Asia Practice

September 16, 2014

Canada - China Agreement to Promote and Protect Reciprocal Investment Coming into Force

Overview

In a major step to facilitate and grow trade and investment between Canada and the People's Republic of China, the two countries signed a Foreign Investment Promotion and Protection Agreement (FIPA) in September 2012. The FIPA has now been ratified by both countries, after a significant delay in Canada, and will come into force on October 1, 2014. The agreement is the product of negotiations that commenced in 1994. The FIPA, which is broad in scope, is primarily intended to protect investors against discriminatory treatment (primarily through each country's commitment to accord to investors of the other country treatment no less favourable than it accords to its own investors), supported by an effective and meaningful dispute resolution mechanism. The agreement, which features other reciprocal protections such as most-favoured-nation status and minimum standards of investor treatment, is subject to exceptions, including exceptions relating to investments in cultural industries, the regulation of financial institutions and the protection of essential security interests.

In addition to assisting Canadian investors in their Chinese investments, it is hoped that the FIPA will help promote Canada as a market for Chinese investment and, more generally, raise the profile of Sino-Canadian business opportunities and strengthen the countries' reciprocal commercial relationships.

Key Features

The FlPA provides investors from each country with additional legal protection for investments in the other. The key obligations of each of the parties include:

- the *national treatment* obligation, requiring each party to treat investors of the other party no less favourably than it treats its own;
- the *most-favoured-nation treatment* obligation, requiring that each party treat investors of the other party no less favourably than investors of another country (this obligation excludes rights granted under free trade agreements, such as the North American Free Trade Agreement (NAFTA));
- the *minimum standard of treatment* obligation, which imposes a minimum standard of treatment for investments made by investors of the other party;
- the *expropriation* obligation, which prohibits a party from expropriating an investment made by an investor of the other party without the payment of prompt, adequate and effective compensation;
- the *transfer of funds* obligation, which permits transfers of capital into and out from the other country by investors; and
- the *performance requirements* obligation, which prohibits the parties from imposing requirements on investors that are inconsistent with the parties' commitments under World Trade Organization agreements and commitments.

Remedies and Dispute Settlement

The FIPA provides for an arbitration tribunal to address breaches of the agreement. Investors of a country can make a claim for damages resulting from breaches by the other country directly to the tribunal, and the tribunal has the power to make orders for compensation.

Similar to other bilateral trade agreements, disputes between the parties as to the interpretation or application of the FIPA are to be resolved by consultation and, if consultation is not successful after six months, by binding arbitration. If the arbitration decision is not implemented by a party, the other may claim compensation.

Exceptions

The FIPA includes exceptions for certain categories of issues, including investments in cultural industries, environmental matters (subject to certain limitations), regulation of financial institutions, and the protection of essential security interests. The FIPA also does not apply to tax matters (which are governed by the existing tax convention between the countries) or to decisions under the *Investment Canada Act* or its Chinese counterpart.

Notably, the FIPA does not apply to existing non-conforming measures which are "grandfathered." A discriminatory law can thus remain in force provided it is not made worse. In contrast, under NAFTA, the federal governments had to list the non-conforming measures they wished to retain, with other non-conforming measures to be repealed. For provincial and municipal governments, the FIPA rule is similar to NAFTA.

Advantages and Possible Downsides

The benefit of the FIPA is that it may provide a Canadian investor with redress that the investor might not otherwise have. Breaches of FIPA obligations such as the obligation not to discriminate are usually not covered at all by domestic law, such that the benefit of this protection could be meaningful.

However, as FIPA is subject to exceptions and grandfathering of existing laws, it is not comprehensive. As for inbound investment, the FIPA may make it riskier for the Canadian government to take steps that displease Chinese investors. Unlike many FIPAs with other countries, there are many Chinese investors with significant stakes in Canadian companies, and they will likely not hesitate to use investor/state procedures.

Ironically, while the FIPA should be a significant help to Canadian companies doing business in China, it may result in the Canadian government being less likely to itself intervene to assist a particular company in China. In our experience, when investor/state procedures are available, the government tends to to advise the Canadian investor to pursue the remedies available to it and to not seek assistance from Canada.

Looking Forward

The FIPA is a robust bilateral investment agreement, the implementation of which is intended to strengthen investment and trade between Canada and the People's Republic of China. As noted, the agreement includes broad protections and remedies by its terms, and perhaps equally importantly sends a strong signal of governmental interest in, and support for, bilateral investments.

Please contact any member of our Asia Practice Group to discuss the FIPA.