

INVESTMENT CHAPTER

Introduction

The investment chapter is a comprehensive set of classic standards found in investment agreements throughout the world. The chapter is in large part modeled after the NAFTA investment chapter, but also draws from United States bilateral investment treaties and customary international law. The chapter also incorporates a number of innovations to traditional investment agreement provisions that reflect U.S. experience with the implementation of investment agreements, and innovations that respond to new investment objectives set forth in the Trade Promotion Act of 2002.

The chapter is divided in three parts. Part A contains a set of definitions. Part B sets out each government's obligations with respect to investors from the other Party and their investments in its territory. Part C affords investors the right to seek compensation through international arbitration for a breach of an obligation under Section B, breach of an investment agreement, and breach of an investment authorization. The chapter also contains a set of annexes.

Section B - Investment Obligations

Scope and Coverage

Part B provides six basic protections to "investors of the other Party": non-discriminatory treatment relative to domestic investors as well as investors of non-Parties; freedom from "performance requirements;" free transfer of funds related to an investment; expropriation only in conformity with customary international law; so-called "minimum standard of treatment" in conformity with customary international law; and the ability to hire key managerial and technical personnel without regard to nationality.

"Investment" is broadly defined to cover all forms of investment, including enterprises, securities, debt, intellectual property, concessions and contracts. Both existing and future investments are covered, but not events that predate the entry into force of the Agreement. "Investor of a Party" is defined to encompass both nationals of the Parties and firms (including branches) established in one of the Parties, and subject to very limited exceptions discussed below, without distinction as to the ultimate nationality of ownership. The chapter applies where such firms or nationals make or attempt to make investments in the territory of the other Party.

The chapter applies to all governmental measures, at all levels of government, relating to investment, with the exception of measures governing financial services, which are treated in a separate financial services chapter. In other words, with the exception of financial services, the investment chapter covers all sectors, including service sectors. However, the Parties may exclude particular sectors or measures if explicitly stated in annexes to the Agreement. In the event of any inconsistency between the investment chapter and another chapter, the other chapter will prevail.

Non-discrimination Standards

The basic non-discrimination rules of "national treatment" and "most-favored-nation treatment" are set out in two articles. These rules require, respectively, each government to treat investors of the other Party and their investments:

- * no less favorably than its own investors and their investments when they are in like circumstances, and
- * no less favorably than investors of other countries and their investments when they are in like circumstances.

The phrase "in like circumstances" is very important and is intended to ensure that all appropriate circumstances are taken into account in making a determination of whether the treatment is less favorable. For example, factors such as the sector or geographic location may be relevant.

Minimum Standard of Treatment

This article affords investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. Through this provision, the chapter provides investments, *inter alia*, with the due process standards of customary international law, nondiscriminatory treatment with respect to losses suffered as a result of armed conflict or civil strife, and compensation or restitution for the requisitioning of property or unnecessary destruction of property by authorities or their armed forces.

This article, together with a supplementary annex, provides more detail than previous investment agreements with respect to the standards of treatment of aliens and their property found in customary international law. This new detail and supplementary information has been added to ensure the proper interpretation and application of the standards, consistent with the guidance of the Trade Promotion Act of 2002. For example, the provisions explain that fair and equitable treatment under customary international law includes the obligation not to deny justice in adjudicatory proceedings in accordance with the principles of due process embodied in the principal legal systems of the world, including that of the United States.

Performance Requirements and Incentives

This article disciplines particular types of mandatory performance requirements, as well as certain performance requirements that are conditions for receiving incentives. The rules prohibiting performance requirements apply with respect to all investments, whether by non-Party investors or domestic investors.

The first paragraph of this article imposes disciplines on “mandatory” performance requirements. Under the first paragraph, a government may not, as a condition for the establishment or operation of an investment, require a firm to:

- * achieve a minimum level of "domestic content;"
- * buy, use, or accord a preference to goods produced locally or to purchase goods from a local supplier;
- * limit its imports to a certain percentage of exports or foreign exchange inflows associated with the investment;
- * limit sales of goods or services that the investment produces to a certain percentage of exports or foreign exchange inflows associated with the investment;
- * export a specified level of good or services;
- * transfer particular technology, production process, or other proprietary knowledge to any domestic entity;
- * supply designated regional or world markets solely from its local production.

The second paragraph addresses performances requirements as a condition for receiving incentives, stating that a government may not use the first four of the requirements listed above as a condition for receiving an advantage, such as a tax holiday.

The third paragraph of this article states explicit exceptions to some of these disciplines. For example, government procurement, qualification requirements for export and foreign aid programs, and nondiscriminatory health, safety, and environmental requirements are excluded from some of the performance requirements disciplines. With regard to the transfer of technology, a Party’s authorized use of an intellectual property right in accordance with Article 31 of the TRIPs Agreement are excepted, as are measures requiring the disclosure of proprietary information that fall within the scope of, and are consistent with, Article 39 of the

TRIPs Agreement, and enforcement measures by competition authorities.

Senior Management and Boards of Directors

This article prohibits governments from requiring local firms owned by investors from the other country to fill senior management positions based on nationality. A government may require a simple majority of the board of directors to be local nationals, however, as long as the requirement does not materially impair the investor's control over its investment.

Non-Conforming Measures

This article creates a system of limited, country-specific exemptions (“non-conforming measures”) for specified laws and regulations that are not in conformity with the non-discrimination, performance requirements, and senior management obligations described above. The article also excepts government procurement and subsidies and grants from such obligations.

The non-conforming measures referred to above are recorded in either of two schedules, Annex I or Annex II. Annex I is for existing measures and Annex II is for future measures. These two annexes are also used to list measures relating to services that are inconsistent with particular provisions of the services chapter.

Annex I: Annex I sets out each government's non-conforming measures for existing, inconsistent measures at the federal or regional level. Existing measures at the local level are generally exempted or “grandfathered” for both Parties without having to be specifically listed.

Laws and regulations that are "grandfathered" or listed as a reservation in Annex I are exempt from challenge under the chapter, even if they are amended or renewed, so long as they are not made more inconsistent with the Agreement. If a measure is liberalized, however, any such liberalization may not be reversed by a subsequent amendment.

For its part, the United States exempted existing, non-conforming legislation in respect of such matters as nuclear power, broadcasting, mining, customs brokers, and air transportation. The United States also took an exemption for all existing measures at the state level.

Annex II: The two governments also recorded a limited number of broader exemptions for measures falling into certain sectors, such as basic telecommunications, broadcasting, and maritime trade. Those exemptions, listed as reservations in Annex II, allow a government to maintain existing and adopt new laws and regulations that vary from the chapter's rules regarding non-discrimination, performance requirements, and senior management.

Transfers

This article requires each government to permit transfers relating to an investment covered by the chapter to be made freely and without delay, into and out of its territory, including transfers of profits, royalties, sales proceeds, and other remittances relating to an investment. Exceptions permit a government to prevent transfers under certain laws of general application, such as bankruptcy laws and other law enforcement purposes.

There is an annex that is unique to Chile that, for certain types of speculative capital, allows Chile to impose capital transfer restrictions for 12 months, as long as those restrictions do not substantially impede transfers. If Chile's capital transfer restrictions are found to substantially impede transfers, then damages would accrue from the date of the initiation of the measure. If Chile imposes any restrictions on any transfers for longer than 12 months, it may be required to compensate the investors for the extent and loss of asset value beginning in the second year.

Expropriation and Compensation

This article contains the classic customary international law obligations with respect to expropriation. Under this article, a government may not expropriate, directly or indirectly, an investment made by an investor from the other Party other than for a public purpose, on a non-discriminatory basis, and in accordance with due process of law. Compensation must be paid without delay at the fair market value of the expropriated investment, plus any applicable interest, and must be freely realizable and transferable. Pursuant to the directives of the Trade Promotion Act of 2002, the article is supplemented by an annex that elaborates on relevant principles of United States takings law and clarifies the relationship of indirect expropriations and domestic regulation.

Special Formalities

This article permits a Party to adopt or maintain "special formalities" in connection with the establishment of an investment, so long as such requirements do not materially impair the substance of any right accorded by the chapter. Special formalities include requirements such as typical incorporation requirements. The article also permits a government to seek information and data from investments covered by the chapter.

Denial of Benefits

This article describes those circumstances under which a government may refuse to apply the protection of the chapter to firms, or their investments, that otherwise qualify for coverage under the chapter, where the firms are owned or controlled by investors from a non-Party.

The article preserves the foreign policy prerogative of each government to deny benefits to firms owned or controlled by nationals of a non-Party with which it does not have diplomatic relations or to which it is applying economic sanctions.

It also permits each government to deny benefits to firms owned by nationals of non-Parties and of the denying Party, if they have no substantial business activities in the territory of the Party where they are established. Thus shell companies could be denied benefits but not, for example, firms that maintain their central administration or principal place of business in the territory of, or have a real and continuous link with, the country where they are established.

Investment and the Environment

This article affirms that the chapter does not preclude a government from adopting, maintaining, or enforcing measures otherwise consistent with the chapter to ensure investment is consistent with its environmental protection goals.

Section C - Investor - State Dispute Settlement

Introduction

Section C provides a mechanism for an investor to pursue a claim against a host government that it has breached its obligations under Section B or that it has breached an investment agreement or an investment authorization. Like other provisions in the chapter, these provisions draw from the NAFTA and U.S. bilateral investment treaties. However, this section incorporates a number of innovations responsive to new objectives in the Trade Promotion Act of 2002 that are intended to increase public access to information regarding proceedings under the chapter ("transparency") and to enhance the proper application of the provisions.

Nature of Claims

Investors may bring claims for allegations of direct injury to an investor, and allegations of indirect injury to an investor caused by injury to a firm in the host country that is owned or controlled by the investor, where the injury results from an alleged breach of Section B or for a breach of an investment agreement or investment authorization. An investment agreement is a written agreement between a national authority of a Party and an investor or investment of the other Party that grants rights with respect to assets that a national authority control and that the investor relies on in making an investment. An investment authorization is an authorization granted by a foreign investment authority of a Party to an investor or investment. The provisions also make clear that claims for breaches of Section B may be brought where governmental authority has been delegated to designated monopolies and state enterprises.

Choice of Arbitral Rules

The investor may choose the arbitral forum, including the International Centre for Settlement of Investment Disputes (“ICSID”), the Additional Facility of the Centre, under the UNCITRAL arbitration rules, or any other mutually agreed arbitral institution. The rules chosen will govern the proceedings except to the extent modified by the Agreement

Limitations

Six months must elapse since the events giving rise to a claim before initiating the proceedings, and all claims must be brought within three years of the date that the claimant acquired, or should have acquired, knowledge of the breach and injury. The claimant may not initiate or continue any domestic proceedings arising out of the events.

Initiation of Dispute Settlement Proceedings

The settlement of claims through consultation or negotiation is encouraged. Should such consultations fail to resolve the matter, an investor must provide written notice of its intention to submit a claim to arbitration at least 90 days before doing so, and specify the breach of Section B, the investment agreement, or the investment authorization.

Jurisdictional Requirements

The provisions establish the requisite mutual consent for arbitration. The rules require the investor (and, in certain cases, the enterprise that is owned or controlled by the investor) to consent in writing to arbitration, and to waive the right to initiate or continue any actions in local courts or other fora relating to the disputed measure, except for actions for injunctive or other extraordinary relief. To ensure that a host country cannot frustrate an arbitration by withholding its own consent, an article expressly states that it constitutes advance consent by the governments to arbitration.

Appointment of Arbitrators

Section C provides generally for the establishment of three-member arbitral tribunals, one member to be appointed by each of the disputants, and the presiding arbitrator to be appointed by agreement between the disputants. If, within seventy-five days of the submission of the claim to arbitration, a disputant fails to appoint an arbitrator, or the two disputants fail to agree on a presiding arbitrator, arbitrators may be named by the ICSID Secretary-General.

Arbitral Proceedings

The articles ensure that the government that is not involved in the arbitration will be apprised of relevant facts and other information and, if it wishes, to submit views to the tribunal on questions of interpretation. To help ensure the enforceability of an award, an article provides that unless otherwise agreed, the arbitration must take place in a country that is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”).

The provisions ensure that the proceedings are transparent by requiring that all documents submitted to or issued by a tribunal be available to the public, except for certain business proprietary and other confidential information, and requiring that the proceedings be open to the public. The public is also able to give its views on the proceedings through a provision expressly enabling the tribunal to accept *amicus curiae* submissions.

To make the proceedings more efficient and to dismiss frivolous claims, tribunals may decide the preliminary question of whether the investor has made out a claim under the Agreement and whether the tribunal has jurisdiction. Upon written request of the respondent, these questions may be answered on an expedited basis within 150 days, or if a hearing is requested, within 180 days of receipt of the request. For the purpose of discouraging frivolous filings, including frivolous claims, the chapter expressly authorizes the tribunal to award costs and attorney’s fees in connection with submitting or opposing an objection to a claim.

The provisions allow all Parties, including the Party that is not a party to the dispute, to review a draft panel decision. The litigants to the dispute, including the defending government, are also given the opportunity to comment on a draft decision by the tribunal. This mechanism is not intended to substitute for an appellate body, but is intended to improve the consistency and coherence of arbitral decisions.

Governing Law

Section C also addresses the substantive law to be applied in arbitral proceedings. It provides that arbitral tribunals are to decide disputes in accordance with the Agreement and applicable international law rules. In the case of investment agreements and investment authorizations, the tribunal shall apply the domestic law of the respondent, the terms of such investment agreements and authorizations, applicable international law rules, and the Agreement. All interpretations by the Commission of the Parties are binding on tribunals and decisions must be consistent with such interpretations.

Interpretation of Annexes

A Party’s defense that an alleged breach falls within the scope of a reservation set forth in an annex must, at the Party’s request, be referred to the Commission, and any decision it makes on the issue will be binding on the tribunal. If the Commission does not make a decision within sixty days, however, the question is referred back to the tribunal.

Expert Reports

A tribunal may seek advice from experts on environmental, health, safety, or other scientific matters under certain conditions.

Consolidation

The provisions address the possibility that more than one investor might submit to arbitration claims arising out of the same event. It provides for the establishment of a special three-member tribunal to consider whether such multiple claims have questions of fact or law in common and that they arise out of the same events or circumstances, in which case that tribunal may assume jurisdiction over, and decide, all or part of any such claims.

Nature of Relief

A tribunal may order interim protective measures to preserve existing rights of the disputants, including the preservation of evidence. A tribunal cannot, however, order attachment of assets or enjoin the government from applying any measure that is the subject of the dispute.

Final awards are limited to money damages or restitution, or a combination of both; awards of restitution must offer the alternative of paying damages. No punitive damages may be awarded.

Enforcement of Arbitral Awards

The chapter includes the traditional rule that an arbitral award is binding only on the particular disputants in the matter. Another provision obliges a disputant to abide by and comply with the award. A disputant has the opportunity to seek revision or annulment of the award before enforcement may be sought.

Section C requires each Party to provide for enforcement of an award in its territory. In the event that a country does not comply with an award, an investor's government may request a government-to-government arbitration panel under the general dispute settlement chapter to consider the matter. The initiation of such proceedings would not prevent the investor from seeking enforcement of the award.

By declaring that claims submitted to arbitration under Section C will be considered to arise out of a commercial relationship or transaction, the Agreement satisfies prerequisites of the New York Convention and the Inter-American Convention on International Commercial Arbitration for the enforcement of awards under those agreements.

Appellate Mechanism

Section C, together with an annex, contemplates the establishment of an appellate mechanism to review awards made under the chapter, permitting the Parties to either establish a bilateral appellate mechanism or to access a future multilateral appellate mechanism.