



International Business Bulletin

EDITOR:

Henry J. Chang
Direct 416.597.4883
hchang@blaney.com

This newsletter is designed to highlight new issues of importance in international trade and business related law. We hope you will find it interesting and welcome your comments.

For more information, feel free to contact any of the lawyers who wrote or are quoted in these articles, or one of the co-chairs of our International Trade and Business Group:

Henry J. Chang, Co-Chair
Direct 416.597.4883
hchang@blaney.com

Stan Kugelmass, Co-Chair
Direct 416.593.3943
skugelmass@blaney.com

IN THIS ISSUE:

Canada and South Korea Sign Free Trade Agreement
Henry J. Chang

Canada and China Foreign Investment Promotion and Protection Agreement in Force October 1, 2014
Patrick Gervais

“[The Canada-Korea Free Trade Agreement] will cover virtually all aspects of Canada-South Korean trade, including trade in goods and services, investment, government procurement, non-tariff barriers, environment and labour cooperation, and other areas of economic activity.”

CANADA AND SOUTH KOREA SIGN FREE TRADE AGREEMENT

Henry J. Chang

On September 22, 2014, Prime Minister Stephen Harper and South Korean President Park Geun-hye officially signed the Canada-Korea Free Trade Agreement (the “CKFTA”), which was announced on March 11, 2014. The ceremony took place during Park Geun-hye’s official visit to Canada.

As we previously reported in the March 2014 issue of *International Business Bulletin*, the CKFTA will cover virtually all aspects of Canada-South Korean trade, including trade in goods and services, investment, government procurement, non-tariff barriers, environment and labour cooperation, and other areas of economic activity. Some tariffs will be eliminated immediately while others will be phased out over several years.

One of the most controversial issues arising from the CKFTA was the elimination of Canadian duties applied to South Korean automobiles. This prompted strong objections from Ontario’s automobile industry, which claimed that the elimination of this duty would cause an even greater trade imbalance with South Korea. Although these objections are certainly understandable, many of the South Korean cars sold in Canada are already expected to enter the country duty free from the United States

pursuant to the North American Free Trade Agreement.

Some critics of the CKFTA have pointed to the increased trade deficit that the United States has experienced since the U.S.-South Korea Free Trade Agreement (“KORUS FTA”) came into force on March 15, 2012. The Congressional Research Service considered this change in its recent report on the KORUS FTA (the “CRA Report”), which was prepared for members and committees of the United States Congress.

The CRA Report, which was published on September 16, 2014, found that from 2011 (the last full year before the KORUS FTA was implemented) to 2013, U.S. goods exports to South Korea decreased from \$41.3 billion to \$39.2 billion (a 5% decrease) and imports increased from \$56.0 billion to \$62.1 billion (an 11% increase). This caused the U.S. goods trade balance with South Korea to decrease (become more negative) from \$-14.7 billion to -\$23.0 billion (a 56% decrease). However, during the same period, U.S. services exports increased from \$16.7 billion to \$20.9 billion (a 25% increase), while imports increased from \$9.7 billion to \$10.8 billion (a 10% increase). This caused the U.S. services trade balance with South Korea to increase from \$6.9 billion to \$10.1 billion (a 46% increase).

“[S]imulation models of projected market changes [found] that South Korea would always gain relative to the United States from bilateral liberalization, because it has been much more successful in accessing the U.S. market than the United States has been in accessing the Korean market.”



Henry J. Chang is co-chair of the firm's International Trade and Business Group. A recognized authority in the field of foreign law, Henry is licensed as a Foreign Legal Consultant by the Law Society of Upper Canada, and is the Official Research Partner of the International Bar Association and the Strategic Research Partner of the ABA Section of International Law.

Henry may be reached directly at 416.597.4883 or hchang@blaney.com.

Although the CRA Report acknowledged that the increased U.S. goods trade deficit has been a cause of concern for some U.S. policymakers, it also explained that some of the decrease in goods exports to South Korea was likely due to fluctuations in the business cycle in South Korea and that this was not unique to the United States. For example, from 2011 to 2013, South Korea's goods imports from the world overall fell 1.7%, as did South Korea's imports from its top three import suppliers.

In terms of the automobile industry, the CRA Report found that the total value of South Korean automotive exports to the United States, including parts, was \$19.7 billion in 2013, compared with U.S. exports of similar products to South Korea of \$1.5 billion. In other words, the United States ran a bilateral trade deficit in autos of \$18.2 billion in 2013; an increase from \$10.6 billion five years ago. However, one analyst who examined the effects of the KORUS FTA found in simulation models of projected market changes that South Korea would always gain relative to the United States from bilateral liberalization, because it has been much more successful in accessing the U.S. market than the United States has been in accessing the Korean market.

The CRA Report explained that assessing the impact of the KORUS FTA on U.S.-South Korea trade flows and the U.S. economy was a difficult question to answer definitively for several reasons:

a) Assessing the impact of a policy change (the KORUS FTA) on an economic variable (trade flows) requires a careful analysis that takes into account other variables, which may also affect the outcome. Otherwise, one may mistakenly

attribute a change in the trade balance to the KORUS FTA when changes in exchange rates or aggregate demand are instead responsible.

- b) The KORUS FTA has only been in effect for about two years, making it difficult to determine its long-term direct economic and trade effects on the United States. Tariffs on the most sensitive products will be phased out over several more years, and production and consumption patterns take time to adjust.
- c) Aggregate data on trade flows may not capture the full impact of the agreement. Any significant effects of the KORUS FTA are more likely to be evident on individual firms and industries rather than trade flows as a whole.
- d) Some of the potential benefits of free trade, which include lower-priced and more diverse goods and services, as well as improved productivity among firms, cannot be easily measured by trade balances.

It would appear as though we should not rely too much on U.S. trade numbers during the early years of the KORUS FTA, as an indicator of how the CKFTA will affect Canada's trade with South Korea. Although it is inevitable that some Canadian industries will benefit more than others, it is too early to determine whether the overall effect of the CKFTA on Canada's trade balance will be positive or negative. ■

“[The Foreign Investment Promotion and Protection Agreement] aims to stimulate trade between the two countries by protecting investors in each market, China now being Canada’s second largest commercial partner.”



Patrick Gervais is a member of Blaney McMurtry's International Trade and Business practice group. His practice focuses on a range of commercial matters including M&A, securities and commercial agreements (distribution, service, product and outsourcing agreements).

Patrick also advises companies on compliance requirements, anti-corruption, money-laundering and regulatory matters. His clients include large and medium size companies with a focus on F&B, franchise and manufacturing.

Patrick may be reached directly at 416.597.4891 or pgervais@blaney.com.

CANADA AND CHINA FOREIGN INVESTMENT PROMOTION AND PROTECTION AGREEMENT IN FORCE OCTOBER 1, 2014

Patrick Gervais

Canada ratified the Foreign Investment Promotion and Protection Agreement with China¹ (FIPA) on September 12, 2014, almost two years to the day following its signature. FIPA will come into force on October 1, 2014 creating new standards for investments between China and Canada. FIPA aims to stimulate trade between the two countries by protecting investors in each market, China now being Canada’s second largest commercial partner.

The key aspects of the FIPA include (i) non-discriminatory government treatment for investments made by Canadian investors in China and vice-versa, (ii) a defined dispute resolution mechanism, and (iii) protection measures for damages suffered by investors in each respective market.

Key Distinctions of the Canada-China FIPA

The Canada-China FIPA differs from the other two dozen similar Canadian agreements in the following ways:

1. Initial 15 Year Term

Unlike other FIPAs with an indefinite term and a one year termination notice by either party, the Canada-China FIPA has an initial term of 15 years, with the usual one year termination notice thereafter. Investments made prior to FIPA’s termination will be subject to FIPA rules for an additional 15 year period after its effective termination date. For example, an investment made in 2028 prior to

FIPA’s earliest termination in 2029 would still be subject to the terms of the agreement for 15 years thereafter, meaning 2043.

2. No ‘National Treatment’ at the Establishment and Acquisition Stage

A second key distinction of FIPA is its lack of ‘national treatment’ protection at the prospective stage. ‘National treatment’ protection allows foreign firms the same treatment as national firms. Generally, in other Canadian bilateral treaties, investors receive ‘national treatment’ at the establishment and acquisition stages. Instead of ‘national treatment’ at the establishment and acquisition stages, FIPA allows the lower threshold of ‘most-favoured-nation treatment’ at these stages. National treatment protection only kicks in after the investment is made and excludes everything prior to the close of the transaction. This is in line with other Chinese bilateral investment treaties but not with most Canadian treaties. The *Investment Canada Act* and its Chinese equivalent still apply, allowing both governments to veto investments at the establishment and acquisition stages when they do not meet the net benefit test in the target country.

3. By Default Private Dispute Resolution

Dispute resolution of FIPA is by default by way of private arbitration. In contrast with other Canadian treaties, the arbitration is private unless the host government determines that it would be in the public interest to make the dispute resolution public. For example, an arbitration hearing relating to a dispute by a Canadian company in China claiming damages under FIPA would be private unless the Chinese government requested it be made public.

¹ *Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments*. Please follow this link for the full text of FIPA: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=eng>.

4. Exempted Industries

Certain industries are explicitly exempt from the application of FIPA. For investments in China, many of the excluded industries mirror the industries prohibited to foreign investors under the *Catalogue of Prohibited Foreign Investment Industries* issued by the Ministry of Commerce of the People's Republic of China. Cultural and media industries are excluded, as well as certain environmental industries, security related industries, and a broad catch-all for industries related to the protection of essential security interests.

5. Expropriation

Expropriation provisions in FIPA mirror similar Canadian treaties and prohibit the expropriation of investments or returns of investors, other than for a public purpose and in exchange of compensation at fair-market value. The mechanism for determining fair market value is specified in FIPA.

Moving Forward

Proponents of FIPA believe that it will help increase direct investment between the two countries because of the greater certainty it allows investors from both countries. As trade between both countries continues to grow, greater expertise will be needed in the field of dispute resolution for Canadian investors operating in China as well as in the field of dispute resolution between Chinese investors and the Canadian government. ■

EXPECT THE BEST

**Blaney
McMurtry**
BARRISTERS & SOLICITORS LLP

2 Queen St. East, Suite 1500
Toronto, Canada M5C 3G5
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com

International Business Bulletin is a publication of the International Trade and Business Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The view and comments contained in this newsletter are those of the author alone, and do not necessarily reflect the views of Blaney McMurtry LLP or other members of the firm. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Kelly Macneil at 416 593.7221 ext. 3600 or by email to kmacneil@blaney.com. Legal questions should be addressed to the specified author.