadian FIPAs. The exception – which is rarely found in non-Canadian BITs – clearly offers meaningful protection for environmental or conservation measures, insofar as it stipulates that governments may take bona fide measures “to protect human, animal or plant life or health”, as well as “for the conservation of living or non-living exhaustible natural resources”.

14 Methanex Corporation v. United States, Award, Part IV, Chapter D, p. 4, para.7; Saluka Investments BV (Netherlands) v. Czech Republic, Partial Award of March 17, 2006, at para 255; Cases available on-line at: http://ita.law.uvic.ca/alphabetical_list.htm


16 Todd Weiler, “Methanex v. USA: Turning the Page on NAFTA Chapter Eleven?”, 6 Journal of World Investment & Trade, No 6, pp. 918-920

3.2 Reforms to the Dispute Settlement Mechanism

While the investor-state dispute settlement mechanism continues to be offered in new Canadian FIPAs, it is a much more open and accountable process than that found in earlier Canadian agreements. First, all disputes must be publicly notified. Second, all arbitration proceedings are to be accessible to the public, notwithstanding that efforts might be taken to shelter sensitive commercial information. Third, all documents and pleadings are to be made public. Fourth, participation of amicus curiae is affirmed in principle, with the FIPA clarifying the criteria tribunals should use to assess would-be interventions.

Despite these changes, investor-state arbitration may still be criticized at the policy level for providing a more favourable legal recourse to foreign investors, without extending similar opportunities to domestic investors. Moreover, the process continues to bypass local courts in the country of the investment for the most part, and imposes no general duty for foreign investors to exhaust domestic legal remedies. Nor does the new FIPA offer greater judicial or appellate review of rulings by arbitration tribunals. Whatever its merits for foreign investors who encounter arbitrary or capricious government interference, investor-state arbitration has been criticized for its potential to undermine or detract from good governance reforms. One argument is that less pressure and emphasis will be devoted to improvements in rule of law and good governance in developing countries if major foreign investors are simply permitted to leap-frog over emerging legal systems.18

3.3 List of Prohibited Performance Requirements Expanded

Civil society organizations have criticized Canadian FIPAs for limiting the use of certain performance requirements that have the potential to be effective tools – in certain circumstances – for exacting greater development benefits from foreign investment. It is often noted that many of these same policy tools were employed by Northern governments to grow and strengthen their economies. However, the new Canadian FIPA template continues to follow the NAFTA practice of prohibiting a selected list of performance requirements, including domestic content rules; local purchasing or procurement obligations; to transfer certain technologies.

Of special concern to development CSOs, the new FIPA expands the list of proscribed performance requirements beyond those prohibited under earlier FIPAs. Under the new template, countries are also forbidden to: “relate in any way the volume of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment”; “restrict sales of goods or services in its territories that such investment produces or provides by relating such sales in any way to the volume or value of its exports of foreign exchange earnings”; and “to supply exclusively from the territory of the Party the goods it produces or the services it provides to a specific regional market or to the world market.”19

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19 See Article 7 of the Model FIPA; for comparison’s sake, note that the Canada-Ecuador and Canada-Philippines FIPAs do not prohibit these types of measures.
Blanket prohibitions on the use of performance requirements may run counter to some economic evidence that shows that such policy measures can contribute to host state development. For example, the UNCTAD has recently highlighted how export performance requirements have been used to harness inward FDI to an export-led growth strategy and diversifying a country’s export base.20 Malaysia has used such export requirements to positive effect in relation to electronic components, where the country now controls a meaningful slice of the world market; likewise, South Africa has internationalized its automotive exports through the imposition of such export requirements on foreign investors.21 As such, UNCTAD has argued that developing countries are best-placed to make case-by-case decisions as to whether the use of performance requirements can serve their development interests, rather than have recourse to such requirements prohibited by investment treaty commitments.22

3.4 National Treatment

The National Treatment principle requires host states to treat foreign investments as favourably as it treats investments by its own nationals, if the two investments are “in like circumstances”.

CSOs have criticized the operation of the National Treatment principle, particularly at the so-called entry or establishment phase. The new Canadian FIPA follows the NAFTA path in providing foreign investors with the ability to enter a host state on the same terms as local players; in other words, foreigners may establish new investments or acquire existing investments on a national treatment basis. Any sectors that countries wish not to open to foreign investment must be listed in a so-called negative-list annex to the agreement. Some developing countries have voiced objections to such liberalization on a negative-list basis – citing the difficulty of anticipating all sectors that should be sheltered from such disciplines.23

A second concern articulated by CSOs focused on development issues has been that investment agreements should not curtail the ability of governments to use tools such as subsidies or other measures in order to develop local industries. Special incentives for infant industries could run afoul of the National Treatment commitment made to foreign investors in Canada’s FIPAs, unless governments shelter such measures from the National Treatment obligation. Notably, the new model FIPA moves to exclude subsidies, loans and other government grants from the reach of the National Treatment provision (as well as the MFN obligation).24 In so doing, it follows the pattern set by some (but not all) earlier Canadian FIPAs, continuing to provide wider discretion to host governments.25

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21 Ibid.
22 Ibid.
23 One South African trade official told the author at a May 2006 workshop that the pre-establishment demands of the Canada-SA FIPA lie behind the decision of South Africa not to ratify that agreement, despite its having been concluded some years ago. Similarly, South Africa has expressed unease with a US Free Trade Agreement which would provide pre-establishment national treatment subject only to a negative list of excluded sectors. See also the discussion at the WTO in “Non-Discrimination, Most-Favoured-Nation Treatment and National Treatment”, Note by WTO Secretariat, Working Group on Trade and Investment, WT/WGTI/W/118, June 4, 2002, at paras 85-8.
24 Article 9 (5) (b).
25 See, for example, Article VI (2) (b) of Canada-Ecuador FIPA. Of those FIPAs omitting such an exception, most appear to have limited National Treatment commitments at any rate. For example, Article IV of the Argentina FIPA is a best-endeavours obligation.
3.5 **Most-Favoured Nation (MFN) Treatment No Longer Retrospective**

Most Favoured Nation Treatment requires that a host government provide a foreign investor with treatment no less favourable than the treatment offered to investors of any third country. Responding to concerns that foreign investors might be able to use the MFN clause to treaty-shop or cherry-pick the most favourable selection of rights offered in the full back-catalogue of treaties signed by a government, Canada has moved to rein in the operation of the clause. Under the new FIPA, investors may not access better treatment found in earlier bilateral or multilateral agreements. By this means, foreign investors may not circumvent the reforms to the substantive provisions and the dispute settlement mechanism that are being introduced in new FIPAs and FTAs. This innovation is a logical move, given the concern that an open-ended MFN clause could permit foreign investors to detour around intentional restrictions of rights found in future Canadian investment agreements.

3.6 **Portfolio Investments Covered, but Government Debt Excluded**

To the extent that CSOs harbour concerns that investment agreements verge beyond foreign direct investment, to provide protection for portfolio or other speculative investments the new Canadian FIPA may be unwelcome. The agreement’s definition of covered “investments” remains very broad, offering coverage for debt securities and equity securities.

However, the FIPA does exclude government debt securities, which may be viewed as a positive trend by many CSOs. The exclusion of the latter category of investments would limit the ability of foreign investors to pursue treaty arbitration against governments in the event of default on sovereign debt – a spectre which has hung over countries such as Russia and Argentina following their respective financial crises. It should be emphasized that earlier Canadian FIPAs do not exclude government debt from the list of covered investments, thus leaving open the prospect of investor-state lawsuits over debt default against such countries. Also of concern, the new Canadian FIPA does not permit host governments to place temporary limits on foreign investor repatriation of funds in case of balance of payments or other financial crisis.

3.7 **Minimum Standards of Treatment Clarified**

Following several international arbitrations that gave broad interpretation to the NAFTA Article 1105 requirement to provide a “minimum standard of treatment under international law”, the NAFTA parties issued a statement that clarified that this obligation provided only the minimum standard of treatment owed to foreigners under customary international legal practice. In particular, it was stressed that provisions like Article 1105 do not permit foreign investors to sue governments over a breach of any of its international law obligations (including under other treaties or in other chapters of the NAFTA). In early NAFTA arbitrations, foreign investors had sought to use the investor-state arbitration mechanism as a launch pad for suing governments over breaches of other treaty obligations, thereby expanding the scope of a state’s vulnerability to investor lawsuits.

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The new FIPA also hems in the minimum standard provision by stressing that it provides a minimum base-line level of protection, more specifically fair and equitable treatment and full protection and security. However, commentators observe that the change to the FIPA language still fails to clarify the meaning and content of this minimum standard. US-based CSOs have criticized the standard – which is also incorporated into new US BITs – as “completely unbounded and open-ended”, and one which invites tribunals to offer their own views as to what constitutes “fair” or “equitable” treatment. Debate as to the meaning of these terms is critical, particularly now that expropriation claims are proving difficult for foreign investors to make out. Many BIT arbitrations now hinge on allegations that foreign investors have been denied “fair and equitable treatment”

Currently, the concepts remain relatively subjective. One related concern is whether tribunals will take into account the level of development of the host state in determining what constitutes “fair” or “minimum” treatment of foreign investors by host state authorities or officials. For example, will Niger be held to the same standards of administrative and bureaucratic competence as Chile or Argentina? Also of interest to CSOs, one observer has argued that the “fair and equitable treatment” standard may impose certain duties upon investors, not least of which is to conduct their investments in a reasonable manner, to refrain from unconscionable conduct, and to anticipate that certain regulatory changes might be a risk that companies should shoulder. If tribunals endorse such an interpretation, this might be a means for reading corporate social responsibilities into agreements that have been roundly criticized for focusing myopically on investor rights and privileges.

4.0 Conclusion

The recent series of changes to the model FIPA, make Canada’s investment treaties some of the more progressive agreements being advocated by northern governments. Certainly, Canada’s record is better than that of the United Kingdom, where government officials have sounded progressive notes in the context of proposed multilateral negotiations on investment, yet have pursued narrow investor-oriented agreements at the bilateral level – with little concern for the impact of these agreements upon government policymaking.

Specific changes to the investor-state dispute settlement mechanism to bring about greater transparency and legitimacy are marked improvements for a process that has been duly excoriated for permitting foreign investors the luxury to sue governments under international law with no duty to disclose the basis of such claims, much less open the proceedings to public scrutiny. Notwithstanding such procedural improvements, Canada did not move to provide for greater judicial or appellate review of arbitration rulings. Nor does the powerful investor-state

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27 Letter to Mendenhall and Scholz by CIEL et. al., op. cit.
mechanism have an analogue in other areas of international law. In the trade context, disputes are arbitrated at the government to government level. Meanwhile in the human rights context, where international remedies are available, claims must proceed through domestic judicial channels prior to being heard at the international level.

Questions can be raised as to the foreign policy priorities of governments that pursue foreign investor arbitration rights in preference to broader rights of remedy for the victims of human rights breaches. Moreover, concerns have been voiced that the conclusion of vast numbers of foreign investment protection agreements may provide foreign investors with the ability to detour around host country legal systems, thus obviating the need for such foreign investors to lend their voices to wider calls for good governance and the rule of law in such territories. Further research needs to be undertaken by social scientists to examine whether BITs undermine improvements in good governance within developing countries. Such research should be a priority given that large quantities of Canadian foreign aid are directed to rule of law and good governance projects throughout the developing world, and these efforts might be impacted by decisions to construct extra-territorial arbitration mechanisms for the use of foreign investors.

In terms of the broader sustainable development impacts of Canada’s FIPAs, the new framework does not alter the fundamental principle of national treatment found in previous Canadian agreements, nor the prohibition of performance requirements on foreign investors. Indeed, the new FIPA actually lengthens the list of proscribed performance requirements found in earlier FIPAs. The National Treatment obligations require the liberalization of the foreign investment climate – and on the negative list (opt-out) basis, which had proven so unworkable at the WTO. As such the new Canadian FIPA is more constraining to a developing country than a typical OECD BIT, and imposes restrictions on developing countries that did not apply to developed countries in the course of their own economic development.

The new FIPA does address certain concerns that have arisen with respect to the impact on government’s right to regulate for legitimate public policy purposes. In addition to the clarification of the definition of indirect expropriation, the FIPAs also boast a general exception for health and environmental measures. What’s more the FIPA preamble now incorporates a reference to sustainable development, which is not found in most BITs, and which could have some limited usefulness in contexts where ambiguous provisions are subject to interpretation by arbitral tribunals.

In sum, the new FIPA appears to take on board certain concerns expressed by civil society organizations, particularly with respect to concerns about health and environmental regulation and non-transparency. However, in terms of the development impacts of the new FIPA, the agreement remains a relatively narrowly-cast instrument – geared to providing high levels of liberalization and protection of property rights for foreign investors, with little in the way of

31 In particular, Canada is pursuing foreign investor protections with China, at the same time as China has not ratified the International Covenant on Civil and Political Rights which would accord basic human rights protections and remedies to citizens.
32 Notably, the new FIPA follows earlier Canadian agreements in featuring a general exception for subsidies, loans and other government grants for local firms, lest such preferential policies otherwise breach the National Treatment obligation.
33 See Article 10(1).
explicit countervailing duties or responsibilities imposed on foreign investors or their home countries. While international agreements have been conceptualized that would provide for a much more balanced approach to investor rights and responsibilities, the 2004 FIPA displays little imagination in this respect, and has been drafted from a defensive posture, so as to address pressing deficiencies in early models, without engaging with more fundamental questions as to the relationship between foreign investment and development.34

34 One example of a balanced investment treaty template is that undertaken by the author and colleagues at the International Institute for Sustainable Development. See: http://www.iisd.org/publications/pub.aspx?id=685