

Bilateral Investment Treaties: A Canadian Primer

***The Issue:** There are growing concerns that certain areas of international policy and law inhibit effective government and citizen action to address human rights and poverty, particularly in the poorest countries. Policy concerns include donor-imposed conditions of aid programmes, loan conditions from the IMF, and the rules governing international trade. International investment treaties are a major part of this controversial policy framework and must be contested.*

1. What is a Bilateral Investment Treaty?

Bilateral Investment Treaties (BITs) make up one part of a global investment regime that governs how countries and their governments can regulate foreign-owned assets. In Canada, BITs are called Foreign Investment Protection and Promotion Agreements (FIPAs). Provisions nearly identical to those found in BITs have also been written into bilateral free trade agreements (FTAs) as investment chapters alongside other trade provisions (e.g. the North America Free Trade Agreement's Chapter 11). This investment regime is an area of international law designed to provide very strong levels of protection to foreign investors (individuals and corporations) from arbitrary treatment by host states in which they own assets.

There are over 2600 bilateral treaties between states worldwide. The treaties regulate governments very intensively while applying few if any corollary responsibilities for investors.

Canada is a major promoter of these instruments. Canada has 23 FIPAs that were concluded between 1990 and 2001.¹ In recent years, Ottawa has accelerated its pursuit of FIPAs and regional and bilateral trade agreements that include investment provisions. Since 2007, 4 FIPAs have been concluded² and 20 are either under negotiation or planned for the future.³ The Canadian government has also recently concluded 4 trade agreements⁴ that include chapters on investment and has 9 more such trade deals under negotiation or in exploration phase.⁵

2. What are the Main Elements of these Treaties?

The key investor protections in BITs/FIPAs restrict governments' ability both to encourage the potential social, economic and environmental benefits of foreign investment and to minimize potential damage from such investment. (See box for a description of key contentious elements) Through these provisions, BITs impose restrictions on developing countries that did not apply to developed countries in the course of their own economic development.

“These instruments have locking effects on possible economic flexibilities of developing countries and on space for citizens' voice in public policy choice.”

Abdulai Darimani, TWN Africaⁱ

Key Investor Protections and Contentious Elements of BITS and FIPAs

Investor State Dispute Resolution: This mechanism allows investors to leapfrog domestic courts and sue governments in international arbitration tribunals if there has been an alleged breach of treaty protections. Arbitrators responsible for adjudication lack institutional safeguards of independence, creating a bias in favour of investors and powerful states. The arbitration process is hence inappropriate for resolving disputes, which often affect public policy areas such as human health, the environment or human rights.

Protections against “Indirect” Expropriation: Investors are protected against changes in the host state’s policy that arbitrators may characterize as “regulatory expropriations” on the basis that a law or other measure has reduced the value of an investment. Tribunals have made clear that compensation may even be required for investors challenging measures that address legitimate public interest concerns. A country cannot be forced to repeal a law or regulation, but the threat of a massive award may deter proposed policy initiatives in virtually any field.

“Fair and Equitable Treatment” Standards: These standards exist to ensure investors are treated justly but provide very broad protections and are interpreted in very different ways by different tribunals. Arbitrators have often read additional requirements into these standards such as the requirement to protect investors’ “legitimate expectations.” This has profound implications for Canadian public law, which limits the notion of legitimate expectations to the process of government decision-making and does not require payment of public compensation, after the fact, where an investor’s expectation was not met.

National Treatment: Foreign investors and their investments must be treated no less favourably than investors from the host state (although they may be given *more* favourable treatment, such as subsidies, tax holidays, or regulatory exemptions). This provision blocks various measures most governments have used historically to support local industry or promote regional development.

Most Favoured Nation (MFN) Treatment: This principle ensures that foreign investors and their investments are treated comparably to investors from third states. Remarkably, it has been interpreted broadly by some tribunals to allow investors in effect to “mix and match” provisions from all of the treaties concluded by a state in order to construct the most favourable set of provisions for the investor.

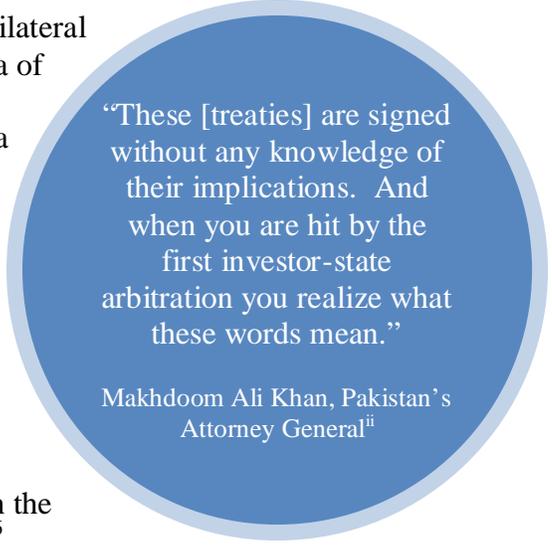
Bans on Performance Requirements: National governments are prohibited from imposing requirements on foreign investors that were typically used by industrialized countries in their development e.g. requirements to use a certain percentage of local inputs in production processes, to guarantee employment in certain regions or marginalized groups, or to enable the transfer of technology. Canada often uses exceptions to maintain its right to institute performance requirements in certain sectors, or as part of an investment screening process, while denying the same exceptions to developing country partners.

Bans on Capital Controls: These are prohibitions on a government applying restrictions on flows of capital in or out of its economy. Such restrictions are used, for example, to curb speculative finance or to restrict repatriation of funds so as to protect economic stability in case of a financial or balance of payments crisis. Instead treaties normally protect the principle of **Free Transfer of Funds**, granting investors the right to transfer investment related funds out of the host state. In the aftermath of the recent financial crisis, it is clear that a ban on capital controls carries serious risks for governments.

Adapted from Peterson, 2009, p.13 and Anderson and Grusky, 2007, p. 4.

3. A Controversial Instrument

Efforts to negotiate investment protections through multilateral negotiations have repeatedly failed. The Free Trade Area of the Americas (FTAA) negotiations collapsed after 11 years of negotiations, in part due to insistence by Canada and the U.S. on the inclusion of broad investment protections. The Multilateral Agreement on Investment (MAI) talks at the Organization for Economic Cooperation and Development (OECD) were defeated in the late 1990s for similar reasons. Plans to discuss investment at the World Trade Organization were blocked by developing country members in 2003. What has proven impossible to achieve through multilateral dialogue, however, has been achieved in one on one bilateral negotiations, often outside of public scrutiny. In the 1990s, the number of BITs increased from 385 to 1857.⁶



“These [treaties] are signed without any knowledge of their implications. And when you are hit by the first investor-state arbitration you realize what these words mean.”

Makhdoom Ali Khan, Pakistan’s Attorney Generalⁱⁱ

While the Canadian Government has had success convincing smaller developing countries, or those with a strong free trade orientation, to agree to sign FIPAs, countries with more negotiating power, such as Brazil, India, and South Africa are not signing up. The South Africa-Canada FIPA remains unratified. Brazil has not ratified a single BIT. Many governments that have signed BITS/FIPAs have buyer’s remorse, and admit they were unaware of the profound implications for their policy space.

4. A Dangerous Enforcement Regime

The investment protections in the treaties are backed by an exceptionally powerful international arbitration mechanism. The most commonly used international arbitration forum is the International Centre for the Settlement of Investment Disputes (ICSID), which is part of the World Bank. Another prominent forum is the so-called International Court of Arbitration of the International Chamber of Commerce (ICC), a private business organization. Tribunals established at ICSID or the ICC rule on cases brought before them by foreign investors against governments for alleged violations of investor protections. Each tribunal has typically three arbitrators. One is named by the investor, one by the government being sued, and a third by agreement or by default appointment by a supervisory body.⁷

The entire arbitration system has been criticized as unpredictable and open to bias. Arbitrators lack the safeguards that apply to judges of both domestic and international court, including e.g. security of tenure and prohibitions on getting paid for non-judicial activities. It is common for lawyers who advise large corporations to simultaneously work as arbitrators and advocates. Because mainly investors bring claims under the treaties, arbitrators may be suspected of deciding cases in favour of investors in order to encourage claims and expand their market. According to commentators, the “most basic legal principle of any legal process, that justice must be blind, is clearly not at play here.”⁸

BITS have transformed international law by giving private investors the right to initiate suits against host states for alleged breaches of investor protections. The mere threat of such a suit, which can lead to an award for hundreds of millions of dollars, has been shown to have a “chill effect” on governments looking to raise regulatory standards or consider new policies in the public interest.

Unlike any other area of international law, investors are typically not required to go first to the domestic courts of a country in order to resolve a grievance against the government. This ability to bypass domestic courts undermines democratic process and the sovereignty of host governments. Even when an investment emanates from a country that is not party to a treaty, the investor can often simply incorporate in one of the countries that is party to the desired treaty in order to obtain the protections of that agreement. This is often called “forum-shopping.”

The lack of transparency is also a major concern. Many arbitration cases have significant public interest implications. However tribunals are generally not required to open hearings, disclose documents, or accept briefs by third parties. Unless the terms of the BIT require openness (as would be the case if an arbitration arises from a new model Canadian FIPA), the rules of the body arbitrating a given case determine the procedures. In the case of ICSID, procedures are closed to the public unless both parties favour disclosure. In the case of the ICC, even the existence of a claim and the identity of the arbitrators are typically kept secret.

5. What is the Canadian FIPA Model?

In 2003, Canada underwent a review of its approach to investment treaties and adopted a ‘revised model’ in 2004. This revised model has been used as the basis for negotiating Canadian investment treaties since. While the new Canadian model shows improvements over the investment treaties of some other countries, the fundamental structure of Canadian FIPAs remains unchanged and highly problematic.⁹

The 2004 FIPA model introduces welcome improvements on the transparency of the arbitration process, with hearings and documents now open to the public. The new FIPA language also pays greater attention to preserving the right of governments to regulate in the public interest.¹⁰ But the efficacy of the language remains untested in any arbitration, and will always be subject to the tendencies of the arbitrator of the day.

Many other controversial elements of the FIPA remain however, and new concerns have been introduced. The new FIPA model leaves investor-state dispute settlement intact, and continues to require developing countries to liberalize their foreign investment climate. While developing countries are able to exempt select sectors from liberalization at the time the treaty is being negotiated, governments are often unable to predict which sectors will require exemption. The model has also expanded the list of banned “performance requirements” on foreign investors, further curtailing government discretion to use selected policy tools in a strategic way in key sectors. (See Box)

6. Promotion and Protection of Human Rights and the Environment

The investment regime lacks any consideration for international human rights and environmental legal standards and indeed creates a major disincentive for their implementation at the domestic level. In practice, this results in a perverse primacy of commercial and business priorities, despite the legal principle of human rights being the first obligation of States.

Human Rights

BITs are part of the complex body of international law to protect investors that has evolved separately from human rights law. While BITs define state obligations to protect investors' rights to "fair and equitable treatment" and to compensation for expropriation, they do not recognize other State obligations under environmental or human rights law. Arbitrators in investment treaty disputes are neither mandated nor qualified to investigate whether or not human rights obligations have been met or violated.¹¹

Under international human rights law, States have obligations to respect, protect and fulfill human rights and to do so through the progressive enactment of international standards in domestic law and through regulatory powers. A major concern is that the protections guaranteed to investors in BITs can conflict with or limit a state's ability to meet its human rights obligations.¹² Initiatives, for example, to raise environmental or labour standards, to regulate the cost or availability of public services, or to reform tax, technology, or financial policy in response to changing development needs are vulnerable to challenge as a threat to business interests. (See case examples in Section 4 below).¹³



Two thirds of all investor-state lawsuits have been filed since 2002 and almost a third are against Argentina for having taken actions to alleviate the negative impact on citizens of the financial crisis in that country in 2001.ⁱⁱⁱ

Environment

While there are environmental exceptions written into some investment treaties, e.g. measures to protect human, plant and animal life and to conserve natural resources, there is no mechanism to enforce these environmental provisions.¹⁴ Moreover, often these exceptions are significantly weakened by a requirement that they apply only to measures that are "otherwise consistent" with the treaty.

NAFTA's Chapter 11 for example has undermined efforts to enact new environmental laws and regulations in the public interest and has led governments to pay compensation to polluters, even where their activities were considered harmful to public health. By early 2000, 10 of 17 NAFTA Chapter 11 cases were brought against environmental and natural resource measures, including "hazardous waste management decisions, maintenance of clean drinking water, and gasoline additives barred in other jurisdictions."¹⁵ The trend of lawsuits against environmental measures continues to be a major issue, with several outstanding claims against Canada, including a US firm seeking \$100 million in damages for its market losses after a decision by a Canadian regulatory agency to ban the harmful agro-chemical Lindane, and a lawsuit by Dow AgroSciences against Canada for Quebec's decision to restrict pesticide use.

7. Some Illustrative Arbitration Cases

1. NATURAL RESOURCE CONTROL in South Africa

Piero Foresti, Laura De Carli and others v. South Africa

A group of Italian investors who own granite production companies in South Africa filed a lawsuit under the Italy-South Africa bilateral investment treaty over the 2004 Mineral and Petroleum Resources Development Act (part of South Africa's "Black Economic Empowerment" agenda). This law aims to promote greater participation of blacks and racial equity in the South African mining sector, for example through setting minimum criteria for black ownership and management. The investors argued that the MPRDA requirements were tantamount to expropriation and discrimination. The case is not yet resolved but could set a negative precedent for governments seeking to protect human rights and expand opportunities for historically disadvantaged peoples.

2. WATER PRIVATIZATION in Argentina

*Azurix vs. Argentina*¹⁶

In 1999, Azurix, a subsidiary of Enron Corporation, agreed to purchase the exclusive right to provide water and sanitation services to Buenos Aires for 30 years. When the Argentine government issued a warning to citizens to boil their water after an algae outbreak, some customers refused to pay for the water. According to Azurix's claim, the government of Argentina violated their rights under the US-Argentina bilateral investment treaty to protection from expropriation without compensation, "fair and equitable treatment" and other standards. The tribunal found in favour of the investor and ordered the state to pay compensation to Azurix. The case demonstrates the high price that can be paid when governments decide to serve the public good in ways later deemed by a tribunal to be contrary to investor interests.

3. MINING and ENVIRONMENTAL REGULATION in El Salvador

Pacific Rim vs. El Salvador

Pacific Rim, a Canadian gold mining company, was granted an exploration permit for its El Dorado site in El Salvador in 2002. There has been significant opposition due to potentially severe environmental damage including the risk of cyanide contamination and the demands on water resources from the extraction process. Local protests and a government announcement stating that El Salvador would not grant exploitation rights to Pacific Rim have led the company to file a lawsuit through their US subsidiary (Pac Rim Cayman) under the Central American Free Trade Agreement (CAFTA) (to which Canada is not a party) for \$100 million in compensation. The arbitration is scheduled to begin in early 2010. Meanwhile lethal violence and conflict continue around the mine site. In two separate incidents in December 2009, three anti-mining activists, Ramiro Rivera, Felicita Echeverria and Dora Alicia Sorto Recinos (who was pregnant at the time), were killed. The Salvadoran government has promised a thorough investigation into the perpetrators of the crimes.

8. Further Reading

Anderson, Sarah and Sara Grusky. [*Challenging Corporate Investor Rule: How the World Bank's Investment Court, Free Trade Agreements, and Bilateral Investment Treaties have Unleashed a New Era of Corporate Power and What to Do About It*](#). Institute for Policy Studies and Food and Water Watch, April 2007.

CCIC. [*Making a Bad Situation Worse: An Analysis of the Text of the Canada-Colombia Free Trade Agreement*](#). In particular the Investment Chapter in the Canada-Colombia FTA, Scott Sinclair, 2009.

Clarkson, Stephen and Stepan Wood. *A Perilous Imbalance -- The Globalization of Canadian Law and Governance*. UBC Press, 2010.

International Institute for Sustainable Development and World Wildlife Fund. [*Private Rights, Public Problems: A Guide to NAFTA's controversial chapter on investor rights*](#). 2001.

Mann, Howard. [*International Investment Agreements, Business and Human Rights: Key Issues and Opportunities*](#). International Institute for Sustainable Development (IISD). February, 2008.

Peterson, Luke Eric. *Evaluating Canada's 2004 Model Foreign Investment Protection Agreement in Light of Civil Society Concerns*. CCIC, June 2006.

Peterson, Luke Eric. [*Human Rights and Investment Treaties: Mapping the role of human rights law within investor-state arbitration*](#). Rights and Democracy, 2009.

Schneiderman, David, *Constitutionalizing Economic Globalization*. Cambridge University Press, 2008.

Shrybman, Stephen. *In the Matter of the United Nations Human Rights Council Declaration 2/104: Human Rights and Access to Water*. [*Preliminary Submissions of the Council of Canadians Blue Planet Project*](#). The Council of Canadians. 2007.

Van Harten, Gus. *Investment Treaty Arbitration and Public Law*. Oxford University Press, 2007.

END NOTES

¹ Croatia, Costa Rica, Lebanon, Uruguay, El Salvador, Armenia, Thailand, Panama, Venezuela, Egypt, Ecuador, Romania, Barbados, Philippines, Trinidad and Tobago, South Africa (NB never ratified), Latvia, Ukraine, Hungary, Argentina, Czech and Slovak Federal Republic, USSR and Poland.

² India (concluded not ratified), Madagascar (concluded not signed), Peru and Jordan.

³ In negotiation: Bahrain, Tunisia, Tanzania, Indonesia, Vietnam, Mongolia, China and Kuwait. Planned: Algeria, Cameroon, Cuba, Ghana, Kazakhstan, Libya, Malaysia, Mali, Nigeria, Saudi Arabia, United Arab Emirates and Zambia.

⁴ Jordan, Colombia, Peru and the European Free Trade Association.

⁵ In Negotiation: European Union Comprehensive Economic and Trade Agreement (CETA), Panama, Korea, Caribbean, Dominican Republic and the Central America Four (CA4). Exploration: Ukraine, Morocco and India (possible Comprehensive Economic Partnership Agreement - CEPA).

-
- ⁶ Peterson, Luke Eric. *Human Rights and Bilateral Investment Treaties: Mapping the role of human rights law within investor-state arbitration*. Rights & Democracy, 2009. p.11. <http://www.dd-rd.ca/site/PDF/publications/globalization/HIRA-volume3-ENG.pdf>
- ⁷ Peterson, 2009. p.15.
- ⁸ Cosbey, Aaron, Howard Mann, Luke Eric Peterson, Konrad Von Moltke. *Investment and Sustainable Development: A Guide to the Use and Potential of International Investment Agreements*. International Institute for Sustainable Development, 2004. p.6. http://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf
- ⁹ For more on Canada's model treaty see: Peterson, Luke Eric. *Evaluating Canada's 2004 Model Foreign Investment Protection Agreement in Light of Civil Society Concerns*. CCIC, June 2006.
- ¹⁰ Ibid, i.
- ¹¹ However, there has recently been an increase in use of human rights arguments in disputes on behalf of investors, host governments as well as by third parties. See Peterson, 2009. p.22.
- ¹² For more see: Mann, Howard. *International Investment Agreements, Business and Human Rights: Key Issues and Opportunities, prepared for John Ruggie, UN Special Representative to the Secretary General for Business and Human Rights*. International Institute for Sustainable Development, February 2008. p.15. http://www.iisd.org/pdf/2008/iia_business_human_rights.pdf
- ¹³ The treaties provide a particularly potent form of sanction when a company has a contract with a government containing a 'stabilization clause' – or promise of an unchanging policy environment. Case law shows arbitrators side more uniformly with investors claims in these cases. See Mann, Howard. 2008. p.16.
- ¹⁴ International Institute for Sustainable Development and World Wildlife Fund. *Private Rights, Public Problems: A guide to NAFTA's controversial chapter on investor rights*. 2001. p.12. http://www.iisd.org/pdf/trade_citizensguide.pdf
- ¹⁵ For more on these cases, see Ibid. p.15
- ¹⁶ There are numerous suits filed against Argentina from water companies including the well known *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal v. Argentina* in which the Argentine government has referred to its human rights obligations in defense of its actions. The eventual ruling will be instructive on the primacy of human rights law versus international investment law. For more on the Suez case and the Right to Water, see: Shrybman, Steven. *In the Matter of the United Nations Human Rights Council Decision 2/104: Human Rights and Access to Water, Preliminary Submissions of the Council of Canadians Blue Water Project*. Council of Canadians, 2007. http://www.blueplanetproject.net/RightToWater/documents/Submission_UN_0407.pdf
- ⁱ Darimani, Abdulai. *An Alternative Investment Framework for Africa's Extractive Sector: A Perspective from Civil Society*. CCIC, 2009. p.16. http://www.ccic.ca/files/en/what_we_do/002_trade_2009-04_aimes_paper.pdf
- ⁱⁱ Anderson, Sarah and Sara Grusky. *Challenging Corporate Investor Rule: How the World Bank's Investment Court, Free Trade Agreements, and Bilateral Investment Treaties have Unleashed a New Era of Corporate Power and What to Do About It*. Institute for Policy Studies and Food and Water Watch, April 2007. p.3.
- ⁱⁱⁱ Ibid.