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Second Generation IIAs: Japanese Perspective

Tarciso Gazzini · Saturday, March 12th, 2022

Japan is traditionally the only developed country where foreign investors are reluctant to do business (see R. Katz). The peculiar case of Japan is evident if one looks at the country's treaty practice, but some recent developments deserve attention.

In the last four decades, states have attracted foreign investment through a wide web of about 2,700 bilateral investment treaties (BITs) and economic agreements dealing with both trade and investment. In the 1990s and 2000s, in particular, states were excited about those agreements and concluded them even if they did not always entirely understand their implications. Japan was a story apart. Until 2011, it had a rather modest portfolio of investment treaties (15) while Germany, the United Kingdom, and the United States had concluded each about 100 of those treaties.

In the last two decades, however, BITs have lost the appeal and several countries have tried to get rid of them (e.g. South Africa) or to modernize them (e.g. India). Against this trend, since 2011 Japan has concluded 20 BITs, a rather unusual tripartite investment agreement (with China and Korea), and several economic integration agreements containing investment provisions.

The popularity of investment agreements has fallen for three main reasons. First, those agreements are normally manifestly unbalanced as they impose obligations only upon States and grant rights only to investors. Second, disputes are normally settled through arbitration, a mechanism that has been criticised for lack of legitimacy, transparency and public scrutiny. Third, investment treaties often restrict – or at least are perceived as restricting – the regulatory powers of States, especially in areas such as public health or the protection of the environment, for fear of arbitral proceedings and requests for massive compensation.

The BITs recently concluded by Japan deserve a close look for some innovative substantive and procedural provisions. An interesting example is offered by the treaty with Argentina, concluded on 1 December 2018 (not yet entered into force) with the aim of creating – as declared in the preamble – stable, equitable, favourable and transparent conditions for investment based on the principles of equality and mutual benefit.

The agreement applies to enterprises of the other Party from the moment they take some concrete measures, such as requesting a permit or license, or obtaining the necessary financing. In this regard, the treaty is more attractive for investors than the majority of investment treaties, which on the contrary protect investors only after they have been admitted in the foreign State in accordance with its laws and regulations.

Since in the past the definition of investment has often been broadly drafted and raised problems of interpretation, the treaty provides a workable and detailed non-comprehensive list of categories of investments falling within the scope of the treaty, including bond debentures, loans and other forms of debt, but excluding sovereign debt and debt of State enterprises.

Bilateral Investment Treaty between Japan and Argentina

A. Treatment of Investors

The substantive provisions of the treaty have been drafted meticulously, considering the difficulties and interpretative problems encountered in the last couple of decades by States and arbitral tribunals in dealing with vague or poorly drafted treaties. Any doubt concerning the scope of the most favoured nation (MFN) clause has been dissipated by excluding its application to procedural provisions. The content of the MFN and national treatment (NT) clauses has been significantly squeezed compared to traditional treaties. The treaty indicates several categories, including government procurement and subsidies or grants, which are not subject to the clauses, thus preserving room for manoeuvre of States, especially with regard to incentives to investment in the renewable energy sector.

The treaty furthermore recalibrates the obligations incumbent upon States in relation to the two most important standards of protection, which account for the overwhelming majorities of investment disputes, namely fair and equitable treatment (FET) or alternatively the minimum standard of treatment (MST), and the provisions governing expropriation. The meaning of FET has been fleshed out by investment tribunals by borrowing general principles recognized in most jurisdictions, such as due process, non-arbitrary treatment, denial of justice etc. The MST, on the contrary, accords to investors nothing more and nothing less that the treatment existing under customary international law. The treaty between Japan and Argentina follows the second approach and further clarifies that the standard includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process, while “full protection and security” is intended as police protection.

The treaty confirms the conditions for lawful expropriation, namely (a) public purpose; (b) non-discrimination; (c) due process; and (d) prompt, adequate and effective compensation. It carefully deals with indirect expropriation, which occurs by virtue of regulatory measures depriving investors from the enjoyment of their investments. As demonstrated by investment jurisprudence, it is extremely difficult to draw the line between indirect expropriation and legitimate exercise of regulatory powers. The distinction is crucial as only the first category triggers the duty to compensate.

In the past, treaty provisions on expropriation were rather rudimentary and generated a worrisome level of legal incertitude. As a result, States have developed increasingly sophisticated provisions intended to better safeguard their right and duty to protect the public interest. From this perspective, the treaty between Japan and Argentina indicates that the occurrence of indirect expropriation must be determined on a case-by-case basis, taking into account, *inter alia*, (a) economic impact of the government action; (b) extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (c) character of the government action. Importantly, non-discriminatory regulatory actions *designed and applied* to protect

legitimate public welfare objectives – such as public health, safety and the environment – constitute indirect expropriations only in rare circumstances. The expression *designed and applied* introduces a high level of deference to the host State policies as it does not imply any necessity test or any inquiry on less investment-restrictive alternatives.

B. Regulatory Powers

The regulatory powers of the host State are further safeguarded by incorporating in the treaty *mutatis mutandis* GATT and GATS provisions on general exceptions. Those exceptions may be invoked by States to justify measures, otherwise contrary to the treaty, necessary to protect public health, animal life, natural resources and public morals, provided they are not discriminatory or abusive.

Regarding measures adopted on security grounds, the treaty follows GATT disciplines and preserves the right of each Party to adopt and enforce the measures it *considers* necessary for the protection of its essential security interests in time of war, armed conflict, or other emergency situations; or related to the implementation of national policies or international agreements on non-proliferation of weapons. This provision is largely, but not entirely self-judging.

C. Disputes

Like virtually all modern BITs, the treaty between Japan and Argentina provides for the settlement of intra-States disputes as well as investor-State disputes. It is however with regard to disputes falling in the second category – which are settled through arbitration under the ICSID Convention, UNCITRAL rules or under any other arbitration rules – that the treaty has introduced an important innovation.

The treaty provides that arbitral claims submitted by investors must relate to alleged breaches of either the treaty or "investment agreements", the latter defined as written contracts between the State and the investor, at the exclusion of (a) administrative or judicial unilateral acts, such as permits, licences or authorisations issued by a Party solely in its regulatory capacity, or decrees, orders or judgements, standing alone; and (b) administrative or judicial consent decrees or orders.

The importance of this provision lays with the extension of the arbitral clause to disputes arising out of eligible contracts. Investors can rely on the dispute mechanism provided for in the treaty in relation to alleged breaches of contracts, which may contain a less advantageous arbitration clause or no clause at all. This can be considered as an attractive development for the standpoint of investors.

D. Environment, Human Rights and Labour Standards

Unlike some recent treaties, such as ECOWAS Supplementary Act or the Canadian European Treaty Agreement (CETA), the treaty between Japan and Argentina remains almost silent on non-investment issues and thus ignoring one of the main sources of criticism moved against investment

agreements. This is unsatisfactory for two main reasons. On the one hand, the treaty could have rebalanced the relationship between investors and the Host State by introducing some obligations upon the former, especially regarding social and environmental impact, corruption and corporate governance. On the other hand, a modern investment treaty cannot neglect the interests and rights of other stakeholders.

Conclusions

The treaty analysed is an interesting attempt to recalibrate the legal protection of foreign investors. It demonstrates that BITs are still perceived by some states as important and flexible tools to attract and protect foreign investments. It reveals a high degree of sophistication in defining Host State's obligations, while effectively preserving its sovereign prerogatives. It also confirms the firm commitment of Japan to investment arbitration, which the treaty extends to eligible contracts. It is not a coincidence that Japan has been one of the staunchest supporters of investment arbitration in talks for the modernisation of the Energy Charter Treaty.

The treaty is however rather conservative if not disappointing insofar as no obligations are imposed upon investors, as it has occurred in other investment treaties, especially in relation to corruption, corporate governance, liability and environmental impact assessment. Furthermore, no mention is made in the treaty to the protection of human rights and labour standards, while Art. 17 merely recognises the importance of encouraging enterprises to voluntary adhere to corporate responsibility principles.

In conclusion, the treaty seems to adequately readjust the legal relationship between investors and the State, but completely refrains from addressing the concern raised since the failure to adopt the OECD Multilateral Investment Agreement in relation to the protection of the interests of other stakeholders. It remains to be seen whether the treaty – as well as the other ones concluded by Japan – may still be successful in tackling the traditional reluctance of investors to invest in Japan.

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This entry was posted on Saturday, March 12th, 2022 at 8:08 am and is filed under Japan, Reform
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