Section 2 Investment 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 2012 the figures were 31.8% and 32.9%, respectively.[11] Looking at Japan's balance of payments, whereas the balance on income in 2012 showed a surplus of approximately ¥14.3 trillion, reflecting the increase in receipts from portfolio investment income and direct investment income, the balance of trade showed a deficit of approximately ¥5.8 trillion, marking the eighth consecutive year in which the balance on income exceeded the balance of trade.

As the increase in foreign direct investment shows, Japanese companies are progressively expanding overseas, but as has been seen to date, further strategic business expansion into emerging economies is essential to the future economic growth of our country. To encourage Japanese companies to expand into emerging economies, it is vital to reduce investment risk by abolishing barriers to expansion in those markets and to the repatriation of funds to Japan. As a means of doing so, Japan intends to endeavor to enhance its investment treaties.

Investment treaties are treaties between countries in which the parties make a commitment that they will protect investors of the other party and their investments, as well as making a commitment to the liberalization of investment between the contracting parties. They contain provisions aimed at encouraging investment by protecting investors who invest overseas and their investments, improving the transparency of regulation, and so forth.

1. Approaches to investment treaties

To date, Japan has signed 33 investment treaties and economic partnership agreements that contain a chapter on investment; 29 of these have already entered into force. Most of the counterparts are Asian countries (as of May 2014) (Table III-1-2-1). To promote overseas expansion by companies and ensure a stable supply of minerals and energy resources, the government will expedite the conclusion of investment treaties, taking into account the needs of Japanese industry and the situation regarding the conclusion of economic partnership agreements that contain a chapter on investment. Accordingly, the government will formulate and promote guidelines for encouraging the conclusion of investment treaties and ensuring their effective use. In addition, it will strengthen the relevant authorities, with a view to bringing them to fruition. In particular, efforts are required to expedite the conclusion of treaties with African countries, where few have been concluded to date (only one – with Egypt – has already entered into force. The treaty with Mozambique was signed but has not yet entered into force).

To determine the specific order of priority, a comprehensive judgment will be made that takes the following elements into account[12].

(1) Actual investment from Japan and prospects of its expansion

(2) Necessity of improving the investment environment and requests from Japanese industry

11 UNCTAD, *World Investment Report 2013.*

12 Ministry of Foreign Affairs, "On the Strategic Use of Bilateral Investment Treaties (BIT)," June 10, 2008.

(including the degree of openness to foreign capital)

(3) Importance as a source of energy and/or mineral resources

(4) Governance capacity of the government of the counterpart country and stability of the political situation there

(5) Political and diplomatic significance

Table III-1-2-1 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
Mongolia	February 15, 2001	March 24, 2002
Singapore (Economic Partnership Agreement)	January 13, 2002	November 30, 2002
Republic of Korea (hereafter referred to as “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
Laos	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

Partner Country/Region	Signed	Entered into Force
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	To be determined
Kuwait	March 22, 2012	January 24, 2014
Japan, China, & ROK	May 13, 2012	May 17, 2012
Iraq	June 7, 2012	February 25, 2014
Saudi Arabia	April 30, 2013	To be determined
Mozambique	June 1, 2013	To be determined
Myanmar	December 15, 2013	To be determined

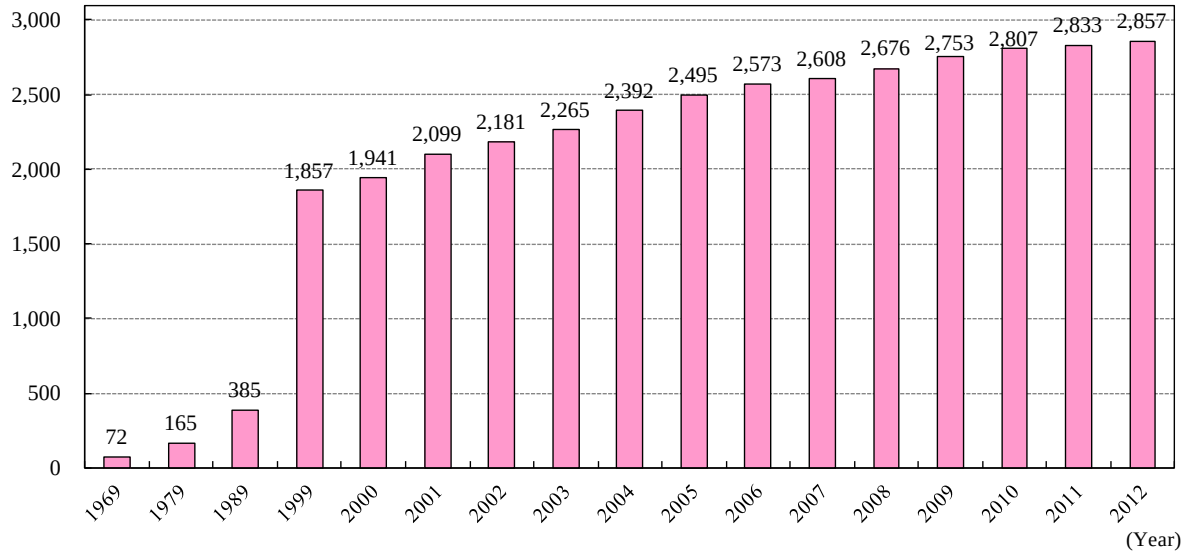
Note 1: Incorporates the content of the Japan-Viet Nam Investment Treaty, which entered into force on December 19, 2004.
Note 2: Incorporates the content of the Japan-Peru Investment Treaty, which entered into force on December 10, 2009.
Note 3: In addition, an agreement with Taiwan was signed on September 22, 2011 by the private sector bodies that act as a conduit for bilateral relations, and the procedures were completed on January 20, 2012.
Note 4: As of end February 2014.
Source: Ministry of Economy, Trade and Industry.

2. Investment agreements concluded worldwide

In light of the increase in foreign direct investment described above, 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 2,857 in 2012 (Figure III-1-2-2). Looking at the situation by country, Germany, China, the UK, and France have each concluded around 100 investment treaties.

Figure III-1-2-2 Trends in the number of investment treaties worldwide



Source: Compiled from UNCTAD, Recent developments in international investment agreements (2008-June 2009), and World Investment Report 2013.

3. Major provisions of investment treaties

Conventionally, investment treaties were mainly concluded in order to protect investors from country risks, such as the expropriation of investment and arbitrary application of the law by the host country. Such treaties are called investment protection treaties and they mainly cover such matters as national treatment and most-favoured-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, investment treaties (called investment protection and liberalization treaties) began to emerge that incorporated not only this kind of protection for investment, but also national treatment or most-favoured-nation treatment when setting up the investment, prohibition of performance requirements[13], 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.) (Figure III-1-2-3)[14].

Disputes concerning investment treaty provisions are subject to state-to-state dispute settlement (SSDS) or investor-to-state dispute settlement (ISDS), respectively, under certain conditions.

The provisions concerning SSDS in Japan's investment treaties prescribe procedures for resolving disputes between the contracting parties regarding the interpretation and application of the investment

[13] For example, a specific requirement imposed as a condition on investment activities, such as ensuring a certain proportion of local content or exporting a certain proportion of the goods manufactured.

[14] 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 P.D.R., Uzbekistan, and Peru are all of this type.

treaty concerned.

In the event that an investor incurs loss or damage to his/her investment due to a breach of the investment treaty by the host country, ISDS makes it possible to refer the matter for international arbitration in accordance with the ICSID[15] Arbitration Rules or the UNCITRAL[16] Arbitration Rules.

According to UNCTAD, although just 14 cases of ISDS based on international investment treaties (number of cases referred to an arbitration body) were brought between 1987[17], when the first case was brought, and 1998[18], there was a sharp rise in the latter half of the 1990s[19] and the total number of cases stood at 514 as of the end of 2012. On the other hand, Japanese companies have used the investment arbitration procedure just once, when an overseas subsidiary of the company in question submitted an arbitration under the treaty between two other countries.[20]

15 International Center for Settlement of Investment Dispute: A permanent arbitration body that is a member of the World Bank Group. It is based in Washington, D.C.

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

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

18 UNCTAD, "Investor-State Disputes Arising from Investment Treaties: A Review," 2005.

19 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.

20 A 1998 case 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 United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, based on the bilateral investment treaty between the Czech Republic and the Netherlands.

Table III-1-2-3 Significance of concluding investment treaties

1. Protection of investments and fair treatment of investors

(i) Ensures **approval for business projects will not be rescinded** once granted

(ii) Ensures business assets will not be illegally **expropriated or nationalized**

(iii) Prevents situations in which **it becomes impossible to continue doing business due to the tightening of regulations** ("indirect expropriation")

(iv) **Ensures adherence to investment contracts and concession contracts** concluded with the government of the counterpart country (umbrella clause)

(v) Ensures **freedom to repatriate money** to Japan

2. Prohibits **discriminatory treatment in comparison to companies other than those funded by local capital (foreign companies) (most-favored-nation (MFN) treatment)**

3. Prohibits **discriminatory treatment in comparison to companies funded by local capital (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) Requirement to **export** a given level or percentage of **goods/services**

(ii) Requirement to **achieve** a given level or percentage of domestic content

(iii) Requirement to **purchase, use, or accord a preference to local goods/services**

(iv) Requirement to relate the volume/value of imports to the volume/value of exports or to the amount of foreign currency obtained

(v) Requirement 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) Requirement to **restrict exports or sales for export**

(vii) Requirement to appoint, as executives or managers, etc., individuals of any particular **nationality**

(viii) Requirement to transfer technology to the partner providing local capital

(ix) Requirement to locate the headquarters for a specific region

(x) Requirement to **hire** a given proportion/number of **local people**

(xi) Requirement to achieve a given level/value of research and development locally

(xii) Requirement for exclusive supply of goods/services to a specific region (i.e. not to establish a separate supply base in another country)

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

Source: Ministry of Economy, Trade and Industry.

4. Major provisions of the Energy Charter Treaty

Another treaty that allows cases to be submitted to international arbitration in the same way as investment treaties is the Energy Charter Treaty. The Energy Charter Treaty, which entered into force in 1998, sought to implement market-based reforms in the energy sector in the former Soviet Union and Eastern Europe and encourage corporate activities, following the collapse of the Soviet Union. The treaty contains similar provisions to ordinary bilateral investment protection treaties (such as the granting of either national treatment (NT) or most-favoured-nation treatment (MFN) (whichever is more favourable) 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 liberalization and protection of investment in the energy field. As of January 2014, 47 states including Eastern European and EU states and one international organization have ratified the Energy Charter Treaty. Russia and Australia have signed it, but have not yet ratified it. There are also countries that have only observer status (including the U.S., Canada, China, Republic of Korea (hereafter referred to as "ROK"), and Saudi Arabia).

5. Examples of international investment arbitration

As corporate activities become increasingly international, the number of investment disputes that arise between investor companies and foreign governments will grow. Although there are no published cases in which investor-to-state dispute settlement procedures have been used on the basis of an investment treaty signed by Japan, UNCTAD has identified more than 500 cases of ISDS based on investment treaties. In utilizing investment treaties, the user must grasp how each provision will be interpreted, so it is vital to refer to arbitral awards in previous international investment disputes[21].

6. Tasks for the future

The only case of investment arbitration involving a company with connections to Japan is *Saluka v. the Czech Republic*. Moreover, according to a private sector survey[22], 80% of major Japanese companies have never used international commercial arbitration. Japanese companies have hitherto tended not to use international investment arbitration and international commercial arbitration.

If international arbitration takes place on the basis of an investment-related treaty, there is a tendency for the arbitral tribunal to refer to similar arbitral awards made in the past. 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 treaty negotiations, and establishing an environment that enables international arbitration to be proactively utilized by Japanese companies as a means of settling disputes with the host country

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21 For an outline of arbitral awards concerning international investment disputes, see Ministry of Economy, Trade and Industry, *2014 Report on Compliance by Major Trading Partners with Trade Agreements* (pp.705-711), etc.

22 *Nihon Keizai Shimbun*, January 20, 2014, p.16

is a task for the future[23]. International rules are dynamic, rather than being set in stone, so international investment arbitration and international commercial arbitration are important fields for the establishment of rules. Further utilization of investment treaties would also be desirable from the perspective of Japan's ability to influence the formation of international rules in the field of international business.

In utilizing international arbitration, it is also vital to put in place rules and places of arbitration. Hitherto, Singapore and Hong Kong have been the main places of arbitration in Asia, but the ROK has been focusing its energies on international arbitration, establishing the Seoul International Dispute Resolution Center in May 2013, and the number of cases of arbitration in ROK is on the rise. As international business hubs, the growing prevalence of arbitration is an essential tool for these countries, so they are striving to promote it.

[23] 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 ADR (Alternative Dispute Resolution) 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."