Going International: Taking Advantage of Investment Protection Agreements

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When taking your business beyond Canada's borders, there are always risks. If you're making a direct investment in a foreign market, such as participating in a joint venture, establishing a subsidiary, entering into an international licensing agreement or purchasing real estate, you have to consider how to best protect your investment in the foreign state. You may face restrictions on capital or cash transfers, competitors receiving unfair subsidies or governments with a history of expropriating foreign property. Taking advantage of an existing international investment agreement between your home state and the state where you will be making an investment can mitigate risks and provide competitive advantages as you expand your international operations.

INTRODUCTION TO INTERNATIONAL INVESTMENT AGREEMENTS

International investment agreements ("IIA") are treaties between two or more countries designed to protect and promote foreign investment between them by creating a predictable and rules-based regime for investors in foreign markets backed up by effective dispute resolution mechanisms. IIAs are sometimes included as part of a broader free trade agreement, such as Chapter 11 of the North American Free Trade Agreement, but more commonly are standalone bilateral agreements between two states. These kinds of IIAs are usually called "bilateral investment treaties" ("BIT") or "foreign investment protection and promotion agreements".

Generally, an IIA will provide most or all of the following protections to investments of a national of one state party in the territory of the other state party:

- Foreign investments will be treated in accordance with the customary international law minimum standard of treatment including fair and equitable treatment with full protection and security.
- Foreign investments will be accorded no less favourable treatment than the host state grants to its own investors or investors of any other country.
- Foreign investments will not be expropriated except in a non-discriminatory manner in accordance with due process of law with prompt and adequate compensation. Expropriation provisions will often cover both traditional "direct" takings and so-called "indirect" or "creeping" expropriation, which results from a measure or a series of measures by a government that have an effect equivalent to direct expropriation without a formal transfer of title or outright seizure of the investment.
- Transfers relating to a foreign investment, such as capital contributions, profits, dividends, proceeds from sales and payments made under a contract, will be permitted to be made in and out of the host state territory freely and without delay.

- A host state will not impose performance requirements on the business operations of a foreign investment. This could include requirements to export a certain level or percentage of goods, achieve a certain level or percentage of domestic content, or purchase or prefer goods or services produced or provided from the territory of the host state.
- An investor-State dispute resolution process is available to a foreign investor in the event that their investment is not provided the protections set out in the IIA. This dispute resolution mechanism allows a foreign investor to directly sue the host state through binding international arbitration, rather than relying on local courts. In some cases, the protections afforded under an IIA will actually provide a better remedy to a foreign investor than would be available under the local law to a domestic investor.

The definition of "investment" will vary from treaty to treaty, but is usually broadly defined to include a business enterprise, shares or other equity interests in a business enterprise, certain debt securities and loans, real estate, personal property (including intangible property such as intellectual property) and interests arising from an investor's commitment of capital or other resources in the foreign state. If the investment has been made by an investor of one state party in the territory of the other state party, it will be entitled to the protections afforded by the relevant IIA.

CANADA'S INTERNATIONAL INVESTMENT AGREEMENTS

As each IIA or BIT is negotiated independently between the contracting states, no two IIAs are exactly alike, and may not contain the same level of protection or scope of investment coverage as explained above. It is important to review any potentially applicable IIA to determine if it will offer protection from the specific risks you expect to face in the foreign state. As a Canadian investor, there are dozens of IIAs that you could take advantage of when exploring foreign market opportunities.

Canada has IIAs or BITs in force with over 30 countries worldwide. These include the United States and Mexico (through NAFTA), Chile, Colombia, Argentina, Costa Rica, Jordan, Panama, Peru, Ukraine and Venezuela. Negotiations are also ongoing for BITs with China, which has been identified as a priority by the Canadian government, and India, in connection with the ongoing negotiations of a comprehensive free trade agreement. Additionally, the Canada-European Union Comprehensive Economic and Trade Agreement, expected to be signed in 2012, will include an investment protection chapter giving Canadian investments strong protections across the 27 member states of the EU.

STRUCTURING YOUR FOREIGN INVESTMENT

The presence of a strong IIA is a key differentiator in determining what foreign markets to target for investment. And although Canada's number of IIA partners is currently limited in number, there is a vast web of IIAs and BITs linking economies, both developed and developing, across the globe – over 2500 IIAs are in force worldwide. So even if Canada does not have an IIA with your target foreign state, there is a good chance that another country does. Structuring your investment to take advantage of such an existing IIA may be possible depending on your business's existing corporate organization. For example, a Canadian interested in making an investment in Hong Kong would not have the protection of an IIA, as Canada is not party to an agreement with Hong Kong. Australia does have a BIT with Hong Kong. If the Canadian uses an Australian company, either already existing or newly incorporated, to make the investment in Hong Kong, the investment will benefit from the protections provided under the Australia-Hong Kong BIT.

This "holding company" strategy does have its limitations. Many recent IIAs contain express language denying such structures protection under the treaty unless the company is carrying on substantial business activities in the jurisdiction where it is constituted – essentially aimed at the practice of incorporating a holding company for the sole purpose of obtaining the benefits of an IIA. A review of applicable IIAs is required to assess the viability of using a foreign subsidiary to obtain protection for your investment.

The benefits of an IIA to a business investing overseas are enormous. They level the playing field by breaking down barriers to foreign investments and reduce uncertainty in the business environment. Understanding the impact of an IIA on your foreign investment opportunities will allow you to make decisions with better information on mitigating risks and establishing competitive advantages for your business to harness.

Contact

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