Section 2 Investment-related treaties

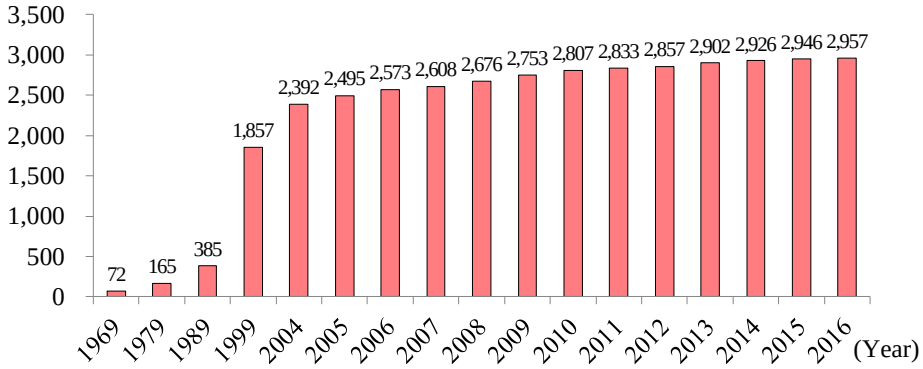
1. Situation surrounding investment-related treaties

Foreign direct investment has been growing rapidly worldwide since the 1980s, playing a major role in driving the growth of the global economy. In terms of the share of GDP accounted for by foreign direct investment, outward direct investment accounted for 5.8% and inward direct investment for 5.3% of GDP by value in 1980, whereas in 2016 the figures were 35.5% and 34.7%, respectively[6].

In light of the increase in foreign direct investment, various countries have concluded investment treaties to protect their own investors and their investments from discriminatory treatment and expropriation (including nationalization) in the host countries. Investment rules mainly take the form of bilateral or regional treaties, rather than being multilateral agreements such as WTO Agreements in the field of trade.

The number of investment treaties worldwide has grown substantially, reaching 2,957 in 2016 (Figure III-1-2-1). Looking at the situation by country, Germany, Switzerland, China, the UK, France, and Egypt have each concluded around 100 investment treaties.

Figure III-1-2-1 Trends in the number of investment treaties worldwide (*World Investment Report 2017* (UNCTAD))



2. Major provisions of investment-related treaties

Conventional investment treaties were mainly concluded in order to protect investors from country risks, such as expropriation of investment and arbitrary application of laws and regulations by host countries. Such treaties are called protection-oriented investment treaties and they mainly cover such matters as: national treatment and most-favored-nation treatment after setting up an investment; prohibition of expropriation in principle, as well as requirements for expropriation to be considered legal and methods for calculating the amount of compensation; freedom to transfer money; and dispute settlement procedures between the contracting parties and between investors and the host country. In the 1990s, liberalization-oriented investment treaties began to emerge that incorporated not only this kind of protection for investment but also national treatment and/or most-favored-nation treatment when

6 World Investment Report 2017 (UNCTAD).

setting up the investment, prohibition of performance requirements[7], prohibition of restrictions on foreign investment and an obligation to strive for progressive liberalization, and efforts to ensure transparency (disclosure of laws and regulations, obligation to respond to inquiries from the counterpart country, etc.) (Table III-1-2-2).[8]

Table III-1-2-2 Matters included in investment treaties

1. Protection of investments and fair treatment of investors
(i) Approval for business projects will not be rescinded if it is once granted.
(ii) Business assets will not be illegally expropriated or nationalized.
(iii) Business discontinuation caused by the tightening of regulations ("indirect expropriation") will be avoided.
(iv) Investment contracts and concession contracts concluded with the partner countries will be complied with (umbrella clause).
(v) Freedom of money transfer to Japan will be guaranteed.
2. Prohibition of discriminatory treatment among companies other than local-capital companies (foreign companies) (most-favored-nation (MFN) treatment)
3. Prohibition of discriminatory treatment in comparison to local-capital companies (national treatment (NT))
4. Obligation to provide fair and equitable treatment (FET) for investors and their investments
5. Some treaties also prohibit the following investment approval requirements. (Prohibition of performance requirements (PR))
(i) To export a given level or percentage of goods/services
(ii) To achieve a given level or percentage of domestic content
(iii) To purchase, use, or accord a preference to local goods/services
(iv) To relate the volume/value of imports to the volume/value of exports or to the amount of foreign currency obtained
(v) To relate the volume/value of the resultant goods/services sold within the country to the volume/value of exports or the amount of foreign currency obtained
(vi) To restrict exports or sales for export
(vii) To appoint as executives, managers etc., individuals of any particular nationality
(viii) To transfer technology to the partner providing local capital
(ix) To locate the headquarters for a specific region

7 For example, a requirement imposed as a condition on investment activities, such as ensuring a certain proportion of local content or exporting a certain proportion of goods manufactured.

8 A typical example is the chapter on investment in NAFTA; in the case of Japan, the chapter on investment in its bilateral EPAs and Japan's investment treaties with ROK, Viet Nam, Cambodia, Lao PDR, Uzbekistan, and Myanmar are all of this type.

(x) To hire a given proportion/number of local workers
(xi) To achieve a given level/value of research and development locally
(xii) To act as the exclusive supplier of the goods or services to a specific region (i.e., not to establish a separate supply base in another country)
(xiii) To limit the royalty amount/rate under a certain level

Note: If the partner country violates these obligations, the investor can submit the matter to international arbitration, naming the state as a party to the case.

Source: METI.

3. Major provisions of the Energy Charter Treaty

Another treaty that allows cases to be submitted to international arbitration in the same way as investment-related treaties is the Energy Charter Treaty. The Energy Charter Treaty, which entered into force in 1998, contains similar provisions to ordinary bilateral investment protection treaties (such as the granting of either national treatment (NT) or most-favored-nation treatment (MFN) (whichever is more favorable) by the contracting parties to the investments of investors of other contracting parties, the prohibition of expropriation unless certain requirements are met, freedom of transfer, and dispute settlement procedures), concerning the protection and liberalization of investment in the energy field. As of February 2018, 48 states including Eastern European and EU states and one international organization have signed the Energy Charter Treaty. Although Russia, Australia, Belarus, and Norway signed the charter, they have not yet ratified it. There are also countries and international organizations that have joined the charter only as observers (e.g., the United States, Canada, China, the ROK, the WTO, the OECD, the IEA, and ASEAN).

4. Situation surrounding investment-related agreements concluded by Japan

In recent years, the number of Japanese companies owning business bases abroad has been increasing, reaching 71,820 in October 2016. The amount of foreign direct investments made by Japan in 2017 has increased by a factor of about 3.9 compared with 2000, and since fiscal 2005, the primary income balance has been recording better figures than the trade balance.

As shown above, foreign investments by Japan are growing further. At the same time, amid the rapidly expanding global market, mainly in emerging economies, Japanese companies and Japanese affiliates abroad are exposed to intensive competition to capture foreign markets. In order to make Japan's economic growth stronger and more sustainable, it is necessary for the country to further improve the business environment around the world with a view to achieving development as a trade and investment-oriented country. From this viewpoint, investment treaties and economic partnership agreements (EPAs)/free trade agreements (FTAs) containing investment chapters (hereinafter referred to as "investment-related treaties"), which prescribe the protection of investors and investment assets, enhancement of regulatory transparency and the expansion of opportunities, among other matters, are becoming increasingly important as investment support tools. As well as tax treaties and social security treaties, investment-related treaties are important for resolving problems related to cross-border

movements of capital, people and goods, and companies' needs for such treaties are strong.

Investment-related treaties are expected to play a role in improving the investment environment that extends across the domestic and foreign markets and promoting overseas business expansion by Japanese companies and foreign direct investments in Japan, in addition to ensuring appropriate protection of Japanese investors abroad. The government of Japan intends to improve the investment environment by further accelerating the conclusion of investment-related treaties as well as the revision of existing treaties while implementing other economic policies.

In 1978, Japan's first investment treaty, which was concluded with Egypt, went into effect. Since then, Japan has concluded investment-related treaties mainly with the Asian countries with which it has important economic relationships. By now, Japan has signed 45 investment-related treaties, of which 41 have gone into effect (as of May 2018) (Table III-1-2-3). Japan has started earnest efforts to conclude investment-related treaties relatively recently, but it is necessary to more actively promote negotiations about the conclusion of new treaties and revision of existing ones in accordance with the needs of Japanese industry and the circumstances of the counterpart countries.

Table III-1-2-3 Investment-related treaties concluded by Japan

Partner country/region	Signed	Entered into force
Egypt	January 28, 1977	January 14, 1978
Sri Lanka	March 1, 1982	August 7, 1982
China	August 2, 1988	May 14, 1989
Turkey	February 12, 1992	March 12, 1993
Hong Kong	May 15, 1997	June 18, 1997
Pakistan	March 10, 1998	May 29, 2002
Bangladesh	November 10, 1998	August 25, 1999
Russia	November 13, 1998	May 27, 2000
Singapore (Economic Partnership Agreement)	January 13, 2002	November 30, 2002
ROK	March 22, 2002	January 1, 2003
Viet Nam	November 14, 2003	December 19, 2004
Mexico (Economic Partnership Agreement)	September 14, 2004	April 1, 2005
Malaysia (Economic Partnership Agreement)	December 13, 2005	July 13, 2006
Philippines (Economic Partnership Agreement)	September 9, 2006	December 11, 2008
Chile (Economic Partnership Agreement)	March 27, 2007	September 3, 2007
Thailand (Economic Partnership Agreement)	April 3, 2007	November 1, 2007
Cambodia	June 14, 2007	July 31, 2008
Brunei Darussalam (Economic Partnership Agreement)	June 18, 2007	July 31, 2008
Indonesia (Economic Partnership Agreement)	August 20, 2007	July 1, 2008

Lao PDR	January 16, 2008	August 3, 2008
Uzbekistan	August 15, 2008	September 24, 2009
Peru	November 21, 2008	December 10, 2009
Viet Nam (Economic Partnership Agreement)*1	December 25, 2008	October 1, 2009
Switzerland (Economic Partnership Agreement)	February 19, 2009	September 1, 2009
India (Economic Partnership Agreement)	February 16, 2011	August 1, 2011
Peru (Economic Partnership Agreement)*2	May 31, 2011	March 1, 2012
Papua New Guinea	April 26, 2011	January 17, 2014
Colombia	September 12, 2011	September 11, 2015
Kuwait	March 22, 2012	January 24, 2014
Japan-China-ROK	May 13, 2012	May 17, 2014
Iraq	June 7, 2012	February 25, 2014
Saudi Arabia	April 30, 2013	April 7, 2017
Mozambique	June 1, 2013	August 29, 2014
Myanmar	December 15, 2013	August 7, 2014
Australia (Economic Partnership Agreement)	July 8, 2014	January 15, 2015
Kazakhstan	October 23, 2014	October 25, 2015
Uruguay	January 26, 2015	April 14, 2017
Ukraine	February 5, 2015	November 26, 2015
Mongolia (Economic Partnership Agreement)	February 10, 2015	June 7, 2016
Oman	June 19, 2015	July 21, 2017
TPP (Economic Partnership Agreement)	February 4, 2016	Undecided
Iran	February 5, 2016	April 26, 2017
Kenya	August 28, 2016	September 14, 2017
Israel	February 1, 2017	October 5, 2017

Note:

1. Incorporates the content of the Japan-Viet Nam Investment Treaty, which entered into force on December 19, 2004.
2. Incorporates the content of the Japan-Peru Investment Treaty, which entered into force on December 10, 2009.
3. In addition, an agreement with Taiwan was signed on September 22, 2011, by the private sector bodies that act as a conduit for bilateral relations, and the procedures were completed on January 20, 2012.
4. As of April 2018.

Source: METI.

5. New initiatives related to investment-related treaties

(formulation of an action plan concerning investment-related treaties)

In May 2016, the Action Plan for improvement of investment climate through promoting the conclusion of investment-related treaties was formulated. From then on, Japan was set to promote the improvement of the investment climate through the conclusion of investment-related treaties based on this plan. As the overview of the action plan, first, Japan aims for signature and entry into force of investment-related treaties with 100 countries and regions by 2020 through intensive efforts to promote the conclusion of such treaties. Second, on the selection of negotiating partners, Japan will consider negotiation partners every year by comprehensively taking into account actual investment from Japan and prospects of its expansion in the counterpart countries and regions, requests from Japanese industry, consistency with Japan's diplomatic policy and the needs and situations of the counterpart countries and regions. Third, on the negotiations concerning investment-related treaties, Japan will pursue high-quality treaties while bearing in mind the "investment liberalization" treaties that require non-discriminatory treatment from the stage of new entry into the investment market. On the other hand, Japan will negotiate flexibly, valuing speed and taking into account the specific needs of the Japanese industry and the situations of the counterpart countries. Fourth, Japan will actively promote negotiations concerning bilateral and plurilateral investment-related treaties, and at the same time, will contribute to international discussion for improvement of the investment climate in multilateral forums. Fifth, Japan will aim to achieve economic growth through the creation of an investment climate suited to new business activities by considering the inclusion of such sectors as trade in services and e-commerce in investment-related treaties in consideration of economic and social changes in recent years.

6. Tasks for the Future

Disputes concerning investment-related treaty provisions are subject to state-to-state dispute settlement (SSDS) or investor-to-state dispute settlement (ISDS) procedures, under certain conditions. The provisions concerning SSDS in Japan's investment-related treaties prescribe procedures for resolving disputes between the contracting parties regarding the interpretation and application of the investment-related treaty concerned.

In the event that an investor incurs loss or damage to his/her investment due to a breach of the investment-related treaty by the host country, ISDS provisions make it possible to refer the matter to international arbitration in accordance with the ICSID[9] Arbitration Rules or the UNCITRAL[10] Arbitration Rules.

According to UNCTAD, although just 14 cases of ISDS based on international investment-related treaties (number of cases referred to an arbitration body) were brought between 1987, when the first

9 International Centre for Settlement of Investment Disputes: A permanent arbitration body that is a member of the World Bank Group; Based in Washington, D.C.

10 United Nations Commission on International Trade Law: Based in Austria (Vienna).

case[11] was brought, and 1998,[12] there was a sharp rise in the latter half of the 1990s[13] and the total number of cases stood at 817 as of July 2017. On the other hand, Japanese companies have resorted to the investment arbitration procedure in just two publicly announced cases.[14] According to a private-sector survey,[15] 80% of major Japanese companies have never used international commercial arbitration. Currently, Japanese companies are not actively using international investment arbitration and international commercial arbitration.

In international arbitration cases based on an investment-related treaty, there is a tendency for the arbitral tribunal to refer to similar arbitral awards made in the past although arbitral awards are not biding as precedents. While a collection of precedents has been built up, as the number of cases of international arbitration based on investment-related treaties has surged since 2000, there are quite a few points on which awards vary. Arbitral awards in international investment arbitration could affect Japan's future strategy in investment-related treaty negotiations. Another task for the future is to establish an environment that enables international arbitration to be proactively utilized by Japanese companies as a means of settling disputes with the host country.[16]

International rules concerning corporate activities are dynamic, rather than being set in stone, so international investment arbitration and international commercial arbitration are important as fields for the establishment of rules. Proactive involvement of Japanese academicians and practitioners in

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11 Asian Agricultural Products Limited v. Republic of Sri Lanka (ICSID Case No. ARB/87/3).

12 UNCTAD (2005) "INVESTOR-STATE DISPUTES ARISING FROM INVESTMENT TREATIES: A REVIEW".

13 Growing interest in investment arbitration is believed to have been triggered by the Ethyl case under NAFTA (a case brought by a U.S. company on the grounds that the Canadian government's environmental regulation constituted "expropriation" under NAFTA. The Canadian government paid the company a sum of money to settle the case out of court) in 1996.

14 In these cases, in 2015 through 2016, two Japanese companies applied for arbitration at the ICSID based on the Energy Charter Treaty concerning a change made by the government of Spain to a renewable energy-related system.
Another representative case of arbitration involving a Japanese company is one in 1998 relating to measures taken by the Czech government against a Czech bank that the London-based subsidiary of a Japanese securities company had acquired via a corporation established under Dutch law. It was submitted to arbitration under the UNCITRAL Arbitration Rules, based on the bilateral investment treaty between the Czech Republic and the Netherlands.

15 Nihon Keizai Shimbun, January 20, 2014, p.16.

16 Many have highlighted concern that ISDS procedures impede the public interest, but there are those who take the view that such opinions are not based on an accurate understanding of arbitral awards. See pp.31-33 of the Report on Arguments Concerning the Issues Connecting the Investment Treaty Arbitration System (ISDS) and the Public Interest, compiled by the Special Subcommittee on International Investment Disputes, within the Alternative Dispute Resolution (ADR) Center of the Japan Federation of Bar Associations. This report outlines the frequently-cited Ethyl case and Metalclad case, and points out certain problems with the arguments in question (it should be noted that the report was compiled by the aforementioned Special Subcommittee as a reference material for discussions within the Japan Federation of Bar Associations and does not represent the opinion of the Federation).
The analysis in the report states, "As can be understood from close scrutiny of both cases, neither ISDS provisions nor the investment protection treaties that contain them are intended to unconditionally prioritize the interests of investors ahead of the public interest. However, problems arose in relation to the investment protection treaties because in the former case, the method of regulation adopted to achieve environmental protection was discriminatory toward some domestic and foreign business operators, while in the latter case, the restriction was imposed by a body that did not have any particular authority under domestic law. Consequently, it would be fair to say that there are certain problems with arguments that ignore the specific nature of these two cases and, based solely on the ultimate outcome of these cases, conclude that ISDS provisions impede the public interest."

international investment arbitration and international commercial arbitration is also desirable from the perspective of influencing the formation of international business rules.

In utilizing international arbitration, it is also vital to put in place rules and places for arbitration. Hitherto, Singapore[17] and Hong Kong have been the main places of arbitration in Asia, but ROK has been focusing its energies on developing the arbitration environment in recent years, establishing the Seoul International Dispute Resolution Center in May 2013. These countries are striving to promote the development of the arbitration environment as an essential measure for them to serve as international business hubs.[18]

17 In January 2015, Singapore established the Singapore International Commercial Court (SICC). While the SICC was established as a Singapore court, its deliberation procedures are similar to international arbitration procedures (e.g. foreign judges may control court procedures; lawyers practicing foreign laws may act as counsels within certain limits; and the application of rules concerning the examination of evidence may be flexible). See "The establishment of the Singapore International Commercial Court (SICC) and various related issues (Part 1)" (KOKUSAI - SHOJI - HOMU (International Business Law and Practice) Vol.43, No.10, 2015 pp.1471-1479).

18 As a result of such efforts, the number of arbitration cases in the ROK is on an uptrend.