MEMORANDUM

PROHIBITIONS ON PERFORMANCE REQUIREMENTS IN INVESTMENT TREATIES

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Index of Abbreviations

ACIA	ASEAN Comprehensive Investment Agreement
BIT	Bilateral Investment Treaty
CETA	The Comprehensive Economic and Trade Agreement (CETA)
CPTPP	The Comprehensive and Progressive Agreement for Trans-Pacific Partnership
E&T	Education and Training
EPR	Export Performance Requirement
FET	Fair and Equitable Treatment
FTA	Foreign Trade Agreement
IIA	International Investment Agreement
LCR	Local Content Requirement
LSR	Local Service Requirement
MFN	Most Favored Nation
MNC	Multi-National Corporation
NCM	Non-conforming Measure
OECD	The Organization for Economic Co-operation and Development
PPR	Prohibition on Performance Requirement
PR	Performance Requirement
RCEP	Regional Comprehensive Economic Partnership
SEZ	Special Economic Zone
TRIMs Agreement	Agreement on Trade-Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
USMCA	United States–Mexico–Canada Agreement
WTO	World Trade Organization

EXECUTIVE SUMMARY

Prohibitions on performance requirements ("**PPRs**") in international investment agreements ("**IIAs**") are one of the core issues in investment negotiations today. The controversy stirred from these obligations is a key area of concern for all states which have entered into bilateral investment treaties ("**BITs**") and Free Trade Agreements ("**FTA**") (collectively, "IIAs").

This paper attempts to show the legal complexities that may arise in the context of negotiations, implementation and interpretation of PPR obligations. The intricacies inherent in the design and application of PPR obligations – especially in the context of "mixed" trade and investment agreements such as the CPTPP, USMCA and the EU-Vietnam FTA – give rise to a series of key findings:

- **Developed countries have used PRs to advance their development and national interests.** While developed countries often support the inclusion of PPR obligations in IIAs negotiations with developing countries, several of these countries (e.g. the US, Japan, UK, Germany and France) and emerging economies (e.g. China and South Korea) have enforced PRs on FDIs in their territories to advance their development and national objectives.
- **The emergence of PPR obligations in IIAs is largely intertwined with the US' leading role in negotiating these prohibitions bilaterally, regionally and multilaterally.** At the bilateral front, the US first included PPR obligations in its US BIT models in the 1980s. The PPR obligations in the NAFTA, however, mark a turning point in how PPRs have evolved into more stringent and broad types from the 1990s until today. At the multilateral front, especially in the 1970s, the US successfully sought confirmation by the GATT panel that certain PRs that required foreign investors to purchase Canadian goods were prohibited under the GATT 1947. In the 1980s, the US also pushed for the inclusion of a negotiating mandate for trade-related investment measures in the Uruguay Round of negotiations, leading ultimately to the adoption of the WTO TRIMs Agreement.
- **States have virtually adopted three approaches to PRs in IIAs: silence, "TRIM-like" and "TRIMs-plus."** The majority of IIAs are entirely silent on PPRs. Some incorporate only trade-related investment measures obligations, making express reference (or using similar obligations) to the obligations in the TRIMs Agreement (local content requirements, export and import restrictions) ("**TRIMs-like**"). Some incorporate more detailed and stringent PPRs beyond the obligations under the TRIMs

Agreement (including prohibitions on technological transfer requirements, on capital restrictions, on R&D requirements, on joint venture requirements, or on local employment requirements) ("**TRIMs-plus**"). This latter approach to PPR obligations is found, for example, in the NAFTA, CPTPP, USMCA, and the EU-Vietnam FTA.

- **Despite the broadened scope of PPR obligations, states have carved out several exceptions to ensure they can still legally enforce certain types of PRs under certain circumstances.** Exceptions to PPRs in the IIAs scrutinized in this paper manifest in three aspects. First, through general treaty exceptions (e.g. temporal exceptions, national security exceptions, and temporary safeguards allowing transitory PRs on capital movements, payments and transfers). Second, exceptions which apply to all types of PPRs (e.g. existing non-conforming measures, sectoral carve outs, PRs not explicitly prohibited in the IIAs). Third, exceptions which apply to some types of PPRs (e.g. to locate production, to carry out R&D, to supply a service, to train/employ workers, to construct/expand facilities, with respect to government procurement, to enforce technology transfer requirements, to qualify for export promotion and foreign aid programs, to qualify for preferential tariffs and preferential quotas, requirements necessary to secure compliance with national laws and to protect the environment). These exceptions, however, may vary considerably from treaty to treaty insofar as each state must carefully carve out relevant sectors or non-conforming measures, amongst other exceptions, from the scope of PPR obligations – often, this will be negotiated as annexes to the treaties.

- **PPRs exceptions are often drafted in such a way that they allow host states to confer an "advantage" upon compliance by investors of certain PRs**. This exception applies, for example, for advantages a host state offers to investors to (re)locate production to its territory. This PR provision is found in the NAFTA, CPTPP, USMCA, the EU-Vietnam FTA and several ASEAN IIAs. This exception is likely to relate to the US practice of encouraging foreign investors to relocate their headquarters and operations in the US.

- **Alongside PPR obligations, other substantive protections in IIAs may have similar effects as PPRs when applied.** Certain PR or PR-like measures may not fall within the scope of PPR provisions but may nevertheless be inconsistent with other provisions. Notably, this features indirectly through the national treatment, most-favored nation, and fair and equitable treatment provisions. These provisions can operate akin to PPR provisions to varying degrees depending on the drafting of such provisions, as well as

tribunals' interpretation. Therefore, states need to be cautious while negotiating and drafting these provisions, with particular attention to cross referencing to other obligations in the IIA.

- **Out of a universe of around 800 investor-state disputes and more than 500 disputes at the WTO, only a few dozen relate, directly or indirectly, to PPRs**. These decisions help us to better understand eventual limitations states may face when designing and implementing PRs. A majority of the investor-state disputes on PPRs involves the US or NAFTA, whereas WTO disputes involve both emerging economies (e.g. China, Indonesia, India) and advanced economies (e.g. Canada, US). Drawing a consistent pattern under investor-state disputes proved to be a difficult exercise since the disputed PR and PPR provisions was not consistently challenged. In any case, such disputes are relevant in demonstrating how PPRs have been delimited, in order to better appreciate how PR and PPR provisions should be *ex ante* drafted during the negotiations process.

The findings of this paper suggest that PPR obligations have evolved into complex and widely-framed substantive protections for investors in IIAs. Yet, these obligations have applied indistinctively to developed and developing countries alike. Disputes on PPRs, in both the investor-state and WTO Dispute Settlement Body context, have affected developed countries as well since such states have also used PRs to advance their development and national interests. There are indications that this framework might be changing: uncertainty with regards to investor-states disputes may be steering IIAs towards a new direction where investor-state dispute settlement mechanisms only apply to specific provisions (and do not apply to PPRs) – as seen in the recently negotiated USMCA. Though, it is too early to tell what impact, if at all, the recently signed USMCA will have on future IIA negotiations. Nevertheless, the USMCA is still relevant in tracing ongoing developments in the realm of international investment law and trade obligations.

1. INTRODUCTION

1. Prohibitions on performance requirements ("**PPRs**") in bilateral investment agreements ("**BITs**") or in free trade agreements with investment chapters ("**FTAs**"), collectively referred to as international investment agreements ("**IIAs**"), are one of the core issues in investment negotiations today. The controversy stirred from this obligation is a key area of concern for developing and developed states alike.[1]

2. This paper attempts to show the legal complexities that may arise in the context of negotiations, implementation and interpretation of PPR obligations. First, the negotiation of PPRs provisions is likely to be a complex exercise. States may have different approaches to PPRs in the different IIAs to which they are party to and, in turn, the PPRs provisions may also differ in these IIAs. ASEAN Member States, individually, and ASEAN itself, have in force several investment treaties with different approaches to PPRs: being entirely silent on PPR provisions[2]; incorporation of Trade-Related Investment Measures ("**TRIMs**")[3] obligations[4]; more detailed and stringent PPRs beyond TRIMs obligations ("**TRIMs-plus**")[5]. Second, implementing PPRs may limit (to varying degrees depending on the content of the provision) the state's ability to adopt policies advancing their essential national economic, financial, labor or other interests by means of performance requirements ("**PRs**"). Third, out of a universe of around 800 investor-state disputes[6] and more than 500 disputes at the World Trade

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[1] For example, in the recently negotiated United States-Mexico-Canada Agreement ("USMCA") which purports to replace NAFTA, the investor-state dispute settlement mechanism provision does not apply, *inter alia*, to breaches of PPR obligations. See USMCA, Annex D, Art. 3.
[2] For example, ASEAN-China Investment Agreement (2009); ASEAN-Japan Comprehensive Economic Partnership Agreement (CEPA) (2008); Japan-Vietnam Agreement for the Liberalization, Promotion and Protection of Investments (2003); Japan-Vietnam Economic Partnership Agreement (2008); United States-Brunei Trade and Investment Framework Agreement (2002); United States-Malaysia Trade and Investment Framework Agreement (2004); ASEAN-United States Trade and Investment Framework Agreement (2006); Singapore-Australia FTA (2003).
[3] TRIMS Agreement: Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 186 [hereinafter "TRIMS Agreement"].
[4] For example, Art. 7(1) of ASEAN Investment Agreement (2009); Art. 6 of ASEAN-Korea Investment Agreement under the Framework Agreement on Comprehensive Economic Cooperation (2009); Art. 10(6)(1) of Malaysia-New Zealand FTA (2009); Art. 61(1) of Japan-Brunei Economic Partnership Agreement (2007); Art. 79(1) of Japan-Malaysia Economic Partnership Agreement (2005);
[5] For example, Art. 93 of Philippines-Japan Economic Partnership Agreement (2008); Art. 3 of Philippines-France BIT (1995); Art. V of Philippines-Canada BIT (1995); Art. 75 of Japan-Singapore Economic Partnership Agreement (2002); Art. 6 of Japan-Cambodia Liberalization, Promotion, and Protection of Investment Agreement (2007); Art. 7 of Japan-Laos Liberalization, Promotion, and Protection of Investment Agreement (2008); Art. 6 of Japan-Myanmar Liberalization, Promotion, and Protection of Investment Agreement (2013, EIF 2014); Art. 4 of Art. 6 Japan-Vietnam Liberalization, Promotion, and Protection of Investment Agreement (2003, EIF 2004).
[6] See UNCTAD IIA Issues Note, "Special Update on Investor-State Dispute Settlement: Facts and Figures" (United Nations, 2017). According to the United Nations, the cumulative number of known investor-state dispute settlement (from 1987 to 31 July 2017) is 817 disputes; See, however, Alexandre Genest, *Performance*

Organization ("**WTO**"),[7] only a few dozen relate, directly or indirectly, to PPRs. These decisions help us to better understand eventual limitations states may face when designing and implementing PRs. This web of complexities in negotiation, implementation and interpretation of PPRs is likely to increase the intricacies of IIAs negotiations, especially if state parties to regional agreements (like ASEAN) negotiate IIAs that involve all member states (for example, Regional Comprehensive Economic Partnership ("**RCEP**")) and, at the same time, IIAs that involve only a few member states (for example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("**CPTPP**")).

3. Against this background, this paper aims to provide a legal background on PPR obligations in IIAs. Before doing so, it is first necessary to expound upon PRs. Specifically, the rationale underpinning PRs, the types and uses of PRs, and its criticisms will be analyzed. Of specific importance is our assessment of how selected developed and developing states have used PRs as a developmental tool. This will lay the groundwork for advancing and exploring PPRs in three main areas: (1) the emergence of PPRs, (2) the content of PPR obligations in IIAs, and (3) the exceptions that states can carve out to utilize PRs, in relation to essential national and developmental interests. In particular, this paper will show that exceptions in certain IIAs allow host states to enforce requirements for investors to relocate production and/or headquarters in its territory without breaching PPR obligations.

4. This paper will seek to address PPR obligations by evaluating the key legal aspects of and the exceptions to PPRs. In doing so, it will rely on the textual language of selected BITs and FTAs, as well as disputes that have been brought to various arbitral tribunals, and the WTO. Our analysis centers around the assessment of PPRs in more recent BITs or FTAs, such as the CPTPP, the United States–Mexico–Canada Agreement ("**USMCA**"), and the European Union-Vietnam Free Trade Agreement ("**EU-Vietnam FTA**"). The cases discussed in each section below were selected based on their relevance to the specific PPR content obligation[8]

Requirement Prohibitions in International Investment Law (2017) (unpublished doctorate monograph). To the best of our knowledge, there are few dozen investor-state disputes on PPRs.

[7] Out of 570 disputes for which consultations have been requested at the WTO, only few dozen refer to PPRs. To the best of our knowledge, the GATT and WTO DSB decisions addressing PPRs in the form of trade-related investment measures ("TRIMs") are *Canada – FIRA*, *Indonesia – Autos*, *Canada – Renewable Energy/Feed in Tariffs*, *India – Solar Pane, India – Autos; China – Auto Parts; Korea – Various Measures on Beef; Canada – Provincial Liquor Boards; Colombia – Ports of Entry; China – Audiovisuals.* They will be discussed in this paper to the extent of their relevance.

[8] *ADF Group Inc. v United States of America*, ICSID Case No. ARB (AF)/00/1, Award (9 January 2003) [henceforth referred to as ***ADF v USA***]; *Cargill, Incorporated v United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award (18 September 2009) [henceforth referred to as ***Cargill v Mexico***]; *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability (14 January 2010) [henceforth referred to as ***Lemire v Ukraine***]; *Pope & Talbot Inc. v The Government of Canada*, UNCITRAL, Interim Award (26 June 2000) [henceforth referred to as ***Pope & Talbot v Canada***]; *Mobil Investments Canada Inc. and Murphy Oil Corporation v Government of Canada*, ICSID Case No. ARB(AF)/07/4, Decision on Liability and Principles

and/or exceptions.[9]

5. This paper is structured as follows: In Section 2 we will discuss PRs, its definition (Section 2.1), classification (Section 2.2), rationale (Section 2.3), types (Section 2.4), historical uses (Section 2.5) and criticisms (Section 2.6). Section 3 is dedicated to PPRs, where we explore its definition (Section 3.1), consider their emergence and evolution (Section 3.2), appraise its content under the selected IIAs (Section 3.3), explore the exceptions to PPRs that could afford states more policy space to implement PRs (Section 3.4), and highlight potential changes in investor-state dispute settlement methods which could influence the use of PPRs in the future (Section 3.5). This paper concludes in Section 4.

of Quantum (22 May 2012) [henceforth referred to as ***Mobil v Canada***]; *Merrill & Ring Forestry L.P. v The Government of Canada*, UNCITRAL, ICSID Administered Case, Counter-Memorial of Canada (13 May 2008).[henceforth referred to as ***Merrill v Canada***]; *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v United Mexican States*, ICSID Case No. ARB (AF)/04/5, Award (21 November 2007) [henceforth referred to *as* ***ADM v Mexico***].

[9] *ADF v USA*; *Mobil v Canada*

2. PERFORMANCE REQUIREMENTS

- *Despite the pervasiveness of PRs, there is no single authoritative definition of what a PR is. To address this, we adopt a working definition for a PR as set out in* ***Section 2.1****, and address the ways of classifying PRs in* ***Section 2.2****.*
- *States use PRs for a multitude of reasons. Generally, PRs are used to ensure that the host state benefits or is more likely to benefit from foreign direct investment, either in economic development or other policy objectives. These rationales are examined in* ***Section 2.3****.*
- *To achieve these objectives, states use various types of PRs. While non-exhaustive,* ***Section 2.4*** *lists the different types of PRs, how they operate, as well as some examples of these PRs being used where applicable.*
- *Building on the above,* ***Section 2.5*** *examines the historical use of PRs by some selected states to advance their industrial and development policies.*
- *Finally,* ***Section 2.6*** *discusses some criticisms of PRs.*

6. The right to regulate is the *raison d'etre* of sovereign states.[10] This includes the conditions under which it admits investments in its territory, amongst which is the imposition of PRs. However, this right is subject to international legal obligations. The purpose of this section is to define PRs, explain the rationale behind their usage, set out the categories and types of PRs, the historical usage of PRs by selected states, and address the criticisms against PRs.

2.1 Performance Requirements: Definition

7. Despite extensive literature, there has been no single authoritative definition of PRs. The most comprehensive attempt was made by the United Nations Conference on Trade and Development ("**UNCTAD**") in 2003, which described PRs as "stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host state" and which "may cover all aspects of investment."[11] At the same time, the Organization for Economic Co-operation and Development ("**OECD**"), having looked at the operation of PRs, recognized that "[the] meaning of [performance requirements] is likely to change depending 'not only on the nature, but the end-purpose' pursued by a government",[12]

[10] David Collins, *Performance Requirements and Investment Incentives under International Law* (Cheltenham: Edward Elgar Publishing, 2015) at p. 4.
[11] UNCTAD, Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries, UN Doc. No. UNCTAD/ITE/IIA/2003/7 (2003) at p. 2.
[12] OECD, Negotiating Group on the Multilateral Agreement on Investment, DAFFE/MAI (96)4 (15 January 1996) at p. 2

in essence defining PRs by the objectives which the host state aims to achieve. Various states had also, in negotiating the TRIMs agreement, either stated that PRs are "an important policy instrument for realizing the larger economic and developmental goals, especially their technological and industrial development objectives",[13] or even omitted explicit mentions of PRs.[14]

8. To add on to the definitional complexity of PRs, distinctions have been made in the literature between (1) mandatory performance requirements and (2) non-mandatory performance requirements, or advantage-conditioning performance requirements. The former applies mandatorily to foreign investors at the point of foreign direct investment ("**FDI**") entry and subsequent expansion, while the latter comprises of non-mandatory conditions which must be satisfied for a foreign investor to obtain an advantage, such as a tax-exemption, waiver or another investment incentive.[15] These distinctions are often discussed without sufficiently defining what a PR is (the various classifications of PRs will be discussed in greater detail in Section 2.2 below).

9. Given the pervasiveness of PRs and the emergence of PPRs, there is clearly a need for a proper definition of PRs. For the purposes of this paper, we propose a working definition of PRs which aims to capture the essence of the prevailing understanding within the various approaches. However, this definition is not authoritative; whether a certain measure would be considered a PR will, in practice, depend on the specific language in each treaty and its interpretation.

10. PRs will refer to policy measures by host states which impose conditions on investors that must be fulfilled for an investment either to be made in the state, or for an advantage, such as investment incentives like tax benefits or exemptions, to be conferred. To be considered a PR, these conditions must be imposed by the host state to achieve national developmental or economic objectives, including, *inter alia*, the development of infrastructure, creation of domestic industries, reduction of unemployment, improvements in technology and the promotion of economic development in general.[16] The rationale for imposing PRs, which relate very closely to these objectives, will be further elaborated in Section 2.3 below.

2.2 Classification of Performance Requirements

[13] India, *Submission to the GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/W/18* (11 September 1989) para 19.
[14] Japan, *Submission to the GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/W/20* (13 September 1989).
[15] UNCTAD 2003 (n 11) at p. 2.
[16] Collins (n 10) at p. 3; UNCTAD 2003 (n 11) pp. 6-9.

11. There are generally three ways of classifying PRs: (1) mandatory vs advantage-conditioning PRs, (2) pre- vs-post establishment PRs, (3) regulatory vs contractual PRs.[17]

12. First, PRs can be mandatory or non-mandatory. Mandatory PRs enforce requirements on investors as a condition for entry into the market (e.g. the requirement to enter only upon creation of joint ventures or only upon the investors commits to transfer a given technology) or as a condition for the investor to continue to operate (e.g. the requirement to export a given amount of production or to buy certain components from domestic components).[18] That is, the investor has no option but to agree to comply with the PR in order to either start or continue to operate. In contrast, non-mandatory PRs, which are also known as "advantage-conditioning PRs", relate to the access to certain investment incentives or "advantages" (e.g. fiscal exemptions, subsidies or grants), in connection with an investment in the host state's territory, that the host state may offer upon compliance by the investor of a PR. More specifically, the host state may offer investment incentives or "advantages" if the investor complies with the requirement to, *inter alia*, locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory. In principle, the investor could choose not to comply with them, given that they are not mandatory for market access. However, in practice, "some incentives do not really give the investor the possibility of refusing to comply with the PRs, because of the attractiveness of incentives offered."[19]

13. Second, a distinction can be made with respect to the time at which the PR is imposed on the investor – whether it is imposed before or after the investment was made. Pre-establishment PRs, also known as market access requirements, consist of requirements (commitments or undertakings) that the host state enforces with respect to the conditions of entry, establishment, acquisition or expansion of an investment of an investor of a party or a non-state party to a IIA on its territory (for example, by requiring that investments in certain sectors be made only by creation of joint ventures).[20] Post-establishment PRs consist of any requirement (commitments or undertakings) that the host state enforces with respect to the conditions of management, conduct or operation of an investment of an investor of a party or a non-state party to a IIA in its territory. [21]

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[17] Suzy H. Nikiema, IISD Performance Requirements in Investment Treaties: Best Practices Series (International Institute for Sustainable Development, December 2014) at p. 2.
[18] *Ibid*.
[19] *Ibid.*
[20] *Ibid* at p. 11.
[21] *Ibid* at p. 8.

14. Lastly, a distinction can also be made based on whether the PR is governed by national legislation/regulation or by investment contracts (between the state and the investor).

2.3 Rationale

15. Fundamentally, the primary goal of IIAs has been to advance the economic development of developing countries through FDI. This positive attitude towards FDI was driven by the belief that unlike speculative or short-term capital flow, FDI promises a more stable source of capital as it involves an element of control by the foreign investor, which could in turn translate into positive spillovers to the rest of the host state economy, such as reduced unemployment and the creation of infrastructure.[22]

16. These positive impacts of FDI, albeit feasible in theory, do not always occur automatically. Most foreign investors are commercial entities with commercial interests that do not always coincide with a state's development goals and needs.[23] Therefore, this misalignment of interests resulted in a need by host states for specific policies that could either create an environment that encourages the positive effects of FDI, or attain such positive effects as a direct condition of entry of an investment into a host state.[24] PRs are just one manifestation of the policy measures which host states have adopted.

17. As mentioned, PRs seek to achieve a wide-range of policy objectives. These objectives generally include: (1) economic developmental goals, such as developing national expertise in a given sector, broadening the domestic market, creating upstream and downstream economic links in a given economic sector; (2) employment related goals, such as creating local employment or contributing to the training of local employees; (3) technological advancement goals, such as improving domestic technology; and (4) national security goals, such as preserving national enterprises in key sectors or guaranteeing security in the industrial sector.

18. Depending on the objective(s) they seek to achieve,[25] states have used many different types of PRs.[26] Specific types of PRs will be discussed in the following section.

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[22] Jonathan Bonnitcha, Lauge N Skovgaard Poulsen & Michael Waibel. *The Political Economy Of The Investment Treaty Regime*, ed (New York, NY: Oxford University Press, 2017).

[23] IISD Performance Requirements in Investment Treaties: Best Practices Series (n 17) at p. 1

[24] United Nations Human Rights Council, Working Group on the Right to Development, *International Investment Agreements and Industrialization: Realizing the Right to Development and the Sustainable Development Goals*, 23 – 27 April 2018, A/HRC/WG.2/19/CRP.5

[25] It must be noted that a single PR could be adopted for multiple reasons or to achieve many different objectives; it would be artificial to suggest that there is only one objective which each type of PR tries to achieve.

[26] M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2017) at pp. 242-243.

2.4 Types of Performance Requirements

19. Having defined PRs and examined its rationale and objectives, this section will introduce the different types of PRs. The following PRs listed below are the types which are recognized by international organizations such as UNCTAD and the OECD.[27] They include: local content/services requirements, export-related requirements, domestic sales requirements, local employment and/training requirements, local equity and joint venture requirements, technology transfer and local R&D requirements, capital controls, and manufacturing requirements.

2.4.1 Local Content/Services Requirements

20. Local Content Requirements ("**LCRs**") and Local Services Requirements ("**LSRs**") are also often referred to as "import-substitution", "minimum value-added", "domestic value-added" or "local sourcing" requirements. Generally, LCRs mandate that investors purchase (often in a specified percentage) goods from domestic suppliers, while LSRs often require that investors purchase certain services from domestic sources. Therefore, the operation of LCRs and LSRs may imply changes in the operational patterns of foreign investors' investments in host states by directing their focus towards the utilization of local suppliers (of inputs or services).[28]

21. An example of PRs involving LCRs or LSRs is Indonesia's National Car Programme in 1996. Under this program, Indonesia mandated that car producers would have to source high percentages of their production inputs from domestic sources to qualify for tax benefits, an advantage conditioning PR.[29] This was done to encourage the development of Indonesia's auto industry as well as to create local employment. The WTO dispute involving this programme will be discussed in Section 3.3.2 below.

2.4.2 Export-Related Requirements

Export Performance Requirements

22. Export Performance Requirements ("**EPRs**") entail the export of a specified proportion,

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[27] UNCTAD 2003 (n 11) at pp. 4-5; Aaron Cosbey, "Everyone's Doing It: The Acceptance, Effectiveness and Legality of Performance Requirements" 6(1) Investment Treaty News (IISD) (February 2015) 9-11

[28] Nagesh Kumar, "Performance Requirements as Tools of Development Policy: Lessons from Developed and Developing Countries," ch. 9 in Kevin Gallagher and Alice H. Amsden (eds), *Putting Development First: The Importance of Policy Space in the WTO and IFIs* (Zed Books, 2005) at pp. 179-180.

[29] WTO, Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WTO doc WT/DS54/PR/R, 02/07/1998.

percentage or minimum amount of goods produced locally by reference to value or quantity of local production or to a proportion of an investor's imports. By imposing EPRs on foreign investors, a host state limits their supply into its domestic market, thereby reducing pressure of foreign competition on local producers. This gives the host state the benefits of FDI - increased employment of locals and development of infrastructure - without the corresponding increase in competition in the domestic market.

Export Restrictions and/or Limitations

23. Export restrictions are limitations on the quantity of goods exported to a specific state or states by a government. They have been used historically to address military security or related foreign policy concerns, mainly to deny hostile states acquisition of sensitive military technology or scarce natural resources.[30]

24. For example, in 2012, China imposed three distinct types of legislative restrictions on the export of rare earths, tungsten and molybdenum which are used in the production of high-tech electronic circuits.[31] These included taxes on the export of these materials, and an export quota on the amount of materials that could be exported within a given period and a limitation on the enterprises permitted to export the materials. These export restrictions resulted in complaints against China by the US, the EU, and Japan in the WTO.[32]

2.4.3 Domestic Sales Requirements

25. Domestic sales requirements compel investors to sell a predetermined proportion or a fixed value of their local output in the host state's domestic market. Such requirements are imposed because prices in the domestic market are lower and hence less attractive than those on the international market. These measures ensure that specified products which are produced in the host state are available in the host state domestic market.

2.4.4 Local Employment and Training Requirements

26. Local employment and/or employee training requirements are imposed to ensure a

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[30] UNCTAD, "Investment-Related Trade Measures" in UNCTAD Series on Issues in International Investment Agreements, UN Doc UNCTAD/ITE/IIT/10 (vol. IV) (1999) 8 at pp. 27-28.
[31] WTO, Panel Report, *China – Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, WTO doc WT/DS431/R; WT/DS432/R; WT/DS433/R, 26/04/2014.
[32] WTO, Appellate Body Report, *China – Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, WTO doc WT/DS431/AB/R; WT/DS432/AB/R; WT/DS433/AB/R, 07/08/2014.

minimum level of local employment, to increase the level of education and knowledge of the domestic workers, or to increase the number of skilled workers in the host state.[33] This can results in a rise in the average skill level of the domestic workforce, depending on the level of interactions and engagement between foreign employees and local employees and the capacity of the latter to absorb new knowledge, which can contribute to the host state's overall human resource development.[34]

2.4.5 Local Equity and Joint Venture Requirements

27. Local equity requirements or joint venture requirements impose a requirement on foreign investors to form a joint venture with national partners in order to make the investment. These requirements are often intended to ensure that certain key sectors of the economy do not fall under foreign control. This is done by preserving and strengthening partial or majority local management control over foreign investments. They may also facilitate the transfer of skills, technology and management know-how to local companies.[35]

2.4.6 Technology Transfer Requirements

28. Technology transfer requirements compel investors to use production or processing methods that utilize superior technology which would not normally be used by either domestic producers or investors in the host state. Host states use technology transfer requirements in order to acquire advanced technology that would normally remain with the investor, enabling the development of the domestic industry.

2.4.7 Research and Development Requirements

29. R&D requirements compel investors to spend specified amounts on R&D. For example, in *Mobil v Canada*[36], Canada imposed requirements on oil companies to spend specified amounts to conduct R&D domestically using domestic service providers.

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[33] UNCTAD 2003 (n 11) at pp. 4-5.
[34] UNCTAD, Investment Policy Framework for Sustainable Development [2015 Edition], UN Doc. No. UNCTAD/DIAE/PCB/2015/5 (2015) at p. 40.
[35] Kumar (n 28) at pp. 179-180.
[36] *Mobil v. Canada* (n 8).

2.4.8 Capital Controls

Foreign Exchange Restrictions, and/or Earning Requirements

30. Foreign exchange restrictions limit an investor's access to foreign currency and hence reduce an investor's ability to import foreign goods. This is an indirect way of reducing imports, increasing purchase of local goods, and easing pressures on the balance of payments of a state. These restrictions, which condition an investor's access to foreign exchange upon foreign-exchange inflows attributable to that same investor, or which obligate an investor to use only the foreign exchange generated by its own exports in order to purchase imports, essentially amount to trade-balancing requirements and closely resemble EPRs.[37]

Remittance Restrictions

31. Remittance restrictions limit the ability of a foreign investor to repatriate profit, dividends, royalties, capital and other investment related funds. They share the same purpose as that of foreign exchange restrictions - to improve the balance of payments of a host state.[38]

2.4.9 Manufacturing Requirements

32. Manufacturing requirements or limitations stipulate that investors manufacture only specified goods in the host state. They may also restrict or prohibit foreign investors from producing specific types of goods to protect the exclusive production of such goods by domestic producers.

2.5 The Historical Use of Performance Requirements

33. Having examined the various types of PRs and their various rationales, this section provides a historical overview of the use of PRs by certain states. This section will focus on the United States, the United Kingdom, Germany, France, Japan, South Korea and China and how these states used PRs to advance their industrial and developmental policies.

34. In examining the historical use of PRs by these states, we do not purport to be exhaustive. These states may have used PRs to varying degrees over time depending on their national interests. The fact that these states enforced PRs or other types of restrictions on

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[37] Kumar (n 28) at pp. 179-180.
[38] *Ibid*; See Section 2.4.2.

foreign investments before the emergence of PPRs in the 1980s[39] (discussed in Section 3.2) should not be understood to mean that these states no longer use PRs. The use of certain PRs may be allowed as a PPR exception under IIAs or may not be at all prohibited (discussed in Section 3.4).

35. It must be noted that this section does not purport to evaluate the success of these states in using PRs to achieve their economic goals. Doing so would entail an in-depth economic analysis that falls beyond the scope of this paper. Rather, the goal of this section is to discuss *how* the selected states have adopted PRs into their investment regimes.

2.5.1 The United States

36. Following the Second World War, more than one study reveals that the US kept a relatively open policy towards foreign investment,[40] a trend that changed after the1970s. This is best understood in the context of the US being the largest exporter of FDI in the years after the end of the Second World War,[41] and inward FDI into the US only started gaining traction in the 1970s.[42] Data reveals that the US' share of inward FDI globally was 15 percent in the 1970s, and increased to approximately 50 percent in the 1980s. [43]

37. The US policy towards foreign direct investment shifted in the 1970s, when foreign investors started facing more restrictions than before. These restrictions on FDI, however, did not always take the exact form of PRs as defined in this paper, rather they consisted of sectoral restrictions justified by national security considerations. Sectoral restrictions included shipping, domestic aviation, communications, and nuclear energy. Of importance to that shift was the creation of the Committee on Foreign Investment in the United States ("**CFIUS**") in 1975 and the issuance of the Domestic and Foreign Investment Improved Disclosure Act of 1977 ("the **1977 Act**"). [44] CFIUS screened mergers and acquisitions of US companies by foreign companies, monitored the impact of the foreign investment in the United States and

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[39] Barton Legum, "Understanding Performance Requirements in Investment Treaties", in Arthur W. Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2007* (Martinus Nijhof, 2008), 53, at 55-56

[40] Mark L. Hanson "Regulation of Foreign Direct Investment in the United States Defense Industry" at 668; David W. Heleniak "Restrictions on Foreign Investment: Developments in United States Law (1981) *Journal of Comparative Corporate Law and Securities* Regulation 3, p. 330, at 330; Elliot L. Richardson "United States Policy Toward Foreign Investment: We Can't Have it Both Ways" (2011) 4(2) *Amercian University International Law Review* 281 at pp. 283, 287, 290.

[41] Robert E. Lipsey, "Foreign Direct Investment in the United States: Changes over Three Decades" Chap.5 in Kenneth A. Froot (ed) Foreign Direct Investment, University of Chicago Press: 1993. p. 113, at 114.

[42] Lipsey (n 41) at p. 116; See also Mark L. Hanson "Regulation of Foreign Direct Investment in the United States Defense Industry" (1989), *Northwestern Journal of International Law & Business*, 9(3), at 668.

[43] Lipsey (n 41) at p. 116.

[44] The 1977 Act amended the Securities Exchange Act of 1934; See Hanson (n 44) at 669.

coordinated necessary responses.[45] The 1977 Act imposed further disclosure requirements on foreign investors with at least five percent ownership of US companies.[46] In addition, section 5021 of the 1988 Omnibus Trade and Competitiveness Act gave authority to the President to block acquisitions, mergers, or takeovers that threaten national security.[47]

38. Other examples reinforce the US' enforcement of PRs to pursue national interests or develop specific sectors. For example, the Buy America requirements under US Federal Regulation 23 CFR 635.410,[48] which established rules for purchase of general material in connection with construction and maintenance projects, ties the granting of federal aid for these construction and maintenance projects (part of government procurement procedures), to LCRs. In particular, the Buy America obligations provide that federal aid for highway projects will not be authorized unless "all manufacturing processes" for steel or iron materials to be used in these construction or maintenance projects "occur in the United States".[49] Alternatively, the Buy America requirements provide that federal aid for highway projects will not be authorized unless the state that carries out the procurement has "standard contract provisions that require the use of domestic materials and products, including steel and iron materials".[50] Further, the *Domestic Market Assessment* legislation, under Section 1106(a) of the *1993 Budget Act*, required each cigarette manufacturer located in US territory to "use at least 75 percent domestic tobacco" in the production of cigarettes each year, and, in the case of failure to comply with this requirement, the manufacturer of cigarettes would be "subject to penalties" and be obliged "to purchase additional quantities of domestic burley and flue-cured tobacco".[51]

2.5.2 The United Kingdom, France and Germany

39. The UK, Germany, and France have all enforced, to different degrees, different types of PRs to achieve their national interest. While these states were major sources of outward FDI

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[45] Hanson (n 40) at p. 669.
[46] *Ibid* at 664, 670.
[47] Richardson (n 40) at p. 301.
[48] Available at < https://www.law.cornell.edu/cfr/text/23/635.410>. Accessed on 17 November 2019.
[49] 23 CFR 635.419(b)(1).
[50] 23 CFR 635.419(b)(2). Note that a Canadian investor challenged these requirements in *ADF v USA*. The tribunal, albeit recognizing that these requirements amounted to LCRs, found that the US did not breach the PPRs obligations under the NAFTA Art. 1106 because the states parties to NAFTA had carved out an exception that allowed the imposition of LCRs in connection with government procurement procedures such as in these case under NAFTA Art. 1108(7)(a) and 8(b) (see further explanation about this dispute in section 3.4.3 below). See tribunal's findings in *ADF v USA, at paras.* 170; 173-174.
[51] GATT Panel, *United States – Measures Affecting the Importation, Internal Sale and Use of Tobacco*, (Report adopted on 4 October 1994) (DS44/R), at para. 63.

stocks in the 19th century until the First World War,[52] attracting FDI after the Second World War became a new challenge. Some of the PRs put in place are explained below**.**

The United Kingdom

40. After 1945, the UK applied a variety of restrictions on inward FDI. Notably, the government passed the Exchange Control Act in 1947 ("**1947 Act**").[53] The 1947 Act imposed several PRs on FDI. First, it enforced capital controls insofar as it permitted free inward FDI only if the investment was effected through the purchase of securities listed on the London Stock Exchange.[54] In addition, capital controls also operated by means of stipulating that, without former approval, any subsequent repatriation would need to be made at a discounted foreign exchange rate, rather than the official rate.[55] This had the effect of increasing foreign-exchange reserves insofar as the 1947 Act required that foreign investments be financed by foreign capital, rather than by borrowing in the UK domestic market. Second, the legislation also imposed foreign ownership controls on foreign investors,[56] requiring prior approval by the Treasury if the purchase would result in transfer of ownership to foreigner investors (meaning that more than 50 percent of voting shares would be transferred).[57] Since this requirement was applied only to a particular type of business structure (with majority of foreign ownership), ensuring that British nationals retained control over sectors considered strategic to the interests of the UK, it can also be considered as equivalent to PRs.

41. Furthermore, other types of ownership controls were also relevant in the 1960s. In 1965, the UK government issued the Monopolies and Mergers Act ("**1965 Act**"). This essentially gave the government significant power to prevent foreign investors' take-over of domestic companies in vital sectors to the national interest.[58] Again, since this legislation dictated that foreign investors adopt particular business structures it can also be considered as equivalent to PRs.[59] Merger and acquisitions in strategic sectors would be referred to the Monopolies

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[52] Michael J. Twomey, *A Century of Foreign Investment in the Third World* (Routledge, 2002) at 32-33; Ha-Joon Chang, "Regulation of foreign investment in historical perspective" (2004) 16(3) *The European Journal of Development Research*, at pp. 694-95.

[53] Robert W. Gillespie, "The Policies of England, France, and Germany as Recipients of Foreign Direct Investment", ch. in Fritz Machlup, Walter S. Salant, and Lorie Tarshis (eds), *International Mobility and Movement of Capital* (NBER, 1972), 397-441 at p. 339.

[54] *Ibid*.

[55] *Ibid*.

[56] According to Collins, measures "dictating particular business structures which must be adopted by investing firms", such as joint venture requirements with respect to certain sectors, are considered PRs; See Collins (n 10) at p.125.

[57] Gillespie (n 53) at p. 339.

[58] *Ibid* at p. 402.

[59] Collins (n 10) at p. 125.

Commission, created under the 1965 Act, that would, in turn, issue a favorable or disapproving report.[60] In 1967, the UK government also approved the US Chrysler Corporation to acquire majority control of British Rootes Motors. The approval, however, was conditioned upon the fulfilment of PRs, including: (1) export performance requirements; (2) employee requirements (the majority of directors needed to be British), and (3) the requirement that national interests would be represented in the board by means of participation by the government, as a minority shareholder, on the board of directors.[61]

France

42. France's use of restrictions on foreign investors (in the form of PRs or other types of restrictions) became apparent in the 1960s. As of 1962, the French approach to FDI moved towards a more rigorous approach than the immediate postwar period,[62] and moved towards more stringent enforcement of restrictions on FDI. The French policy set out strict controls on foreign majority ownership, or foreign take-overs, of French companies. The policy aimed to "protect vulnerable sectors".[63] These were sectors in which the most technological changes were taking place, such as electronics and, more specifically, computers.[64] FDI in these sectors were also subject to strict approval requirements and required to conform to the objectives of the French National Plan.[65] The overarching goal was that economic activities seen as vital to French interests would remain "under French management and French control".[66]

43. Although a new law on FDI was issued in 1966,[67] the rigorous French approach to controlling FDI continued. The new law retained, and even expanded, controls on foreign ownership of French companies in three main aspects.[68] First, the transfer of ownership between foreigners needed prior approval. Second, mergers and acquisitions of two foreign firms, where one of the merging foreign firms owned a French subsidiary, was also subject to prior approval. Thirdly, foreign subsidiaries needed to obtain prior approval to expand using capital – either cash or debt – from abroad.[69]

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[60] Gillespie (n 53) at p. 402.
[61] *Ibid* at p. 401.
[71] *Ibid at* p. 407.
[63] *Ibid.*
[64] *Ibid* at p. 411.
[65] Speech by Minister of Finance Giscard-d'Estaing, "Nationalism and Cooperation" December 16, 1964, quoted in Gillespie (n 53) at 407.
[66] Speech by President Charles de Gaulle "The Independence of France", address given on 27 April 1965, quoted in Gillespie (n 53) at 407.
[67] Gillespie (n 53) at p. 412.
[68] *Ibid*.
[69] *Ibid*.

Germany

44. In the years following the end of the Second World War, Germany had in place a number of measures that, albeit not exactly fitting in the PR definition, enforced measures which had the effect of limiting the presence of FDI.[70] In particular, limitations on FDI were effected by means of the significant presence of the state – either by state-owned enterprises or by significant government shareholding – in sectors of the economy considered vital to Germany's interests, rather than by a specific policy or regulatory measure.[71] Moreover, the close relationship between German banks and German industry, coupled with strong labor unions with seats in the companies' supervisory boards also prevented FDI take-overs of national companies.[72] In addition, isolated cases show that in the 1960s the German government blocked foreign investors from taking over German oil companies due to competitiveness concerns.[73] Yet, German law neither required prior approval of a FDI, nor did it give the government legal power to block certain types of FDI.[74]

2.5.3 Japan

45. Japan has historically used a range of controls on FDI and, at the same time, pursued policies consistent with its national interests.[75] As such, it was not until 1899 when Japan reviewed the treaties of commerce with the UK, the US and other nations, that foreigners were granted the right to invest in Japan.[76] From then until the mid-1930s, Japan remained relatively open to FDI.[77]

46. In the aftermath of the Second World War, however, Japan issued a range of controls on FDI. In particular, the 1949 Foreign Exchange Control Law and the 1950 Foreign Investment Law were issued and imposed tightened restrictions on FDI. Art. 1 of the Foreign Investment Law permitted foreign investment only on the condition that it "contributed to the attainment of self-sufficiency and the sound development of the Japanese economy and to the

[70] Chang (n 52) at p. 696; Gillespie (n 53) at pp. 414-415.
[71] Chang (n 52) at p. 696.
[72] *Ibid.*
[73] Gillespie (n 53) at p. 414
[74] *Ibid*.
[75] Ralph Paprzycki and Kyoji Fukao, "The Extent and History of Foreign Direct Investment in Japan", in N.84, *Foreign Direct Investment in Japan: Multinational Role in Growth and Globalization* (Cambridge University Press, 2008) at 36; Dirk W. te Velde and The United Nations Conference on *Trade and Development, Foreign direct investment and development: An historical perspective* (2006) Overseas Development Institute at 4; Chang (n 52) at p. 700.
[76] In the Meiji Era (1968-1912) Japan remained relatively closed to FDI. See Paprzycki and Fukao (n 75) at p. 37.
[77] Paprzycki and Fukao (n 75) at pp. 37, 49-50.

improvement of Japan's balance of payments."[78] From 1960 onwards, FDI was admissible in Japan insofar as it did not "unduly oppress small-size enterprises, seriously disturb industrial order, and seriously impede the domestic development of industrial techniques."[79]

47. During this period, Japan applied a range of controls on foreign ownership of Japanese companies. These controls mandated particular business structures to be adopted by foreign investors thus being equivalent to joint venture PRs. In particular, before 1963, Japanese policies limited foreign ownership to 49 percent, while in some 'vital' industries, FDI was altogether banned.[80] In 1967, the new FDI policy allowed a maximum of 50 percent of foreign ownership for 33 industries (so-called "Category I" industries, e.g., household appliances, sheet glass, cameras, pharmaceuticals); and 100 percent ownership for 17 industries (so-called "Category II" industries). However, for Category I industries, in addition to joint venture requirements, requirements related to the nationality of management or personnel of foreign firms were also enforced: (a) the Japanese partner must own at least one-third of the joint venture, and be engaged in the same line of business as the foreign investor; (b) the representation of Japanese officers in the board of directors should be proportionally higher than the Japanese ownership share in the joint venture; and (c) corporate affairs decisions must not be conditioned upon approval of a particular stockholder.[81]

2.5.4 South Korea

48. South Korea also imposed a range of requirements on foreign ownership of Korean firms in order to pursue its national objectives.[82] South Korea's use of PRs on FDI, however, became more institutionalized with the enactment of the White Paper on Foreign Investment (Economic Planning Board or *Oegoogin Tooja Baeksuh*) in 1981.[83] The new law introduced certain flexibility to attract FDI. Yet, controls on foreign ownership and requirements to form joint ventures with majority-owned capital in the hands of Koreans were predominant, especially in strategic sectors.[84] In addition, the Korean government established strict requirements related to technology. In particular, the Korean authorities carefully screened the

[78] *Ibid* at p. 38.
[79] *Ibid*.
[80] Chang (n 52) at p. 701.
[81] *Ibid*.
[82] Chang (n 52) at p. 703.
[83] In the first three decades after independence from Japan (1945) and separation from North Korea (1948), South Korea virtually banned FDI. FDI accounted for only five percent of the total foreign capital inflow into South Korea, excluding foreign aid, in that period. Furthermore, FDI were not allowed in 50 percent of all industries and in 20 percent of manufacturing industries. See Chang (n 52) at pp. 702-703.
[84] Chang (n 52) at p. 703.

technologies brought by investors to check whether the technology was obsolete and whether the royalties which were to be transferred to the parent company were not too excessive.[85] Those investors who were more willing to transfer technology received easier access to the Korean market. Further, the Korean government also applied certain local content measures on foreign investors.[86]

2.5.5 China

49. China has also used a wide range of PRs in order to achieve its national interests. Foreign investment in China was virtually non-existent before 1979. Yet, in the first ten years of liberalization after the "Open Door Policy" was introduced in 1979, FDI inflow into China grew exponentially. From less than annually US$ 0.25 billion from 1979 to 1981, FDI in China increased to US$ 4.4 billion in 1991.[87]

50. The "Open Door Policy" sought to actively encourage FDI by means of different investment incentives (fiscal or other types of "advantages") which were ultimately tied to the fulfilment by foreign investors of specified PRs (advantage-conditioning PRs). First, cities such as Shenzhen, Zhuhai, Shantou, Xiamen, and Hainan were classified as special economic zones ("**SEZ**") in the 1980s.[88] Under the SEZ policy, China explicitly conferred "advantages" to investors upon compliance with certain PRs. Advantages included preferential taxes, fewer restrictions on foreign exchange and fewer restrains on land use on the condition that the FDI be located in a SEZ territory. Second, Chinese government also enforced regional advantage-conditioning PRs. Evidence suggests that different regions in China offered preferential policies incentives to overseas Chinese who could prove their ancestry from those specific regions and that could make investments in disadvantageous regions in China.[89] Albeit this policy was intrinsically discriminatory (and therefore in violation of national treatment and most favored nation principles), it had the effect of attracting FDI to regions in China the government sought to develop.

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[85] *Ibid.*
[86] *Ibid.*
[87] Amirahmadi, Hooshang, and Weiping Wu, "Foreign direct investment in developing states" (28) *Journal of Developing Areas* 1994, 167-90, citing the original source IMF: International Monetary Fund, *Balance* of *Payment Staristics Yearbook* (Washington, D.C.: IMF, 1990 and 1991). Data for 1991-93 are from China State Statistics Bureau (1994), quoted in Shang-Jin Wei, "Foreign Direct Investment in China: Sources and Consequences", ch. In Takatoshi Ito and Anne O. Krueger (eds), *Financial Deregulation and Integration in East Asia*, Vol. 5, (University of Chicago Press, 1996) 77-105 at p. 79.
[88] *Ibid* at p. 96.
[89] Shang-Jin Wei, "Foreign Direct Investment in China: Sources and Consequences", ch. In Takatoshi Ito and Anne O. Krueger (eds), *Financial Deregulation and Integration in East Asia*, Vol. 5, (University of Chicago Press, 1996), 77-105, at p. 82.

51. Mandatory joint ventures requirements also played an important role in China's foreign investment policy. The "Law of the PRC on Joint Ventures and Chinese Investments" was China's first law promulgated with a view to attracting and controlling FDI.[90] A significant number of Chinese companies entered into joint ventures with foreign companies since then. In 1991, joint ventures, contractual joint ventures or joint exploration accounted for more than two thirds of FDI in China in 1991.[91] Of importance is that several provisions of China's joint venture laws and implementing regulations enforced technology transfer requirements, acquisition of managerial expertise, opportunities to train Chinese staff, and local content requirements as conditions for approval of joint ventures.[92] For instance, the "1997 Law on Chinese-Foreign Joint Ventures" (as amended) establishes that technology of foreign joint venture partners should be "advanced" and "fit for China's needs".[93] The "2001 Regulation for the Implementation of the Law on Sino-Foreign Equity Joint Ventures" ("the 2001 JV Regulation") sets forth that joint ventures aim to raise China's technology level and promote China's development.[94] As a condition for approval of foreign joint ventures, the 2001 JV Regulation establishes that foreign partners must show the technology contribution and the technical and managerial training that is intended to occur.[95] Joint ventures with Chinese firms also implied foreign partners needed to meet local content requirements for parts and components, especially in the electronics and automobile industries.[96]

52. Finally, the Chinese government also enforced informal export performance requirements on foreign investors. This had the effect of booming Chinese exports in the sectors where such requirements were enforced. Data shows that exports of foreign-invested companies in China increased from about 1 percent of China's total exports in the mid-1980s to almost 30 percent in 1994. [97] This was done as part of Chinese industrial policy and deregulation measures in the 1990s to not only attract FDI, but also to promote exports. In particular, the Chinese government at different levels (provincial, state and central) imposed different advantage-conditioning export performance requirements by offering direct financial

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[90] Lu Yuan and Terence Tsai, "Foreign Direct Investment Policy in China" (2000), *China Review*, pp. 223-247, at p. 223.
[91] China Ministry of Foreign Economic Relations and Trade (1993) quoted in Wei (n 89) at p. 80.
[92] Bernard Bishop, "Why did China Benefit from a Joint Venture Policy? A Case Study of Shanghai (2007), *China & World Economy,* 19(2), 89-103, at pp. 93-96.
[93] Wei (n 89) at p. 80.
[94] *Ibid*.
[95] *Ibid.*
[96] Sun, Haishun, 1998, Foreign Investment and Economic Development in China 1979–1996, Aldershot: Ashgate Press; and Rosen, Daniel, 1999, Behind the Open Door – Foreign Enterprises in the Chinese Marketplace, Washington DC: Institute for International Economics, quoted in Bishop (n 92) at pp. 95-96.
[97] Lu Yuan and Terence Tsai, "Foreign Direct Investment Policy in China" (2000), *China Review*, 223-247, at p. 223.

support or lower tax burdens to attract FDI to vital and strategic industries.[98] Many of the sectors targeted by these policies (high-technology, machinery, electronic and telecommunications) are the sectors currently leading Chinese exports.[99]

2.6 Criticisms of Performance Requirements

53. As demonstrated above, developed countries used PRs to advance national interests at their earlier development stages. Yet, as will be discussed below, today many of these states include PPRs in their IIAs. What explains the emergence of this new approach and how has it developed? To address this question, we must first examine the key criticisms of PRs that has led to the evolution of PPRs.

54. Despite the benefits of PRs, to date, they remain controversial. The traditional view maintains that PRs are a necessary tool in ensuring that investments contribute effectively to the development of the host state, with the WTO itself having acknowledged that PRs could assist in economic development.[100] In contrast, an opposing view sees PRs as ineffective at best, and counter-productive at worst.[101] UNCTAD has suggested that the economic advantages of PRs are not clearly empirically demonstrated,[102] and even then, PRs can be damaging not only to the foreign investor, but also to the host states which impose them.[103] Over the years, we increasingly see this divide between developing states who support PRs as a tool for economic development, and developed states who oppose PRs, which they perceive as impeding investment and trade flow.[104]

55. The primary economic criticism of PRs is that they prevent the efficient allocation of resources across states and thus, have a distorting effect that is detrimental to international trade[105] and the free-flow of FDI. This criticism stems from the liberal economic theory of comparative advantage, which operates on the basis that both national and global welfare are

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[98] Wei (n 89) at p. 82.

[99] In 2017, the top two group of products in China's world exports are sectors for which China applied informal export performance requirements ("electrical machinery, equipment" and "machinery including computers"), and they account for around 40 percent of China's total exports. Extracted from Trade Map, International Trade Center, Accessed on 20 August 2018.

[100] Ministerial Declaration on Doha Work Programme, adopted at Hong Kong, 18 December 2005, Annex F (WT/MIN(05)/DEC)

[101] World Bank Guidelines on the Treatment of Foreign Direct Investment Guideline II(3), (1992) 31 ILM 1363.

[102] UNCTAD World Investment Report 2014, 112 (linking performance requirements with investment incentives) <http://unctad.org/en/Publications Library/wir2014_en.pdf> accessed 17th October 2018

[103] C. Fontheim and M. Gadbaw, 'Trade Related Performance Requirements Under the GATT-MTN System and US Law' (1982) 14 *Law & Policy of International Business* 129 at p. 139.

[104] IISD Performance Requirements in Investment Treaties: Best Practices Series (n 17) at p. 1.

[105] Sornarajah (n 26) at p. 114.

maximized when governments allow market forces to direct trade flows,[106] and as an extension, the flows of FDI.[107] According to this view, the liberalization of FDI allows capital to be channeled to the places where it can be put to the most productive use, generating wealth and income that can then be used as a basis for further production and trade. PRs, which direct capital in order to achieve public policy goals, prevent that efficiency.

56. Moreover, with the global liberalization of trade and investment and as the industrialized, capital exporting states increasingly invested in developing countries, they have sought to better protect and advance their companies' interests abroad (see below in Section 3.2). These criticisms, along with neoliberalist theories of economics advanced by the industrialized economies (see below in Section 3.2.), have led some states to turn away from PRs, and towards PPRs. Having dealt with a brief overview of PRs, the next section will discuss the development of PPRs in IIAs.

[106] Collins (n 10) at p. 22
[107] *Ibid*.

3. PROHIBITION ON PERFORMANCE REQUIREMENTS

- *The definition of PPRs is set out in **Section 3.1**.*
- ***Section 3.2** explores the reasons behind the inclusion of PPRs in IIAs of some states.*
- *There are two key approaches in which PPRs manifest: (1) PPR obligations that expressly reference to the TRIMs Agreement ("TRIMS-like approach"), and (2) PPRs that include TRIMs-like prohibitions and other prohibitions that go beyond the level of protection afforded in the TRIMs Agreement ("TRIMs-plus approach"). The various types of PPR provisions that fall within both approaches will be examined in **Section 3.3**.*
- ***Section 3.4** examines the exceptions and carve outs in IIAs.*
- *Finally, **Section 3.5** highlights potential changes in investor-state dispute settlement methods which could influence the use of PPRs in the future.*

3.1 Prohibition on Performance Requirements: Definition

57. Similar to PRs, there has been no single authoritative definition of PPRs. For the purposes of this paper, PPRs will be defined as policy measures which prohibit host states from imposing conditions on investors that must be fulfilled in order for an investment either to be made in the state or for an advantage to be conferred.

58. PPRs have emerged as an extension of the economic criticism directed towards PRs. With that context in mind, the next section discusses the emergence and evolution of PPRs.

3.2 The Emergence and Evolution of Prohibition on Performance Requirements

59. This section explores the reasons behind the inclusion of PPRs in IIAs of some states. Understanding the rationale would allow us to better appraise the situations in which PPRs can be used.

60. PPRs only emerged in the 1980s.[108] The United States took the lead role in pushing for the early development of those obligations at both bilateral and multilateral levels. At the time, the US did not see BITs as instrumental to investment policy changes in the host states, but rather as a tool to encourage and protect US investment abroad.[109] Moreover, as one of the leading capital-exporting states,[110] outward FDI was progressively seen as a tool to foster US exports and domestic production oriented to affiliated companies abroad.

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[108] Legum (n 39) at pp. 55-56

[109] Kenneth J. Vandevelde, *US International Investments Agreements* (Oxford University Press, 2009) at p. 111.

[110] Velde shows that the US had the third largest outward stock of FDI (behind the Netherlands and the UK) in the 1970s and 1980s. See Velde (n 75) at p. 5.

61. The US first began signing BITs in the first half of the 1980's and it was (to the best of our knowledge) the first state to include PPRs in its 1982 Model BIT and consequently signed BITs.[111] The choice for a hortatory ("shall seek to avoid") rather than mandatory ("shall") language did not diminish the importance of the first-time reference to PPRs in an IIA. More specifically, the provision included a substantive obligation in the body of the treaty (as opposed to preambles), referred to the subject of the obligation ("each Party") and set out the specific types of performance requirements that should be avoided ("which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally").[112] . The PPR provision in Art. II.7 of the 1985 US-Turkey BIA,[113] one of the first BITs the US signed, reads as follows:

> Each Party shall seek to avoid performance requirements as condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirements.[114]

62. This new approach under US treaty practice was a result of the US BIT Program launched in 1977. This program aimed to create new and uniform rules of international investment law to protect and encourage US investors, including those related to PPRs.[115] The negotiations that followed suit in the 1980s, and the successful conclusion of several BITs with different developing countries, strengthened the US negotiating stance with respect to the BITs obligations, including PPR obligations.[116]

63. The success of these negotiations brought about a change in perception with respect to BITs, especially in developing states. In the 1990s, these states started to view BITs as conducive to attracting FDI and thus were more willing to enter into BITs with capital

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[111] Wayne Sachs, "The New US Bilateral Investment Treaties" 2(1) Berkeley Journal of International Law (1984) 192 at 192. The author acknowledges that the first US BIT Model was influenced by the U.S. Treaties of Friendship, Commerce, and Navigation (FCN), BITs negotiated by various European states with less developed states in the 1960s and 1970s, and suggestions from the legal and business communities, at 193 ft. 1.

[112] Albeit it left open the definition of "any other similar requirements".

[113] Vandevelde acknowledges that the first treaty language in US BIT Model 1981 underwent several changes from December 1981 through 1986, and it only started to harmonize treaty language in BITs from the mid-1980s onwards. See, for example, US-Turkey BIA and US-Egypt BIA (1986). See Kenneth J. Vandevelde, "US Bilateral Investment Treaties: The Second Wave", 14(4), *Michigan Journal of International Law* (1993), 621, at 628

[114] A similar provision is found in Art. II.6 of US-Egypt BIT (1986) which stipulates: "In the context of its national economic policies and objectives, each Party shall seek to avoid the imposition of performance requirements of the investment of nationals and companies of the other Party".

[115] Vandevelde (1993) (n 113) at p. 627.

[116] The US successfully concluded several treaties in the first half of 1980s: Egypt, Panama, Morocco, Zaire, Cameroon, Bangladesh, Senegal, Haiti, Turkey, and Grenada. See Vandevelde (1993) (n 113) at pp. 628-629; and Vandevelde (2009) (n 109) at p. 638.

exporting states.[117] At the same time, the US by obtaining a more advantageous negotiating position, was progressively less willing to accept requests by developing states to modify the wording set out in its BIT models.[118] This was particularly true with respect to obligations on performance requirements and currency exchange controls.[119] Therefore, even "minor, non-substantive changes in wording" in US BIT models that appeared to be common during the 1980s negotiations, became rarer in the 1990s.[120]

64. NAFTA could be seen as a turning point in US treaty-making policy in terms of obligations on PRs. NAFTA obligations on PRs are framed in more mandatory ("no Party may"), leaving behind the hortatory wording ("shall seek to avoid") of the 1980s BIT models. The NAFTA PPR provisions identify the types of instruments used to enforce PPRs (not only "requirements" but also "commitment" or "undertakings"), which could render circumvention of PPR obligations by use of other instruments useless. The provision also expands the scope of investment activities/phases to which PPRs apply ("establishment, acquisition, expansion, management, conduct or operation" as opposed to only "establishment, expansion or maintenance"). The *chapeau* of Art. 1106(1) of NAFTA reads as follows:

> No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory.

This provision also unequivocally frames PRs that should be prohibited. The prohibition reaches PRs considered in former BIT models (local content and services requirements[121] and export performance requirements[122]) but also other types (export and import restrictions;[123] technology transfer requirements,[124] requirement to supply goods and services to specific markets,[125] advantage-conditioning local content or services requirements,[126] advantage-conditioning export performance requirements,;[127] and advantage-conditioning export

[117] *Ibid.*
[118] *Ibid.*
[119] *Ibid.*
[120] *Ibid.*
[121] Arts. 1106(1)(b) and (c) NAFTA.
[122] Arts. 1106(1)(a) NAFTA.
[123] Arts. 1106(1)(d) and (e) NAFTA.
[124] Arts. 1106(1)(f) NAFTA.
[125] Arts. 1106(1)(g) NAFTA
[126] Arts. 1106(3)(a) and (b) NAFTA
[127] Arts. 1106(3)(c) NAFTA

restrictions).[128] Hence, NAFTA marks a turning point in the US approach to PPRs that, since then, became mandatory, precise, lengthy and detailed.[129]

65. On the multilateral front, the US furtherance of PPR use was largely driven as a matter of trade policy. Since the US firmly viewed PRs as trade-distorting mechanisms "contrary to the spirit, if not the letter of the General Agreement on Tariffs and Trade" (GATT),[130] it initiated dispute settlement proceedings in 1982 to confirm its view. The target was the Canadian Foreign Investment Review Act ("FIRA") enacted in December 1973. The US questioned the practice of the government of Canada to "enter into agreements with foreign investors according to which these [foreign investors] are to give preference to the purchase of Canadian goods over imported goods and to meet certain export performance requirements"[131] including purchase undertakings, manufacturing undertakings, and export undertakings. The Panel's conclusion partially confirmed the US claims. In particular, it confirmed the US position that "local content measures" imposed by a government in an investment were inconsistent with the GATT insofar as they imposed requirements that discriminated imported goods vis-à-vis domestic goods. At the same time, it showed the GATT's limitations to curb the use of export performance or manufacturing requirements. The panel found that "export performance requirements" were not covered, and that "manufacturing requirements" fell outside of its terms of reference.[132]

66. Since the US considered a multilateral approach the most desirable, it sought to advance its position on PPRs in the GATT Uruguay Round of trade negotiations. The US played a "leading and perhaps exclusive role"[133] in including a negotiating mandate for investment-related measures in the Uruguay Round in 1986. During the negotiations, the US clearly favored the prohibition of "trade-distorting" export performance requirements and local content requirements.[134] The US advocated for even more comprehensive prohibitions, beyond

[128] Arts. 1106(3)(d) NAFTA.
[129] Note that similar provisions are found in the 2004 and 2012 US BIT models as well as in the investment chapters in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and United States-Mexico-Canada Agreement (USMCA). One of the main difference in these latter two agreements is that obligations are framed in more mandatory terms ("No Party shall" rather than "No Party may"). See Art. 9.10(1) of CPTPP and Art. 14.10(1) of USMCA.
[130] Edward M. Graham and Paul Krugman, "Current US Policy" in Stephen Young (ed), Multinationals and Public Policy Vol. 2 (Edward Elgar, 2004) 138, 146.
[131] GATT Panel Report, *Canada – Administration of the Foreign Investment Review Act*, ("GATT FIRA") GATT Doc L/5504, adopted on 7 February 1984), BISD 30S/40, para 1.1, 2.5, 2.6, 2.7.
[132] GATT FIRA Panel Report, paras 5.11; 5.18.
[133] "Statement of Asst. Sec. of Commerce Raymond J. Waldmann" in *U.S. Senate Investment Policy Hearings* (n 48) 190, quoted in Genest (n 6) at p. 32.
[134] Australia, Elements of the Framework for Negotiations – Submission to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/32 (30 November 1989) 2; Canada, Framework for Negotiations – Communication to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/25 (28 June 1989) 1-2;

export performance requirements, export restrictions and local content requirements, including requirements to generate net trade balance; manufacturing requirements, and technology transfer requirements.[135] By contrast, the European Community and Japan, among other developed states, adopted a more nuanced approach towards PPRs. They focused on "inherently-trade distorting" investment-related measures "with direct and substantial effect on international trading patterns" and "impacting the business behavior of the investor during the production process".[136] Developing states strongly opposed addressing investment-related matters within the GATT[137] and, more pertinently, the inclusion of any obligations over PRs. They insisted that PRs should be situated within the context of their "economic policy objectives" and development, especially industrial, technological and export growth.[138] Thus, they viewed PRs as falling outside the scope of the negotiating mandate.[139] The compromise that emerged from the negotiations is the Agreement on Trade-Related Measures ("TRIMS Agreement") of the WTO (discussed in further detail in Section 3.3.2 below).

67. Three key points are worth noting about the evolution of investment-related measures after the conclusion of the TRIMs Agreement. First, it did not change the fact that the US was already applying, and continued to apply, investment-related measures beyond the TRIMs obligations ("TRIMs-plus") (which we explore in Section 3.3.3 below). Second, certain states started to include explicit reference to the TRIMs Agreement in their IIAs.[140] Third, other states

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Switzerland, Elements of the Negotiating Framework – Communication to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/26 (13 September 1989) 2; Japan, Elements of the Framework for Negotiations – Submission to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/27 (6 October 1989) 1; United States, Communication to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/20 (15 June 1988) 3-4; GATT Secretariat, Meeting of Meeting of 30 November – 1 December 1989 – Note by the Secretariat to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/15 (10 January 1990) para. 4; United States, Elements of the Framework for Negotiations – Submission to the Group of Negotiations on Goods (GATT) – Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/29 (22 November 1989) 2. Quoted from Genest (n 6) at p. 48.

[135] US Submission on Subsidies (fn 52) at 4. Cited in Genest (n 6) at p. 54.

[136] European Communities, Submission to the GATT Group of Negotiations on Goods – Negotiating Group on Trade-Related Investment Measures, MTN.GNG/NG12/W/22 (16 November 1989) 3; GATT, Note on TRIMs (October 1990) para 30 (EC). Quoted from Genest (n 6) at p. 53.

[137] GATT Secretariat, Summary Record of the Seventh Meeting on 20 September 1986, GATT Contracting Parties, Session at Ministerial Level, MIN(86)/SR/7 (22 October 1986) 3-5 (Brazil, Cuba, India, Nicaragua and Peru).

[138] GATT Group of Negotiations on Goods – Negotiating Group on TRIMs, MTN.GNG/NG12/22 (23 November 1990) paras 4&9 (India), para 5 (Nigeria), para 6. (China and Egypt), para 13 (Malaysia), para 11 (Philippines, para 22 (Colombia) para 33 China).

[139] GATT Group of Negotiations on Goods, Report to the Trade Negotiations Committee meeting at Ministerial level, December 1988, MTN.GNG/13 (22 November 1988) para 79; India and others, GATT Communication 25 (n 48) para 4; GATT Group of Negotiations on Goods, Fifteenth meeting: 19 and 20 December 1989, MTN.GNG/21 (23 January 1990), para 19; GATT, Note on TRIMs (April 1990) para 3. Quoted from Genest (n 6) at p. 33.

[140] See, for example, ASEAN Comprehensive Investment Agreement.

have not included any reference to PPRs at all,[141] which is eventually the approach the majority of states follow in IIAs ("silence", see below in Section 3.3.1). Notwithstanding this silent approach, WTO members states still need to abide by the obligations on TRIMs (such as prohibitions on local content requirements and on export and import restrictions on goods) regardless of express reference to incorporation of TRIMs Agreement obligations into IIAs to which they are parties. The next section will explore in more detail these different legal regimes that regulate PPRs, setting the foundation for the following section appraising the content of different PPR provisions.

3.3 Approaches to Prohibition on Performance Requirements

68. This section examines the reasons for including PPR provisions in the IIAs of some states and the corresponding content of the obligation.

The types of approaches towards PPRs can be broadly classified into three categories: (1) IIAs which are silent on PPRs; (2) IIAs which incorporate by reference, or *mutatis mutandis*, the TRIMs Agreement ("**TRIMS**" or "**TRIMS-like**"); and (3) IIAs which include TRIMs-like and other obligations that go beyond the level of protection afforded in the TRIMs Agreement ("**TRIMs-Plus**"). Within each category, the types of PPRs will be discussed, and, where relevant, disputes that have been adjudicated involving a breach of a PPR. The exceptions and carve outs to PPRs, which give host states certain regulatory flexibility to enforce PRs consistent with their IIAs obligations, is explored in the following section.

3.3.1 Silence

69. Most commonly, IIAs are entirely silent on PPRs.[142] In other words, there is no express reference to the TRIMs Agreement in the IIA, nor any other reference to PPRs.[143] This silence does not mean that parties can apply any type of PR, as the TRIMs Agreement will still govern parties' obligations insofar as the state parties are WTO member states. However, one common

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[141] Note, however, that some states, such as Germany, did not mention PPR obligations in its 1991 and 1998 BIT models, but include PPRs in its more recent 2008 BIT Model (which contains PPRs under FET standard).

[142] Collins (n 10) at p. 117.

[143] For example, ASEAN-China Investment Agreement (2009); ASEAN-Japan Comprehensive Economic Partnership Agreement (CEPA) (2008); Japan-Vietnam Agreement for the Liberalization, Promotion and Protection of Investments (2003); Japan-Vietnam Economic Partnership Agreement (2008); United States-Brunei Trade and Investment Framework Agreement (2002); United States-Malaysia Trade and Investment Framework Agreement (2004); ASEAN-United States Trade and Investment Framework Agreement (2006); Singapore-Australia FTA (2003).

limitation of the 'silence approach' is that an investor is unable to bring a claim against the host state through investor-state dispute settlement mechanisms for imposing a PPR (but insofar as they are WTO member states and the PPRs are covered by the TRIMs Agreement their home state could (theoretically) bring a claim under the WTO dispute settlement mechanism ("DSM")).[144] Investment treaties between developing countries, especially those concluded after 2013, typically do not include any reference to PRs.[145]

3.3.2 TRIMs Agreement-like Obligations

70. TRIMs obligations in relation to PPRs feature in both the TRIMs Agreement and in IIAs. For example, TRIMs obligations feature in IIAs such as the ASEAN Comprehensive Investment Agreement 2009, the ASEAN-Korea Investment Agreement under the Framework Agreement on Comprehensive Economic Cooperation 2009, the Malaysia-New Zealand FTA 2009, the Japan-Brunei Economic Partnership Agreement 2007 and the Japan-Malaysia Economic Partnership Agreement 2005.[146]

71. The scope of such provisions is limited to the standard set out by the TRIMs Agreement.[147] That is, the state parties to these IIAs are under an obligation not to impose trade-related PRs, such as LCRs, trade balancing measures foreign exchange and export restrictions.[148] There are two noteworthy points that bear mentioning in that regard. First, the scope of the TRIMs Agreement limits the host state's ability to impose these types of PRs affecting trade in goods (and not trade in services) in connection with an investment in the host state's territory. Second, the TRIMs Agreement focuses on measures that discriminate between imported and exported products and/or those that create import/export restrictions.[149]

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[144] Collins (n 10) at p. 117

[145] *Ibid.*

[146] For example, Art. 7(1) of ASEAN Comprehensive Investment Agreement (2009); Art. 6 of ASEAN-Korea Investment Agreement under the Framework Agreement on Comprehensive Economic Cooperation (2009); Art. 10(6)(1) of Malaysia-New Zealand FTA (2009); Art. 61(1) of Japan-Brunei Economic Partnership Agreement (2007); Art. 79(1) of Japan-Malaysia Economic Partnership Agreement (2005).

[147] *Ibid* at p. 116.

[148] Arts. 2.1 and 2.2 TRIMS Agreement: Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 186 (TRIMs Agreement).

[149] As a point of clarification, the TRIMs Agreement focuses on the discrimination between imported and domestic *products*, not between domestic producers and foreign investors. The implication of such a distinction is that even if PRs are applied in a non-discriminatory fashion to both domestic producers and foreign investors, and both are required to buy local goods, such a measure would still be inconsistent with TRIMS as it involves discriminatory treatment which favors domestic products over imported products, albeit it might not give rise to a breach of a PPR.

72. The expression "trade-related investment measures", or simply "TRIMs" is not defined in the TRIMs Agreement. However, it contains an illustrative list that exemplify PRs that should be deemed to be inconsistent with Art. III:4 (national treatment of imported goods) or Art. XI:1 (prohibition of quantitative restrictions on imports or exports) of the GATT 1994. Art. 2 of the TRIMS Agreement, which prohibits the use of performance requirements, reads as follows:

> 1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.
>
> 2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Art. III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

73. The illustrative list lists measures that are inconsistent with Art. III:4 and Art. XI:1 of the GATT. The list is not exhaustive and covers both mandatory and advantage-conditioning PRs.

74. Regarding Art. III:4, the illustrative list includes: local content requirements (which require the purchase or use by an enterprise of products of domestic origin or domestic source),[150] trade balancing measures (which limit the purchase or use of imported products by an enterprise).[151] In these cases, the inconsistency with Art. III:4 is a result of the fact that imported products are subject to less favorable conditions than domestic products.

75. Regarding Art. XI:1, the illustrative list includes: trade balancing measures (which limit the importation by an enterprise of products used in its local production),[152] and foreign exchange balancing measures (which limit access of enterprises to foreign exchange when they import products used in local production),[153] and export restrictions (which restrict export or sale for export by an enterprise).[154] As the TRIMs Agreement only applies Art. XI:1, it only deals with measures that restrict exports. Other measures relating to exports, such as export performance requirements or export incentives, are not covered by the TRIMs Agreement but

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[150] Paragraph 1(a) of the Illustrative List.
[151] Paragraph 1(b) of the Illustrative List.
[152] Paragraph 2(a) of the Illustrative List.
[153] Paragraph 2(b) of the Illustrative List.
[154] Paragraph 2(c) of the Illustrative List.

instead governed by IIAs which are TRIMs-plus in nature and will be discussed below in Section 3.3.3.

76. The TRIMs Agreement approach features in some IIAs. Such IIAs which include the TRIMs limitations are only restricted to imposing PRs which are inconsistent with TRIMs (and would not cover a broader range of PRs which we discuss under TRIMS-plus below in Section 3.3.3). In particular, the ASEAN Comprehensive Investment Agreement ("**ACIA**") expressly incorporates the TRIMs Agreement. [155] The ACIA contains, however, an additional obligation and provides that states parties "shall" undertake "joint assessment" of PRs within two years of the date of entry into force of the agreement with a view to considering whether a TRIMs-plus approach is required.[156]

77. In any case, the Illustrative List to the TRIMs Agreement only exemplifies specific types of PPRs and is not comprehensive nor meant to be exhaustive. The Appellate Body of the WTO confirmed the interpretation that the Illustrative List only "provides examples" of TRIMs that are inconsistent with the national treatment obligation under Art. III and XI of the GATT 1994.[157] Albeit not explaining what other types of TRIMs not included in the Illustrative List could be deemed to be prohibited, the Appellate Body recognized that "measures that did not directly regulate goods, or the importation of goods, have nonetheless been found to contravene" the national treatment obligations under Art. III and Art. XI of GATT obligations.[158] In that respect, panels and the Appellate Body have found "restrictions imposed on investors, wholesalers, and manufacturers, as well as on points of sale and ports of entry" [159] to be inconsistent with Art. III:4 or Art. XI:1 of the GATT 1947 or 1994".

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[155] Art. 7.1, ASEAN Comprehensive Investment Agreement.
[156] Art. 7.2 ASEAN Comprehensive Investment Agreement.
[157] Appellate Body Report, *Canada Renewable Energy/Feed-in* Tariffs (WT/DS412/AB/R and WT/DS426/AB/R) para. 5.26.
[158] Appellate Body Report, *China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (WT/DS363/AB/R) para. 227 [henceforth referred to as *China – Audiovisuals*].
[159] See With respect to Art. III:4 of the GATT 1994, the panel in *India – Autos* found that "indigenization requirements" (requirements to use a minimum amount of domestically produced parts) and "trade balancing requirements" (requirements to export products of an equivalent value to the imported products) imposed on automobile manufacturers were inconsistent with Art. III:4 of the GATT 1994. (Panel Report, *India – Autos*, paras. 7.195-7.198 and 7.307-7.309) Similarly, in *China – Auto Parts*, the Appellate Body found that measures that applied to automobile manufacturers created incentives for those manufacturers to *limit* their use of imported parts relative to domestic parts, or to avoid entirely the use of imported auto parts, and were, therefore, inconsistent with Art. III:4 of the GATT 1994. (Appellate Body Reports, *China – Auto Parts*, paras. 195 and 196; see also Appellate Body Report, *US – FSC (Art. 21.5 – EC)*, para. 212) Requirements that imported products be sold or distributed only through specific points of sale or specific channels have also been found to violate Art. III:4 (see the Panel and Appellate Body Reports in *Korea – Various Measures on Beef*; and GATT Panel Report, *US – Malt Beverages*, para. 5.38), as have purchase undertakings that conditioned investment approval upon the acceptance by investors of undertakings to purchase goods of domestic origin (GATT Panel Report, *Canada – FIRA*, para. 6.1). As for Art. XI:1, the GATT panel in *Canada – Provincial Liquor Boards (EEC)* found that restrictions on

78. It is also apposite to note that Art. 4 of the TRIMs Agreement provides temporary exemptions for developing states from the prohibitions under the TRIMS Agreement,[160] as long as such deviation is in line with the criteria set out in Art. XVIII of the GATT (and the agreements concerning balance of payments).[161] In particular, least developed countries (LDCs)[162] "shall" be free to temporarily deviate from all other GATT obligations (including obligations under Art. 2 of the TRIMs Agreement) and developing states "may" request the other WTO members states for authorization to temporarily deviate from these obligations.[163]

79. In what follows, we discuss one type of PPR provision which falls within the illustrative list to the TRIMs Agreement regarding Art. III:4 of the GATT - the local content requirements prohibition - given the strong focus on it in international dispute settlement cases. The other type – prohibition to enforce export or import restrictions – falls under the quantitative restriction prohibition detailed in the illustrative list to the TRIMs Agreement regarding Art. XI:1 (as explained above). It is typical for TRIMs PPRs to also be included in IIAs which contain TRIMs-plus obligations.

Local Content Requirements Prohibition

80. A local content requirement prohibition is when a party is not permitted to require the purchase or use of domestic products.[164] Examples of IIAs featuring prohibitions on LCRs include the CPTPP, EU-Vietnam FTA and USCMA where no party is permitted to impose or enforce any requirement on an investor to "achieve a given level or percentage of domestic

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points of sale were a restriction on importation (GATT Panel Report, *Canada – Provincial Liquor Boards (EEC)*, para. 4.25), and, in *Colombia – Ports of Entry*, the panel found that a restriction on the ports through which relevant goods could enter Colombia constituted a restriction on importation within the meaning of Art. XI:1 (Panel Report, *Colombia – Ports of Entry*, para. 7.275). Quoted in Appellate Body Report, *China – Audiovisuals*, ft. 432 to para. 226.

[160] In *Indonesia – Autos*, the WTO Panel observed that "a violation of Art. 2.1 of the TRIMs Agreement may be justified under Arts. 3, 4 or 5 of the TRIMs Agreement"". Panel report, Indonesia – Autos, para. 14.92.

[161] Art. 4 reads as follows: "A developing state Member shall be free to deviate temporarily from the provisions of Art. 2 to the extent and in such a manner as Art. XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of- Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Arts. III and XI of GATT 1994."

[162] Art. XVIII.4(a) of the GATT 1994 specifies that "a contracting party, the economy of which can only support low standards of living and is in the early stages of development shall be free to deviate temporarily from the provisions" of the other articles of the GATT including Art. III and Art. XI.

[163] Art. XVIII.4(b) of the GATT 1994 provides that "a contracting party, the economy of which is the process of development, but which does not come within the scope of subparagraph (a) above may submit applications to the Contracting Parties" to request authorization to deviate temporarily from the provisions of the other articles of the GATT including Art. III and Art. XI. Art.

[164] TRIMS Agreement, Annex, Paragraph 1(b) of Illustrative List.

content".[165] The ACIA also includes this prohibition by virtue of incorporating TRIMs by reference.[166]

81. Such stipulations have the effect of minimizing the impetus for efficient production in domestic industries, reducing economic efficiency, and undermining the competitiveness of such industries.[167] Moreover, mandating that foreign investors use more expensive local components, as opposed to cheaper alternatives on the international market, makes little economic sense.[168] From the foreign investors' perspective, where industries are technology and/or knowledge-intensive, LCRs are an obstacle to FDI as inputs may not be available or of the required quality for the type of investment pursued by foreign investors.[169] This, in turn, has the potential effect of substantially reducing the value of the investment.[170] Therefore, a prohibition of LCRs would enhance investors' autonomy in sourcing cheaper and more cost-efficient components of goods abroad, without compromising quality standards.[171]

82. In the WTO case of *Indonesia-Certain Measures Affecting the Automobile Industry,*[172] the Panel found that Indonesian measures which afforded favorable tax and import duty treatment for automobile manufacturers with a minimum percentage of local components was a trade-related investment measure prohibited under Art. 2.1 of the TRIMs Agreement.[173] The Panel found that despite the content requirement not being imposed in a binding contract, it was a necessity for automobile producers or assemblers to "satisfy the local content targets of the relevant measures in order to take advantage of the customs duty and tax benefits offered by the Government", and a violation was hence made out.[174] It can thus be concluded that

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[165] See Art. 9.10(1)(b), CPTPP; Art. 14.10(1)(b): Performance Requirements; USMCA, Art. 8.8(1)(b), EU-Vietnam FTA: "No Party is permitted to impose or enforce any requirement on any investor to "**achieve a given level or percentage of domestic content"**

[166] Art. 7(1), ASEAN Comprehensive Investment Agreement

[167] Matthias Vocke, Investment Implications of Selected WTO Agreements and the Proposed Multilateral Agreement on Investment, International Monetary Fund, 1 May 1997 p. 20; Adhikari, Ratnakar. "The Local Content Paradox at the WTO: A Minor Lapse or Lapse or Organised Hypocrisy?", (2008), online: *Bridges* https://www.ictsd.org/bridges-news/bridges/news/the-local-content-paradox-at-the-wto-a-minor-lapse-or-lapse-or-organised; The same prohibition is found in Art 3.1(b) of the WTO Agreement on Subsidies and Countervailing Measures.

[168] Newcombe, Andrew Paul & Lluís Paradell. "Transfer Rights, Performance Requirements and Transparency" in *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International, 2009) 614 at p. 419

[169] Vocke (n 167) at p. 20

[170] Arthur W. Rovine, "Contemporary Issues in International Arbitration and Mediation: The Fordham Papers (2007)", Brill, at p. 58.

[171] Adhikari, Ratnakar. "The Local Content Paradox at the WTO: A Minor Lapse or Lapse or Organised Hypocrisy?", (2008), online: *Bridges* <https://www.ictsd.org/bridges-news/bridges/news/the-local-content-paradox-at-the-wto-a-minor-lapse-or-lapse-or-organised>.

[172] *Indonesia – Certain Measures Affecting the Automobile Industry* – Reports of the Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1 and 2, adopted 23 July 1998, and Corr. 3 and 4 <http://docsonline.wto.org> (*Indonesia—Autos*)

[173] *Ibid* at p. 345

[174] *Ibid* at para. 14.90

where trade and financial benefits are "*contingent* on meeting local requirements", they could be interpreted to constitute "advantages" for the purposes of finding a violation under Art. 2.1 of the TRIMs Agreement.[175] However, since WTO rulings are not binding on other tribunals, it cannot be said with certainty on how the interpretation will follow in the future. In any case, these findings are of relevance for investment treaties which incorporate TRIMs.[176]

83. Other WTO cases which have dealt with LCRs include the *India Solar* case, where the US challenged India's local content requirements for solar power equipment,[177] and the *Canada-FIT* case where the WTO "rejected Canada's rebuttal that the local content requirements should be considered as government procurement which can be exempted from the national treatment obligation".[178]

84. A seminal case dealing with LCR prohibitions is *Lemire v Ukraine*.[179] The tribunal found that Ukraine's measure of requiring 50% of the broadcasting time of each Ukrainian radio station to be "music produced in Ukraine"[180] did not violate the PPR obligations enshrined in the US-Ukraine BIT. The tribunal did, however, find a violation of the Fair and Equitable Treatment (FET) standard. The effect of the measure – a de facto LCR – was irrelevant in comparison to its objective – protection of Ukraine's legitimate right "to regulate its affairs and adopt laws in order to protect the common good of its people".[181]

85. Art. II.6 of the Ukraine-US BIT provided that neither party "shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which…specify that goods and services must be purchased locally". The Tribunal found that the Ukrainian measure did not "fall foul"[182] of the LCR prohibition in the Ukrainian-US BIT, since it did not require the purchase of local goods. Recognizing the limited effect of this reasoning which failed to include the *de facto* prohibition that the Ukrainian challenged measure entailed, the Tribunal moved to assess the object and purpose of Art. II.6 of the US-Ukraine BIT. The Tribunal looked at the objective "to promote greater economic

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[175] *Ibid.*
[176] Art. 9 Performance Requirements: "The Contracting Parties reaffirm their obligations under the WTO Agreement on Trade-Related Investment Measures (TRIMs), as amended from time to time. Art. 2 and the Annex of the TRIMs are incorporated into and made part of this Agreement."
[177] WTO, Report of the Appellate Body, India – Certain Measures Relating to Solar Cells and Solar Modules, WTO doc WT/DS456/AB/R, 16/09/2016
[178] WTO, Appellate Body Reports, Canada – Certain Measures Affecting the Renewable Energy Generation Sector / Canada – Measures Relating to the Feed-in Tariff Program, WTO doc WT/DS412/AB/R/ WT/DS426/AB/R, 24/05/13.
[179] Breaches of LCRs prohibitions in NAFTA were also addressed in the *Corn Syrup v Mexico* and *ADM v Mexico* arbitral decisions.
[180] This referred to music whose author, composer or performer was of Ukrainian nationality
[181] *Lemire v Ukraine*, at para 505
[182] *Ibid* para. 509.

cooperation"[183] in the preamble, and stated that while the "purpose" of Art. II.6 is "to avoid that states impose local content requirements as a protection of local industries against imports", the "underlying reasons" of the challenged Ukrainian measure were not "to protect local industries and restrict imports, but rather to promote Ukrainian's cultural inheritance".[184] On these grounds, the Tribunal declared the LCR imposed by the Ukrainian Government lawful under Art. II.6 of US-Ukraine BIT, albeit violating the FET standard.

86. In essence, the Tribunal opted to interpret PPRs as granting Ukraine far-reaching policy space in implementing its cultural regulations, in a considerably sensitive matter of national sovereignty. In doing so, the Tribunal shifted away from the textual hook of PPR provisions in the US-Ukraine BIT and instead, focused on the purpose of the disputed measure. However, this case also demonstrates that even if certain PR-like measures are found to be permitted under the PPR provisions, they may still be found to be inconsistent with the FET standard. Thus, host states could be exposed to claims not only on the basis of PPR provisions, but in addition or alternatively, on the basis of the FET provision. The interaction of PPR provisions with the FET standard in IIAs will be discussed in Section 3.3.4 below.

3.3.3 TRIMs-Plus

87. As its name suggests, the TRIMs-plus approach refers to treaties in which PPRs are wider than those listed in TRIMs. The TRIMs-plus approach is generally taken to liberalize markets to attract more inward FDI by lessening the obligations imposed upon investors.[185] NAFTA, CPTPP, the USMCA, the EU-Vietnam FTA and the Canada-European Union Comprehensive Economic and Trade Agreement ("**CETA**") are examples that follow the TRIMs-plus approach. PPRs which fall within the TRIMs-plus approach will be discussed below; in particular, prohibitions on export performance requirements, local equity and joint venture requirements, capital controls, technology transfer and local R&D requirements, and local employment and training requirements. While the TRIMs Agreement only covers PPRs concerning *goods*, and only PPRs which are in violation of trade-related national treatment or quantitative restrictions, TRIMS-plus IIAs have a wider scope and covers more situations.

Export Performance Requirements Prohibitions

[183] 1994 US – Ukraine BIT
[184] *Lemire v Ukraine,* para. 510.
[185] Collins (n 10) at p. 117.

88. Export performance requirements prohibitions refer to prohibitions of any measure that imposes a requirement, whether solely or coupled with several other conditions, on the investor to export a certain level of its production. Distinct from export quantitative restrictions, which are covered by Art. 2.1 of the TRIMs Agreement, export performance requirements are not covered by the TRIMs Agreement but are found in TRIMs-plus obligations in IIAs.[186]

89. The NAFTA, the CPTPP, USMCA and the EU-Vietnam FTA all explicitly prohibit the enforcement of export performance requirements on investors. Art. 1106(1)(a) of NAFTA states that: "[n]o Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory (a) to export a given level or percentage of goods or services."

90. The Tribunal in *Pope v Talbot* dealt with the prohibition of export performance requirements under the NAFTA. The Tribunal found that Canada's enforcement of an "export performance requirement" under the "Export Control Regime" did not violate NAFTA PPR obligations under Art. 1106(1)(a) of NAFTA. The challenged measure required the "investment to export a given level of goods" that was "lower than that which the investor would export if it were not forced to pay export fees on exports above its fee-free allocation.'"[187] In addition, the challenged measure penalized softwood lumber producers "for under-utilization of export quotas" under "use it or lose it" provisions; thus, creating a "de facto requirement" to export up to quota levels.[188] The Tribunal concluded that while the measure at issue "undoubtedly" deterred the investor's exports to the US, that deterrence neither "imposed or enforced" a PR nor was a "requirement" "in connection with" the "establishing, acquiring, expanding, managing, conducting or operating a foreign business in Canada".[189] On those grounds, the Tribunal found that Canada did not breach NAFTA Art. 1106(1)(a).

Local Equity and Joint Venture Requirements Prohibition

91. Joint venture requirement prohibitions bar a host state from, *inter alia*, requiring that an investment must have a minimum level of equity in an enterprise held by the domestic

[186] Note that the prohibition to grant subsides conditioned upon export performance under Art. 3.1(a) of the Subsidies and Countervailing Measures Agreement of the WTO is concerned with a different type of obligation and covers different subject matters. In the case of the SCM Agreement, what is prohibited is the granting of a subsidy contingent upon export performance, not the export performance requirement as such. In contrast, for IIAs with export performance requirement prohibition, what is prohibited are TRIMs in the form of an export performance requirement, not the grant of an advantage, such as a subsidy.
[187] *Pope and Talbot v Canada* (Interim award 2000), at para. 47
[188] *Ibid.*
[189] *Ibid,* para. 75.

nationals of that state, or that an investor of another Party must sell or otherwise dispose of an investment due to its nationality. The economic rationale underpinning this prohibition is as follows: first, where domestic partners are not as qualified or are resource-constrained, the foreign investor will find such a joint venture ineffective; second, in technologically-intensive industries, technology employed in mandatory joint ventures is generally outdated and training provided to local personnel is superficial;[190] third, the arrangement may only thrive after a period of time, once sufficient training has been conducted and the joint venture has been operating in a manner complementary to both parties. Such efforts may entail long and tedious processes, resulting in inefficiency in the operation of the investment which may ultimately prolong the setting up of the investment. Therefore, mandatory joint ventures, attractive as they may be in theory, may often be impractical especially where developing countries are concerned, or where cultural nuances make the collaboration more tenuous than otherwise.

92. It is important to note that local equity and joint venture requirement prohibitions are not typically prohibited under the PPR provisions but more directly targeted under "market access" or "national treatment" provisions. The latter will be discussed further in Section 3.3.4 below.

93. Restrictions on joint venture obligations exist in the market access provisions of several IIAs; for example, the investment agreement between the European Community and Chile,[191] and the Free Trade Agreement between the EFTA States and Singapore[192] for particular service industries. Similarly, Art. 1102(4)[193] of the NAFTA prohibits domestic equity requirements through the national treatment provision.[194] The CPTPP, USMCA, and EU-Vietnam FTA however, do not expressly prohibit a domestic equity requirement.

Capital Controls Prohibition

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[190] Cosbey (n 27); UNCTAD (2003) (n 11) at at p. 9.

[191] Art. 97 Market Access, Agreement Establishing an Association between the European Community and the Republic of Chile: "In sectors where market-access commitments are undertaken, the measures which a Party shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as … (e) measures which restrict or require specific types of legal entities or joint ventures through which a service supplier of the other Party may supply a service…"

[192] UNCTAD (2003) (n 11) at p. 3; Art. 24, Agreement Between the EFTA States and Singapore

[193] Art. 1102(4) NAFTA: For greater certainty, no Party may:
(a) impose on an investor of another Party a **requirement that a minimum level of equity in an enterprise** in the territory of the Party **be held by its nationals,** other than nominal qualifying shares for directors or incorporators of corporations; or
(b) **require an investor of another Party**, by reason of its nationality, **to sell or otherwise dispose** of an investment in the territory of the Party."

[194] Kumar (n 28) at p. 61.

94. Capital controls are administrative measures initiated by governments to alter the composition or size of foreign investments and to restrict capital outflow of the economy.[195] It must be noted that capital controls are not performance requirements *per se*, but rather restrictions which seek to improve the balance of payments of the host state. Hence, prohibitions on capital controls are, likewise, not PPRs in the strict sense. Therefore, they are typically not covered by PPR provisions, but by other provisions in IIA, such as provisions on "transfers" in the USMCA and CPTPP. Nonetheless, it remains worthwhile to examine how states have employed capital controls as, akin to PRs, they are driven by the broader aim of controlling the entry and operations of FDI.

95. Unlike other PRs, capital controls have been viewed in a much more positive light, with the IMF even endorsing their use in the wake of the 2008 Global Financial Crisis, calling them an "essential feature of the monetary policy framework".[196] Indeed, many IIAs[197] allow for capital controls, in some cases referencing the IMF articles.[198]

96. As for prohibition on capital controls, they are most commonly seen in US BITs. These US BITs do not leave much flexibility for the use of capital controls. Instead, they view restrictions on the movement of speculative capital as a violation of their terms.[199] The 2012 US BIT Model contains provisions requiring that capital be allowed to flow between trading partners "freely and without delay".[200] A similar provision is present in the "transfer" provision of the CPTPP,[201] and USMCA.[202] Furthermore, under the exceptions section of the US BIT Model, it is notable that prudential carve outs do not apply to capital controls,[203] and that there is no exception for restrictions adopted to safeguard balance of payments. Hence, it appears that by balancing the protection of investor rights against the adoption of state measures necessary for prudential or macroeconomic reasons, preference is given to investors. Therefore,

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[195] Kinga Z. Elo, "The Effect of Capital Controls on Foreign Direct Investment Decisions Under Country Risk with Intangible Assets", IMF Working Paper 07/79 (Washington: International Monetary Fund).
[196] International Monetary Fund, Press Release, 09/375, "IMF Completes First Review Under Stand-By Arrangement with Iceland, Extends Arrangement, and Approves US$167.5 Million Disbursement," (28 October 28, 2009) online: IMF <https://www.imf.org/en/News/articles/2015/09/14/01/49/pr09375>.
[197] Canada-Chile FTA, EU-Korea FTA, Japan-Peru BIT, Japan-Korea BIT
[198] Kevin P. Gallagher, "Reforming United States trade and investment treaties for financial stability: The case of capital controls", *International Institute for Sustainable Development* (5 April 2011) online: IISD < https://www.iisd.org/itn/2011/04/05/reforming-united-states-trade-and-investment-treaties-for-financial-stability-the-case-of-capital-controls/>.
[199] *Ibid.*
[200] Art. 7, US BIT Model (2012): "Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory."
[201] Art. 9.9(1), CPTPP: "Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory."
[202] Art. 14.9(1), USMCA: "Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory."
[203] Art. 20, US BIT Model (2012).

it is more likely for investors to mount investor-state claims on grounds of capital control disputes.

Technology Transfer Prohibition

97. Technology transfer requirements are no longer prevalent in developed countries and have since been expressed in various IIAs as a PPR.[204] The TRIMs Agreement does not limit technology transfer requirements; instead, this is found in TRIMs-plus clauses.

98. The NAFTA was the first agreement to introduce such provisions, prohibiting requirements "to transfer technology, a production process or other proprietary knowledge to a person in its territory" in Art. 1106(1)(f). This provision is notable as it goes beyond the TRIMs with respect to restrictions on technology transfer conditions imposed on foreign investors.[205]

99. Given the NAFTA's influence on later US and Canadian treaties, compounded with the uniqueness of technology transfer requirements, it is unsurprising that express prohibitions on performance requirements relating to technology transfer are found commonly in many international investment agreements. This features in the CPTPP[206], USCMA[207], and EU-Vietnam FTA,[208] all of which adopt identical language to Art. 1106(1)(f) of the NAFTA.

R&D Requirements Prohibition

100. While technology transfer requirements are clearly prohibited under NAFTA, the status of R&D requirements as a PPR is not as clear. UNCTAD has construed NAFTA Art. 1106 as permitting R&D requirements due to the absence of such a prohibition in Art. 1106(1).[209] Moreover, Art. 1106(4) explicitly allows R&D requirements as a condition for the receipt or continued receipt of an advantage.[210] This implies that states have the autonomy to impose

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[204] United Nations Conference on Trade and Development, IIA Issues Paper Series "Transfer of Technology", p. 49 http://unctad.org/en/docs/psiteiitd28.en.pdf

[205] Collins (n 10) at 120.

[206] Art. 9.10(f), CPTPP: "…to transfer a particular technology, a production process or other proprietary knowledge to a person in its territory."

[207] Art. 14.10(f), USMCA: "…to transfer a particular technology, a production process or other proprietary knowledge to a person in its territory."

[208] Art. 8.1(1)(f), EU-Vietnam FTA: "…to transfer a particular technology, a production process or other proprietary knowledge to a person in its territory."

[209] United Nations Conference on Trade and Development, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, UN Doc UNCTAD/WIR/2005 (2005) 229.

[210] *Ibid*.

R&D requirements as conditions for the establishment and operation of FDI, and that they are allowed to apply such conditions by attaching them to an incentive.[211]

101. In *Mobil v Canada,* [212] the Tribunal decided that the local R&D requirement imposed on Mobil as a condition of operating their investments in Canada constituted an LSR in violation of NAFTA Art. 1106(1)(c).[213] It is apposite to note that the issue in this case turns squarely on Art. 1106(1)(c), and not the more specific provision of Art. 1106(1)(f) on technology transfer requirements. Specifically, the issue is whether the R&D requirements constitute "services" within the meaning of Art. 1106(1)(c).

102. Nevertheless, the case remains relevant in the analysis of R&D requirements as it determines whether R&D requirements constitute LSRs in violation of PPR provisions in NAFTA Art. 1106 in general. Notably, the Tribunal decided that the ordinary meaning of the term "services" in NAFTA Art. 1106(1)(c) is broad enough to encompass R&D, effectively subsuming them into one category of prohibited performance requirements. This decision has been criticized for ignoring the distinctions between LSRs and R&D requirements as set forth in NAFTA Art. 1106(4).[214]

103. More significantly, *Mobil v Canada* demonstrates that even in the absence of an express PPR on technology transfer or R&D requirements, they may still be a PPR insofar as they constitute a prohibited LSR.

Local Employment Prohibition and Education and Training Requirements

104. Prohibitions on local employment and training requirements are found in various BITs. Like prohibitions on technology transfer and R&D requirements, this prohibition is not caught by the TRIMs Agreement, but constitutes a TRIMs-plus obligation. Such provisions guarantee the foreign investor the right to employ staff of any nationality, without interference from the host state which otherwise would typically require them to hire its locals. In addition, prohibition on local employment requirements may also encompass senior management PPRs, as seen in CPTPP[215] and USMCA.[216]

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[211] *Ibid*.
[212] *Mobil v Canada* (n 8).
[213] *Ibid* at paras. 100-101.
[214] Genest (n 6) at pp. 107-108.
[215] Art. 9.11(1), CPTPP: "No party shall require that an enterprise of that Party that is a covered investment appoint to senior management positions natural persons of a particular nationality."
[216] Art. 14.11(1), USMCA: "No party shall require that an enterprise of that Party that is a covered investment appoint to senior management positions natural persons of a particular nationality."

105. The relevance of *Mobil v Canada* may also be extended to prohibition on training requirements. In addition to R&D requirements, the challenged Canadian measures also included education and training (“**E&T**”) requirements. Likewise, it was found that the E&T requirements constituted services which violated the PPR provision in NAFTA Art. 1106(1). Therefore, similar implications apply to these kinds of PPRs, whereby an absence of an express PPR on training requirements does not preclude it from being a prohibited LSR.

3.3.4 Other Approaches: National Treatment, Fair and Equitable Treatment and Most Favored Nation

106. It is important to mention that there are other provisions in IIAs that have similar effects as PPRs. PRs or PR-like measures that do not fall within the scope of the PPR within an IIA may nevertheless be in violation of other clauses in the IIA.

107. Commonly, PPRs are considered a “closed list”. Several treaties explicitly ensure a “closed list” of PPRs, that is, prohibitions that apply only to the types of PRs explicitly mentioned in the treaties. CPTPP, USMCA and EU-Vietnam adopt this “closed list” approach to targeting PRs and set out that PPRs “shall not” apply to any PR other than the PRs specified under the prohibitions. The Tribunals in *Pope & Talbot v Canada*, *Merril & Ring v Canada*, and *SD Myers v US* confirmed the “restricted scope” of the PPRs by means of the explicit inclusion of this type of “closed list” provision in NAFTA Art. 1106(5).

108. However, even if a PR falls outside of the PPR scope, a host state could be exposed to claims of violation of other treaty standards.

109. Three widely utilized routes which implicitly deal with PPRs are: national treatment (“**NT**”), fair and equitable treatment (“**FET**”), and most favored nation (“**MFN**”) clauses. This section will discuss them briefly as, while valid, the specific content of these provisions is outside the scope of this paper.

National Treatment

110. Under states’ NT obligation, host states must treat foreign investors no less favorably than domestic investors in like circumstances. The rationale underpinning the obligation is to provide equal competitive opportunities between foreign and domestic investors by ensuring that there is no discrimination on grounds of the investor’s nationality. NT obligations also closely relate to the obligation of pre-establishment rights which entail investment liberalization. An example of such a clause can be found in Art. 1102 of the NAFTA where a

party is obligated to accord to investors of another Party "treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

111. *S.D. Myers v. Canada* is relevant in demonstrating how the interpretation of a national treatment standard had the same effect as a PPR. The measures found to have breached Art. 1102 of NAFTA were measures preventing the investor from exporting Polychlorinated biphenyl (PCBs) for processing in the US. Arguably, this measure had the same effect as a local service requirement prohibition, or a manufacturing requirement prohibition as the measure would have the inadvertent effect of affording greater opportunities for Canadian companies to process PCBs. The Tribunal found that the issuance of the measures breached Art. 1102 of the NAFTA,[217] even though it did not characterize the measures as "performance requirements". In taking into account that the same end result could have been achieved through alternative measures, the Tribunal found that "preventing SDMI from exporting PCBs for processing in the USA by the use of the Interim Order and the Final Order" was not a legitimate way by which Canada could have achieved its policy objectives.[218] The Award demonstrates that even in cases where a certain PR measure is not found to be in violation of a PPR, it could still be in violation of the NT provision. Moreover, the Tribunal's reasoning in focusing on the effect of the regulation on the investment and whether the requirement was consistent with its treaty obligations, bears heavy resemblance to how PPR provisions are interpreted.

Fair and Equitable Treatment

112. The FET standard has also been a tool to encompass obligations akin to performance requirements. Specifically, France's 2006 Model BIT is an example of an implied PPR clause that is rooted in the FET clause; it would be a violation of the FET standard if there is "any restriction on the purchase or transportation of raw and auxiliary materials… as well as on production and exploitation of any kind, any restriction on the sale and transportation of products within the state or abroad, as well as measures with an analogous effect".[219] Further, a broadly phrased FET clause would result in the same outcome as a PPR in a BIT.[220] However,

[217] *S.D. Myers v. Canada* at para. 255.
[218] *Ibid.*
[219] Art. 4, France Model BIT (2006); also see for e.g., Art. 3, France-Zimbabwe (2001)
[220] Collins (n 10) at p. 127.

given the wide scope of the FET standard,[221] it is plausible that the underlying intention to impose a PPR is to instill greater clarity in the FET standard, as opposed to the FET standard being a route to mount a PPR violation claim.

113. The case of *S.D. Myers v. Canada* (discussed above in Section 3.3.4) is a clear example of the intertwined nature of FET standards and PPRs. There, the NAFTA Tribunal found that the measure prohibiting export of hazardous waste out of the US was a violation of the national treatment clause (Art. 1102, NAFTA) and the FET clause (Art. 1105), but not the performance requirements clause (Art. 1106). The Canadian measure of requiring the Claimant company to dispose contaminated waste in Canada was construed by the Claimant company, as a performance requirement mandating waste disposal operators to "accord preference to Canadian goods and services and to achieve a given level of domestic content contrary to Canada's obligations under Art. 1106."[222] Concurrently, the Claimant company alleged that the same measure was applied in an arbitrary and unjustifiable manner that constituted a disguised restriction on international trade or investment. The Tribunal found that the Order did not fall squarely within the meaning of a "requirement" within Art. 1106(1) and (3) of NAFTA. The tribunal, nevertheless, found the issuance of the Interim and Final Orders to be in violation of the FET clause. It found that the Claimant company was treated in an unjust or arbitrary manner through the Orders that the treatment was unacceptable.

114. The *Lemire* case, as discussed above (see Section 3.3.2), is also indicative of how the lines between breaches of FET and PPRs blur. The Tribunal found that there was a breach of the FET standard, not PPR obligations, and stated that it was Ukrainian's inherent right "to regulate its affairs and adopt laws in order to protect the common good of its people"[223] and asserted that "a rule cannot be said to be unfair, inadequate, inequitable or discriminatory, when it has been adopted by many states around the world".[224]

115. These cases demonstrate that even if a PR-like measure is not found to be in violation of a PPR, it may still be exposed to claims under the FET provision.

Most Favored Nation

116. Where a treaty is silent on express PPR provisions, MFN clauses could potentially fulfil a similar function and act as a gap-filling measure by incorporating a PPR provision from

[221] *Ibid* at p. 128.
[222] *SD Myers v Canada* at para. 140.
[223] Collins (n 10) at para. 505.
[224] *Ibid* at para. 506.

another treaty. This would occur through MFN clauses obliging the signatory Party to grant "no less favorable treatment" to the investors of the other Party than it granted to investors of any non-party state.[225] This is mainly a creation of arbitral activism where MFN treatment clauses apply to import into the IIA in question "any and all substantive protection provisions found within third treaties" either through incorporating provisions which the basic treaty lacks, or a higher level of protection which the basic treaty offers.[226] However, it is crucial to note that while MFN clauses - which typically only cover substantive protection (FET, NT) - have been extended and used to incorporate procedural provisions across treaties,[227] such as in the case of *Maffezini* and *White Industries v India* (which extended to include dispute settlement provisions). To date, however, there have been no arbitral cases applying the MFN treatment clause to PPRs. As it is currently an unsettled question, it remains to be seen whether substantive obligations like PPR provisions can be incorporated through these means.

117. The significance of the MFN clause goes towards more fundamental concerns of how IIAs are drafted. Even if IIAs are silent on PPR provisions, the danger is that a complainant may argue, through the MFN provision, that PPRs provisions are imported by virtue of their presence in other agreements. To sidestep this problem, parties could draft a provision that expressly limits the application of the MFN provision. Examples of such an instrument can be found most clearly in the EU-Vietnam FTA where the use of MFN in investor-state dispute settlement clauses is expressly prohibited.[228]

3.4 Exceptions and Carve Outs

118. Exceptions play a key role in striking a proper balance between the desire to liberalize investment (through PPRs) and the right of host states to preserve sufficient policy space to advance their national goals or protect certain values. States have resorted to different treaty drafting techniques to secure their regulatory prerogatives. In doing so, treaties have moved

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[225] IISD Performance Requirements in Investment Treaties: Best Practices Series (n 17) at p. 12.
[226] Genest (n 6) at 189.
[227] *Emilio Agustín Maffezini v Kingdom of Spain* (Decision on Objections to Jurisdiction, 25 January 2000) ICSID Case No ARB/97/7, 5 ICSID Rep 396 (hereinafter '*Maffezini*'); See also *White Industries Australia Limited v. The Republic of India*, Final Award UNCITRAL (30 November 2011) where the Claimant incorporated the "effective means" of asserting claims and enforcing rights provision from the India-Kuwait BIT into the India-Australia BIT through the MFN provision.
[228] Art. 8.6(5), EU-Vietnam FTA: "For greater certainty, the "treatment" referred to in paragraph 1 does not include dispute resolution procedures or mechanisms, such as resolution of investment disputes between investors and states, provided for in any other bilateral, regional or multilateral agreements. Substantive obligations in such agreements do not in themselves constitute "treatment" and thus cannot be taken into account when assessing a breach of this Art.. Measures by a Party pursuant to those substantive obligations shall be considered "treatment"."

away from more general exclusions included in BITs,[229] to more detailed and specific carve outs regarding PPRs. Yet, certain complications related to implementation and interpretation of such exceptions and carve outs can invalidate their intended effect and lead to uncertainty between parties. Focusing on examples in more recent IIAs – the CPTTP, USMCA and the EU-Vietnam FTA, the following section sets out three main kinds of exceptions: general treaty exceptions, exceptions applied to all PPRs, and specific carve outs applied to only certain types of PPRs.

3.4.1 General Treaty Exceptions

119. IIAs may contain general exceptions that apply to all treaty obligations. They can be: temporal exceptions; national security exceptions; or safeguards exceptions applied to deal with temporarily disruptions in a party's balance of payments.

Temporal Exceptions

120. Some exceptions in IIAs limit the application of the treaty rules in time. That is, they apply only to measures (including PRs) enacted after the treaties entered into force. CPTPP and USMCA contains clear and precise language providing that the investment chapter (including PPR obligations) shall not bind a Party in relation to an "act or fact" (including enactment of PRs) that took place or a "situation" that ceased to exist "before the date of entry into force" of the agreement for that Party.[230] The language in the EU-Vietnam FTA investment chapter is less straightforward insofar as obligations on measures enacted before the date of entry into force of the treaty will differ according to different standards therein (e.g. national treatment[231] and MFN[232]).

Security Exceptions

121. IIAs may include treaty-wide security exceptions (including exceptions to apply PPRs) for a party to enforce measures related to national security interests or international security. CPTPP and USMCA contain clear and precise language to exclude from the coverage of both treaties measures that (a) require a party "to furnish or allow access to" information the

[229] The Protocol to the 1985 US – Turkey BIT includes sectoral exceptions (Arts. 1(a) and 1(b) of the Protocol), broadly-worded non-conforming measures (Art. 1(c)) and limited exceptions related to foreign-exchange (Art. 2(b)).
[230] Art. 9.2(3) CPTPP; Art. 14(2)(3) USMCA.
[231] Art. 8.5(3) EU-Vietnam FTA
[232] Art. 8.6(3) and (4) EU-Vietnam FTA

disclosure of which is contrary to its ("essential") "security interests[233] or (b) preclude a party from applying measures necessary to the maintenance or restoration of "international peace and security" and "its own essential security interests"[234]. The EU-Vietnam FTA contains similar language.[235]

Temporary Safeguards with Respect to Capital Movements, Payments and Transfers

122. IIAs may contain treaty-wide exceptions that allow a party to adopt temporary measures aimed to relieve serious balance of payment difficulties. For example, CPTPP, USMCA and the EU-Vietnam FTA contains temporary safeguard measures exceptions (including exceptions to enforce PPRs) for a party to apply measures that temporarily restricts the investor's ability to move capital from the host state to the home state,[236] or to make cash transfers or payments.[237] These exceptions only apply in exceptional circumstances in the event of "serious balance of payment and external financial difficulties"[238] and shall be temporary (less than one year in USMCA and EU-Vietnam FTA and less than 18 months in the CPTPP).[239]

3.4.2 Exceptions Applied to All PPRs

123. Several treaties include exceptions that apply to all PPRs provisions. In the CPTPP and USMCA, for example, these exceptions allow a state party to apply PRs insofar as these measures conform to the obligations with respect to (1) non-conforming measures ("**NCM**s") as specified by a party in its own schedule of existing NCMs; (2) sectors, sub-sectors, and activities as specified by a party in the body of the treaty or in a party's own schedule of excluded sectors; and (3) PRs applied only between private parties. The investment chapter in EU-Vietnam FTA, however, adopts a different approach. Rather than listing in a party's schedule the measures that shall be excluded from PPRs or other treaty obligations (e.g. NCMs, sectors, sub-sectors and activities) ("negative list approach"), the EU-Vietnam FTA inscribes in a party's "schedule of specific commitments" the specific sectors, sub-sectors and activities

[233] Art. 29.2(a) CPTPP; Art. 32.2(a) USMCA. Note that the Art. 32.2(a) adds the qualifier "essential" before the expression "security interests" in Art. 32.2(a) while Art. 29.2(a) of CPTPP refers to "national interests" only.
[234] Art. 29.2(a) CPTPP; Art. 32.2(b) USMCA.
[235] Art. 17.3(a)-(c) EU-Vietnam FTA.
[236] Art. 29.3(2) CPTPP; Art. 32.4(3) USMCA; Arts. 17.11 and 17.12 EU-Vietnam FTA.
[237] Art. 29.3(1) CPTPP; Art. 32.4(2) USMCA; Arts. 17.11 and 17.12 EU-Vietnam FTA.
[238] Art. 29.3(1) CPTPP; Art. 32.4(2) USMCA; Art. 17.12 EU-Vietnam FTA.
[239] Art. 29.3(3)(e) CPTPP; Art. 32.4(4)(e) USMCA; Art. 17.11 EU-Vietnam FTA.

upon which PPRs and other obligations in the treaty shall apply ("positive list approach")[240].

Existing Non-Conforming Measures

124. Several treaties provide for PPRs exceptions for non-conforming measures. For example, NCMs are *inter alia* existing measures, at the time of the negotiations until entry into force of a treaty, that impose or enforce PRs that would otherwise violate or not be in conformity with PPRs provisions in the treaty. Carve outs for NCMs are, generally, very specific and set out in schedules or annexes to the treaties. For example, under the CPTPP and the USMCA, PPRs shall not apply to (a) NCMs existing "on the day of the entry into force" of the treaty for each party;[241] (b) NCMs applied at the central and regional levels *as specified* in the party's schedules;[242] (c) any NCM issued at local levels;[243] (d) the "continuation", "renewal", or "amendment" of listed NCMs, provided that the amendment does not "decrease the conformity of the measure" with PPR obligations.[244]

125. Implementing and interpreting NCMs exceptions can be a complex exercise. This is exemplified in the majority award *Mobil v Canada* (also mentioned in Section 3.3.3 above).[245] The NAFTA Tribunal found that Canada's challenged measure did not fall within the NCM exception (Art. 1108) under Canada's NCMs schedule and thus violated NAFTA PPRs provisions (Art. 1106). At the origin of the conflict is a Canadian measure, the 2004 new guidelines, requiring a foreign investor to invest *inter alia* specific amounts in R&D and employment and training. The principal question was whether the 2004 guidelines, a PR in the form of local services requirements (prohibited under NAFTA Art. 1106), was covered by the NCMs exceptions (NAFTA Art. 1108), according to NCMs Canada had inscribed in its NCMs schedule. Canada argued that the 2004 guidelines were a "subordinate measure", as were other guidelines issued in former years, to a measure inscribed in Canada's NCMs schedule and thus excluded from the PPR obligations. The majority tribunal concluded, however, that the 2004 guidelines was not covered by the NCM exception because it did not conform to the inscribed NCM and to the subsequent issued guidelines [subsequent measures to the inscribed NCM].

[240] EU-Vietnam FTA Art. 8.8 (1) (refers to sectors inscribed in each party's schedule of specific commitments upon which PPRs apply); Art. 8.8(2) (refers to sectors inscribed in each party's schedule of specific commitments upon which prohibitions on advantage-conditioning PRs apply),
[241] Art. 9(2)(3) of CPTPP; Art. 14(2)(3) USMCA.
[242] Art. 9.12(1)(a)(i) and (ii) CPTPP; Art. 14.12(1)(i) and (ii) USMCA.
[243] Art. 9.12(1)(a)(iii) CPTPP; Art. 14.12(1)(iii) USMCA
[244] Art. 9.12(1)(a) and (c) CPTPP; Art. 14.12(1)(b) and (c) USMCA.
[245] *Mobil Investments Canada Inc and Murphy Oil Corporation v Canada,* Majority Opinion, ICSID Case No ARB(AF)/07/4.

Rather, the 2004 guidelines "significantly altered the legal obligations"[246] and introduced "additional and different expenditure, reporting, oversight and administrative requirements that are quantitatively and qualitatively different and more burdensome"[247] than the inscribed NCM and the subsequent issued guidelines. In so concluding, the majority tribunal stated that the 2004 guidelines rendered the LSRs that arise from it more "non-conforming",[248] "contradictory and incompatible"[249] with the PPRs under Art. 1106. The dissenting arbitrator took issue with the majority tribunal understanding that to be consistent with a NCM exception the 2004 guidelines needed to conform with the inscribed NCM and the subsequent measures, rather than only to the inscribed NCM.[250] In the view of the dissenting arbitrator, this decision "ought to set alarm bells ringing" since neither the US, Mexico or Canada, when invited, expressed their views about it. [251]

126. When negotiating NCMs to be exempted from application of PPRs and included in an annex or schedule, different negotiating stances may widen a state's policy space: (a) include national and regional NCMs in its schedule; (b) specify amendments, and not only existing NCMs, their continuation or renewal; (c) be particular sensitive to treaty language related to *amendments* to NCMs, to NCMs *subordinated* to listed NCMs, or to NCMs *subsequent* to related listed NCMs.

Sectoral Carve Outs

127. Several treaties provide for PPR exceptions for sectors, sub-sectors and activities ("sectoral carve outs") as specified in the treaty itself or in an annex. For example, CPTPP and USMCA establish sectoral exceptions in annexes to the treaties. Accordingly, PPRs shall not apply to "any measure" that a party "adopts or maintain" with respect to "sectors, sub-sectors or activities" as set out by that party in its respective schedule to a given annex ("negative list" approach").[252] Note that sectoral carve outs in these treaties apply to existing and non-existing measures (enforcing PRs), or measures that will be enacted only after the treaty comes into force insofar as these exceptions are inscribed in the specific annexes. Carve outs for specific sectors are, generally, very specific and set out in annexes to the treaties. Therefore, when states

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[246] *Ibid* at para 411.
[247] *Ibid* at para. 409.
[248] *Ibid* at para. 409.
[249] *Ibid* at para 411.
[250] *Mobil Investments Canada Inc and Murphy Oil Corporation v Canada,* Partial Dissenting Opinion by Professor Phillipe Sands, ICSID Case No ARB(AF)/07/4; at para. 29.
[251] *Ibid.*
[252] Art. 9.12(2) of the CPTPP; Art. 14.12(2) USMCA

negotiate PPR sectoral exceptions, careful attention should be paid to current and potential future sensitive sectors, sub-sectors or activities to inscribe in the exceptions annex (having in mind that a change in the government leadership may also lead to a change in governmental priorities, and it is very unlikely to predict the relevance of all possible sectors, subsectors and activities at the time of treaty negotiation).

128. In contrast, the EU-Vietnam FTA does not specify sectoral exceptions in the annexes to the treaty. Rather it establishes sectoral exceptions in the body of the treaty, setting forth that the investment chapter does not apply to certain specified sectors.[253] In addition, the PPR obligations only applies to sectors explicitly inscribed in each party's schedule of specific commitments ("positive list" approach).[254]

3.4.3 Exceptions Applied to Certain PPRs

Location of Production, R&D, Service Supply, Training/Employment of Workers, Construction/Expansion of Facilities

129. Several treaties contain exceptions for PPRs allowing states parties to enforce PRs, in connection with an investment, to locate production, to carry out R&D, to supply services, training or employment of workers, or to construct or expand the facilities. The NAFTA, CPTPP and USMCA provide exceptions that allow the host states to condition the conferral of an "advantage" upon compliance of requirements by investors "to locate production, supply a service, train or employ workers, construct or expand facilities, or carry out R&D" in its territory".[255] This exception allows the host state to apply a PR, but only when it is non-mandatory and a condition for receiving an advantage from the host state. Note that in *Mobil v Canada* (mentioned in Section 3.3.3 above), Canada could not resort to this exception under NAFTA Art. 1106(4) in its defense. This is because such carve out applies only when the host states give the investor an advantage in return of compliance of the said PRs. Since Canada had not conditioned the R&D and E&T PRs upon the receipt of an advantage by the investors,

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[253] The EU-Vietnam FTA establishes that he investment chapter obligations do not apply to (a) audio-visual services; (b) mining, manufacturing and processing9 of nuclear materials; (c) production of or trade in arms, munitions and war material; national maritime cabotage; (e) domestic and international air transport services, whether scheduled or non-scheduled, and services directly related to the exercise of traffic rights; and services supplied, and activities performed in the exercise of governmental authority. See Art. 8(3)(2) EU-Vietnam FTA.

[254] The chapeau of Art. 8.8(1) of EU-Vietnam FTA reads as follows: "<u>In the sectors inscribed</u> in its respective Schedule of Specific Commitments in Annexes 8-A (The Union's Schedule of Specific Commitments) and 8-B (Vietnam's Schedule of Specific Commitments) and subject to any conditions and qualifications set out therein, <u>a Party shall not impose or enforce any of the following requirements</u> which are mandatory or enforceable under domestic law or under administrative rulings, in connection with the establishment or operation of any enterprises of investors of a Party or of a third state in its territory(…)"

[255] NAFTA 1106(4); Art. 9(10)(3)(a) CPTPP; Art. 14.10(3) USMCA; Art. 8.8(3) of EU-Vietnam FTA.

it could not find solace under the exceptions carved out in NAFTA Art. 1106(4) and was found to violate NAFTA PPR obligations.

130. The question of PPRs exceptions that allow host states to confer an advantage upon compliance by investors of certain PRs also relates to the US practice of encouraging foreign investors to relocate their headquarters and operations in the US. The main question is how this practice would affect the application of PPRs in IIAs to which the US is party. If the US is encouraging investment relocation by conferring an "advantage" and, as such, applying a "non-mandatory" PR for investors to "locate production" in US territory, this policy would likely fall under the PPR exception provided in several of US BITs and FTAs and therefore would likely not violate the PPR obligations in those treaties.

131. This exception is found in BITs and FTAs to which ASEAN member states are parties, and they take diverse approaches with respect to this exception. The EU-Vietnam FTA[256] and Japan-Myanmar BIT[257] contain a similar exception that allows host states to confer an "advantage", in connection with an investment, upon compliance by investors of requirements to "locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory". The Japan-Singapore EPA,[258] Japan-Philippines EPA,[259] Japan-Indonesia EPA,[260] Japan-Vietnam BIT,[261] Japan-Cambodia BIT[262] and Japan-Laos BIT[263] contain a similar exception but with somewhat different treaty language. Some of these agreements allow host states to condition the receipt of an advantage on compliance by the investor on a requirement "to transfer technology",[264] "to locate headquarters" in its territory;[265] "to achieve a given level of R&D";[266] "to supply goods and/services";[267] "to hire a given level of nationals"[268] and "to appoint" nationals as executives, managers and members of the board.[269]

Government Procurement

[256] Art. 8(8)(3) Investment Chapter EU-Vietnam Free Trade Agreement.
[257] Art. 6(3) Japan-Myanmar Bilateral Investment Agreement (2013)
[258] Art. 75(2) Japan-Singapore Economic Partnership Agreement (2002)
[259] Art. 93(2) Japan-Philippines Economic Partnership Agreement (2006)
[260] Art. 63(2) Japan-Indonesia Economic Partnership Agreement (2007)
[261] Art. 4(2) Japan-Vietnam Bilateral Investment Agreement (2003)
[262] Art. 6(2) Japan-Cambodia Bilateral Investment Treaty (2007)
[263] Art. 7(2) Japan-Laos Bilateral Investment Treaty (2008)
[264] Japan-Singapore EPA, Japan-Philippines EPA and Japan-Vietnam BIT.
[265] Japan-Singapore EPA; Japan-Philippines EPA; Japan-Indonesia EPA; Japan-Cambodia BIT; Japan-Laos BIT.
[266] Japan-Singapore EPA; Japan-Philippines EPA; Japan-Indonesia EPA; Japan-Cambodia BIT; Japan-Laos BIT.
[267] Japan-Singapore EPA; Japan-Philippines EPA; Japan-Indonesia EPA; Japan-Cambodia BIT; Japan-Laos BIT.
[268] Japan-Philippines EPA; Japan-Cambodia BIT; Japan-Laos BIT.
[269] Japan-Vietnam BIT.

132. As a general rule, several IIAs contain exceptions that allow host states to enforce PRs on government procurement procedures. The CPTPP and USMCA expressly allow host states to enforce *inter alia* LCRs, LSRs, technology transfer requirements, advantage-conditioning LCRs and LSRs, among other types of PRs[270] in government procurement procedures.[271] In contrast, the EU-Vietnam FTA excludes the application of PPR obligations on any government procurement measures adopted or maintained in accordance with Art. III:8(b) of the GATT 1994 on government procurement.[272] It must be noted that the NAFTA, the CPTPP, the USMCA and the EU-Vietnam provisions affecting government procurement are spelled out not only in the investment chapter but also in the procurement chapter. [273]

133. The decision of *ADF v USA* is of importance to illustrate the complexities intertwined in procurement obligations in investment chapters and procurement chapters in FTAs. In that dispute, the NAFTA tribunal found that the US challenged measure, a LCR enforced on an investor in connection with a government procurement procedure, did not violate NAFTA's PPR provisions. The challenged measure, "Buy America requirements",[274] enforced LCRs in procurement contracts which benefited from federal aid. In that case, the Buy America requirements, under the procurement contract of a highway construction, enforced LCRs in connection with the "management, conduct and operation" of the foreign investor's investment. The core question of the dispute was whether NAFTA exceptions allowing host states to enforce certain PRs (including LCRs) in procurement procedures shielded the Buy America requirements.[275]

134. NAFTA Art. 1108(8)(b) establishes that prohibitions on certain PRs, including LCRs, do not apply to government procurement by a party. In applying NAFTA PPR obligations and exceptions to the circumstances of the case, the tribunal first decided whether the challenged measure was a "procurement" and, if so, whether the US had carried out "government

[270] Other PRs include the requirement to supply goods and/or services, the requirement to adopt a given rate or amount of royalty in a given contract or a given duration of a contract. See Art. 9(10)(3)(f) CPTPP; Art. 14.10(3)(e) USMCA.
[271] Art. 9(10)(3)(f) CPTPP; Art. 14.10(3)(e) USMCA.
[272] Art. 8.8(8) EU-Vietnam FTA. Art. III:8(b) of GATT reads as follows: "The provisions of this Art. shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Art. and subsidies effected through governmental purchases of domestic products.". See GATT 1994: General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994].
[273] While CPTPP and USMCA is silent with respect to the obligations in the government procurement chapter, Art. 8.1(5) of EU-Vietnam states that "Nothing in this Chapter shall be construed as limiting the obligations of the Parties under Chapter 9 (Government Procurement) or to impose any additional obligation relating to government procurement.".
[274] Under 23 CFR 635.410(c).
[275] Under Art. 1108(8)(b) NAFTA

procurement" procedures. The tribunal first found that the challenged measure amounted to "government procurement". Since the NAFTA investment chapter, under which PPR obligations are laid down, does not contain a definition of "procurement", the tribunal built its analysis on the definition articulated in NAFTA government procurement chapter. This chapter identifies federal, state or provincial procurement as part of "government procurement".[276] Second, the tribunal found the US had carried out "government procurement" procedures under the highway construction project in the sense of the definition articulated under the procurement chapter.[277] On these grounds, the tribunal concluded that NAFTA PPR carve outs applied to government procurement shielded the Buy America requirements (LCRs) the US enforced on the investor in connection with the procurement contract for the highway construction project.

135. Against this background, when negotiating government procurement exceptions in BITs and FTAs, one should consider the following:

(1) whether there is a chapter on government procurement and, if so, to what extent the definitions of "government procurement" and "procurement by a party" may affect the host state's rights to enforce PRs on government procurement carved out in investment chapters;

(2) to which levels of the government – federal/central, regional, or local/ provincial/ prefectural – the government procurement exceptions under the investment chapter, and obligations, under the government procurement chapter, apply;

(3) where there are differences in the scope of the levels of governments covered by the investment and government procurement chapters, whether it is possible to exempt the governmental levels that are more relevant from the scope of obligations under government procurement chapter.

Technology Transfer Exceptions

136. Some IIAs have also preserved the host states' rights to impose some types of technology transfer requirements. While the approach to technology transfer exceptions may vary from treaty to treaty, exceptions can encompass (1) TRIPs Agreement-like exceptions; (2) exceptions related to uncompetitive behavior; or (3) exceptions related to the protection of

[276] Art. 1001(5) of NAFTA Chapter 10. NAFTA Art. 1001(5) defines "procurement" as including "purchases" of goods but excluding "financial assistance" especially in the form of funding through grants to the state, provincial or regional governmental entity conducting procurement. *ADF v USA*, at para. 161; 164
[277] *Ibid* para. 160.

public welfare. CPTPP and USMCA permit the imposition of technology transfer requirements if a "state party authorizes the use of intellectual property rights" in accordance with Art. 31 of the TRIPs Agreement, or if the requirements at issue "fall within, and are in accordance with" Art. 39 of the TRIPs Agreement.[278] The reference to Art. 31 refers to any "waiver or amendment" implementing paragraph 6 of the Doha Declaration on the TRIPs Agreement and Public Health (which enables developing countries to circumvent their TRIPS obligations for enabling better access to essential medicines).[279] Art. 39 refers to measures used to ensure "protection of undisclosed information". The EU-Vietnam FTA is silent with respect to this exception in the investment chapter,[280] but affirms the parties' rights and obligations under the TRIPs Agreement under the intellectual property chapter.[281]

137. The host state may be also allowed to impose technological transfer requirements if it does so to remedy uncompetitive practice. The CPTPP, USMCA and the EU-Vietnam FTA permit host states to impose technology transfer requirements to remedy a practice, determined after judicial or administrative process, to be "violation of competition laws" and "anticompetitive".[282]

138. In addition, host states may be allowed to impose technology transfer requirements to protect "legitimate public welfare objectives". The CPTPP and USMCA provide that host states are allowed to adopt or maintain technology transfer requirements "to protect legitimate public welfare objectives" (albeit not explaining the meaning of the expression "legitimate public welfare objectives"), provided that such measures are not applied in an "arbitrary or unjustifiable manner", or in a manner that "constitutes a disguised restriction on international trade or investment".[283] The EU-Vietnam is silent with respect to this exception.

Export Promotion or Foreign Aid Programs

139. Some treaties allow host states to enforce certain types of PRs if they amount to

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[278] Art. 9(10)(3)(b)(i) CPTPP; Art. 14(10)(3)(b)(i) USMCA; Agreement on trade-Related Aspects of Intellectual property Rights (15 April 1994), Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 1994.
[279] *Doha Declaration on the TRIPS Agreement and Public Health* (WT/MIN(01)/DEC/2).
[280] Nonetheless, Art. 8.1(1) of EU-Vietnam FTA contains directs reference to WTO agreements which may be understood as incorporating the TRIPs obligations and exceptions. Art. 8.1(1) reads as follows: "The Parties, affirming their respective commitments under the WTO Agreement and their commitment to create a better climate for the development of trade and investment between the Parties hereby lay down the necessary arrangements for the progressive liberalisation of investment and trade in services and for cooperation on electronic commerce"
[281] Art. 12.2(1) EU-Vietnam FTA.
[282] Art. 9.10(3)(b)(ii) CPTPP; Art. 14.10(3)(b)(ii) USMC; Art. 8.8(4) EU-Vietnam FTA.
[283] Art. 9.10(30)(h) CPTPP; Art. 14.10(3)(g) USMCA

“qualification requirements” for goods and services with respect to export promotion and foreign aid programmes. The CPTPP, USMCA and EU-Vietnam FTA establish that EPRs, LCRs, LSRs; and advantage-conditioning LCRs and LSRs are allowed insofar as they are requirements for an investor to qualify for export promotion or foreign aid programmes.[284]

Preferential Tariffs or Preferential Quotas

140. The host state may apply LCRs or LSRs or condition the receipt of an advantage on the investor’s achievement of a certain level of domestic content or the investor’s purchase of domestic goods or services -- if those requirements concern the content of goods necessary to qualify for preferential tariffs or preferential quotas. This exception is set out in CPTPP, USMCA and the EU-Vietnam FTA.[285]

GATT Art XX-like: Security, Environment, Health

141. Under some IIAs, host states may enact certain PRs which are in breach of PPRs, if such measures are “necessary” to secure compliance with national laws and regulations or to protect human, animal or plant life, or health, or to safeguard living or non-living exhaustible natural resources. In language reminiscent of GATT Art. XX, both CPTPP and USMCA explicitly provide that the host state is entitled to adopt or maintain LCRs, LSRs, advantage-conditioning LCRs or LSRs, and technology transfer requirement if the measure is (a) “necessary” to secure compliance with national laws or (b) to protect human, animal, plant life or health, or (c) “related” to conservation of living and non-living exhaustible natural resources.[286] By contrast, the EU-Vietnam FTA provides that “nothing” in the investment chapter shall prevent a party from adopting any of the measures (a)-(c) embedded in the CPTPP and USMCA, but also measures “necessary”: (d) to protect public security or public morals or to maintain public order; (e) to protect national treasures; and (f) to prevent deceptive and fraudulent practices or to deal with the effects of a default on contracts.[287] To prevent misuse of this exception by the host state (which could use it to disguise inappropriate requirements), such measures are only exempt if they have not been applied in an “arbitrary or unjustifiable manner” or do not constitute a “disguise restriction on international trade or investment”.[288]

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[284] Art. 9.10(3)(e) CPTPP; Art. 14.10(3)(f) USMCA; Art. 8.8(5) EU-Vietnam FTA.
[285] Art. 9.10(3)(g) CPTPP; Art. 14.10(3)(f) USMCA; Art. 8.8(6) EU-Vietnam FTA.
[286] Art. 9.10(3)(d) CPTPP; Art. 14.10(3)(c) USMCA.
[287] Art. 8.53 EU-Vietnam FTA.
[288] Art. 9.10(3)(d) of CPTPP; Art. 14.10(3)(c) USMCA; Art. 8.53 EU-Vietnam FTA.

3.5 Dispute Settlement

142. Under the current Investor-State Dispute Settlement regime, PPRs are still covered by the respective investor-state dispute settlement provisions. However, three of the newest agreements that have yet to come into force – the USMCA (which is in the process of final review and signature); the CPTPP which has only been ratified by Mexico (April 2018), Japan and Singapore (July 2018); and the EU-Vietnam FTA which is pending ratification – have adopted different approaches to investor-state dispute settlement. These different approaches to investor-state dispute settlement could have varying effects on the future implementation, interpretation and enforcement of PPRs.

143. For example, the CPTPP allows investors to present claims of treaty breaches, including violations of PPR obligations, against the host state in investor-state dispute settlement mechanisms (Arts. 9(18)-9(30)). In contrast, the EU-Vietnam FTA contains a chapter on "dispute settlement" but articulates detailed investment protection and investor-state dispute settlement obligations and procedures in a separate agreement named "Investment Protection Agreement under which investors have the right to bring claims against host states, including claims of violation of PPR obligations (Art. 8.4).

144. Finally, and most notably, the USMCA has taken an entirely new approach towards investor-state dispute settlement which has excluded PPRs from it. While it has yet to be signed and no tribunal has yet to interpret its provisions, based on the draft text of the USMCA, it can be surmised that only investor-state disputes between Mexico and the US (Art. 14(2)(4)) with respect to NT, MFN and direct expropriation provisions (Annex D Art. 3) can be submitted to investor-state dispute settlement. All other claims, especially those between US and Canada and Canada and Mexico, with the exception of legacy investments that stem from NAFTA, are prohibited. Therefore, breaches of PPR obligations under USMCA cannot be the basis for investor-state disputes.

145. It is too early to determine the impact, if at all, of such a change in attitude towards investor-state dispute settlement on future IIA negotiations. However, this change is an important one and must be noted in order to better inform states which are negotiating IIAs.

4. CONCLUSION

146. This paper attempted to show that negotiating, implementing and interpreting PPRs remain a complex exercise. There are many justifiable reasons for states to use PRs in support of certain economic policy goals. This, in turn, will affect the design and application of PPR obligations in favor of liberalizing trade and investment. To reconcile these two seemingly contrasting aims, states have carved out several exceptions in IIAs in order to legally enforce PRs, even in the presence of PPRs. This reconciliation, however, must be one that each individual state must make for itself based on a careful consideration of its own developmental needs, economic considerations and both its domestic and external agendas.

147. What this paper has done is to lay out the legal framework of PPRs: their origins in both the WTO's TRIMs Agreement and IIAs with PPR obligations, the varying obligations PPRs entail, the interpretation of PPRs in international disputes both before the WTO and investor-state dispute settlement bodies, and the ways in which a state can exempt itself from the PPR obligations, through carefully drafted and negotiated carve outs and exceptions. Further, building on this framework, we also explored and discussed notable differences between the PPR regimes under the WTO and IIAs, and some specific legal considerations arising from these issues.

148. We hope that this paper and information provided serves as a useful guide for states negotiating new, or renegotiating existing, BITs or FTAs with PPR obligations.