Japanese Investor-State Dispute Settlement in a Post-TPP Asia

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I Background

The world of investor-State dispute settlement (ISDS) is in flux, particularly in Asia. The traditional model of ISDS that blossomed over the past two decades—a framework matrix of largely bilateral investment treaties providing nebulous but powerful substantive protections to investors, who enjoy an entitlement to enforce the terms of the treaties through direction arbitration with host States—has come under criticism.[1]

The recent election of Donald Trump to the presidency of the United States of America has complicated matters. Of particular relevance to the future of ISDS in Asia (and Japan, in particular) is that the outcome of the US election likely has brought to an end the Trans-Pacific Partnership Agreement (TPPA).[2] The TPPA would have instituted sweeping changes to the ISDS landscape in Asia, including by creating a variety of new avenues for investors to bring claims against States on both sides of the Pacific. The effect on Japanese investors would have been particularly marked, as the TPPA would have provided direct investment protection along some of Japan's most active investment paths, including between Japan and the United States.

The likely fate of the TPPA resonates with what may be a broader shift in views worldwide as to the proper role of ISDS, as well as to what form it should take. Backlash against ISDS has found expression in various corners. This backlash has come in three main forms. First, some States, such as Indonesia and South Africa, have begun gradual programs to extricate themselves from their existing investment treaty commitments[3]—it remains to be seen what, if anything, will come to replace them. Second, some States have adopted a prospective approach, seeking to be more selective about entering into future treaties, and being more attuned to the risks of future potential claims when negotiating the

[1] Claire Balchin, Liz Kyo-Hwa Chung, Asha Kaushal and Michael Waibel(eds), *The Backlash against Investment Arbitration: Perceptions and Reality* (2010).

[2] Peter Baker, *Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal*, The New Tork Times, January 23, 2017 *available at* https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html?_r=0.

[3] Leon E. Trakman and Kunal Sharma, *Indonesia's Termination of the Netherlands-Indonesia BIT: Broader Implications in the Asia-Pacific?*, Kluwer Arbitration Blog, August 21, 2014 *available at* http://kluwerarbitrationblog.com/2014/08/21/indonesias-termination-of-the-netherlands-indonesia-bit-broader-implications-in-the-asia-pacific/.

substantive terms of new treaties.[4] One example of this approach is India, which has released several versions of a model bilateral investment treaty, which, even in its revised form, directly seeks to address and correct perceived failures in the substantive protections provided by the existing generation of treaties.[5] Finally, a third approach, favored primarily by the European Union in negotiating new treaties to replace the bilateral treaties of its member States,[6] has been to explore more fundamental changes to the prevailing ISDS model.

To date, Japan has not taken any of these three approaches, or indeed to have changed its position vis-a-vis new treaties. Japan continues to pursue a program of negotiating and executing new investment treaties,[7] and, so far, the wave of treaties that Japan recently has entered into have followed the traditional model, with little substantive deviation. That is not to say that all of Japan's new investment treaties have been substantively identical—far from it. The Japan-Iran BIT (signed 2016), for example, focuses to an unusual extent on the role of contractual investment agreements between investor and State, and deemphasizes substantive standards of protection within the treaty itself. But, the overall look and feel of ISDS under Japan's new treaties would be familiar to seasoned practitioners.

Although sweeping in its scope, the TPPA too would have been in that mold: despite some departures from tradition, the core procedural and substantive features of traditional ISDS would have been present in proceedings under the TPPA. If the TPPA had not been stymied by the U.S. election, it is likely enough that, under the auspices of the TPPA, ISDS throughout the Asia-Pacific region would have continued to adhere to the traditional model, even as the rest of the world might have begun to move in a different direction.

But, with the TPPA now off the table, it has become possible that a different model may rise to prominence in Asia after all. This article examines the core features of the main alternative model that has been proposed—the so-called "Investment Courts model"—by looking at two proposed treaties that would implement a version of it, and then concludes with a brief discussion of whether such a model would be appropriate or desirable for Japan.

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4 Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management, p. 10.

5 Gordon Blanke, *India's revised Model BIT: Every bit worth it!*, Kluwer Arbitration Blog, March 20, 2016 *available at* http://kluwerarbitrationblog.com/2016/03/20/indias-revised-model-bit-every-bit-worth-it/.

6 Anne-Karin Grill and Sebastian Lukic, *The End of Intra-EU BITs: Fait Accompli or Another Way Out?*, Kluwer Arbitration Blog, November 16, 2016 *available at* http://kluwerarbitrationblog.com/2016/11/16/the-end-of-intra-eu-bits-fait-accompli-or-another-way-out/; Crina Baltag, *Green Light for Romania to Terminate its Intra-EU Bilateral Investment* Treaties, Kluwer Arbitration Blog, March 14, 2017 *available at* http://kluwerarbitrationblog.com/2017/03/14/green-light-for-romania-to-terminate-its-intra-eu-bilateral-investment-treaties/.

7 Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management, pp 1-3.

Ⅱ "Investment Courts"

One of the primary entrants in the field of alternative ISDS proposals is the Transatlantic Trade and Investment Partnership (TTIP), a contemplated arrangement between the United States and the European Union. While the proposal is on hold, and remains subject to change, the core ISDS features that have come to light are already worth discussing.

The TTIP proposal implements a version of ISDS that was designed to address certain criticisms that have been raised against the "traditional" model of ISDS that has grown organically out of the matrix of bilateral and multilateral investment treaties negotiated on an ad hoc basis between and among various State parties during the past half-century. The signature feature of this proposal is a departure from unfettered party-appointment of arbitrators in favor of a system that would create, in effect, a permanent court of potential arbitrators—for that reason, this proposal might be called the "Investment Courts" model.

The key procedural departures that the TTIP model makes from traditional ISDS are:

- **The restriction of parties' discretion to appoint arbitrators to selection from a predetermined list**. Under the TTIP proposal, instead of having the power to appoint any person as an arbitrator, parties must choose their arbitrators from a predetermined panel of 15 eligible appointees. This panel is to have enforced geographical diversity, with one third of its members hailing from the EU, one third from the United States, and one third from neither area. The State parties to the TTIP appoint panel members, and the TTIP proposal sets out ethical rules applicable to panel members.
- **The establishment of an appellate mechanism**. Traditional ISDS does not include any appeal mechanism other than, in the case of institutional rules such as those of ICSID, annulment procedures. Whereas annulment proceedings cannot review the merits of an award in any way, the appellate procedure set out in the TTIP proposal allows room for the appellate tribunal to disagree with the merits of the lower tribunal's award (albeit with a high standard of review).
- **The inclusion of transparency rules within the treaty itself**. One of the most prevalent criticisms of traditional ISDS is that although the cases involve issues of importance to the public, the public is not always able to get access to information about the proceedings. Unlike most investment treaties, the TTIP proposal would subject arbitral proceedings conducted pursuant to its text to transparency rules.

Together, these changes signify a move toward contracting States aiming to control the procedural features of ISDS through treaty language rather than leaving procedural matters to arbitral rulesets like

the UNCITRAL or ICSID rules. The emphasis on transparency and procedural constraints on decision-making suggest attention to the potential political importance and sensitivity of investor-State disputes.

The TTIP model has sparked considerable controversy. Most controversial of all has been the likelihood that its implementation would limit parties' discretion to select arbitrators.[8] This new feature of the TTIP model would have a particularly noticeable effect on investors, as the pools of potential arbitrators would have been limited in the first instance to candidates pre-selected by the State parties to the treaty.

Ⅲ The EU-Vietnam FTA: a variation on a theme

On 1 February 2016, the European Commission released to the public the text of the proposed free trade agreement between the European Union and the Socialist Republic of Vietnam.[9] What this release revealed was that the model of investor-State dispute settlement (ISDS) to be implemented in the EU-Vietnam FTA will be similar to the innovative but controversial model that has been proposed for the TTIP.

The similarity between the TTIP proposal and the EU-Vietnam FTA with respect to ISDS procedures suggests that, at least in broad strokes, the Investment Courts model found in the TTIP proposal may be the EU's preferred model going forward. It appears likely that future EU investment agreements will contain more detailed provisions relating to arbitral procedures.

The EU-Vietnam FTA adopts a similar approach. Each of the key procedural features from the TTIP proposal listed above (arbitrator choice restriction, appellate mechanisms, and transparency) can be found in the EU-Vietnam FTA as well, in substantially the same form. Where the two treaties differ on these points is at the margins—for instance, instead of a 15-member panel as set out in the TTIP proposal, the EU-Vietnam FTA calls for a nine-member panel.

All of the key procedural features of the TTIP proposal on ISDS can be found in the EU-Vietnam FTA. But, in some instances, the EU-Vietnam FTA goes into further detail than the TTIP proposal in prescribing arbitral procedures. Future EU investment treaties likely will reflect further variations in these and similar provisions.

- **Third party funding**. While both the TTIP proposal and the EU-Vietnam FTA include procedures requiring disclosure with respect to an investor's use of third party funding, the EU-Vietnam FTA goes slightly further in Article 11, requiring the tribunal to take the presence of third party funding into account when

[8] Louise Woods, *Fit for purpose? The EU's Investment Court System*, Kluwer Arbitration Blog, March 23, 2016 *available at* http://kluwerarbitrationblog.com/2016/03/23/to-be-decided/

[9] European Commission, *EU-Vietnam Free Trade Agreement: Agreed text as of January 2016*, February 1, 2016 *available at* http://trade.ec.europa.eu/doclib/press/index.cfm?id=1437

assessing requests for security for costs, and expressly tying the funded party's compliance with the disclosure requirements to the allocation of the costs of the arbitration.

- **Ethics**. The EU-Vietnam FTA's provisions regarding arbitrator ethics mirror those found in the TTIP proposal, except that the EU-Vietnam FTA additionally includes a procedure for removal of an arbitrator from the nine-member panel where there has been a breach of the treaty's ethics provisions.
- **Applicable law**. Both include provisions on applicable law and the role of domestic law in cases brought under the treaty, but the EU-Vietnam FTA's treatment of this issue diverges on the details. In particular, the EU-Vietnam FTA expressly provides that the tribunal will not have jurisdiction to determine the legality of a challenged measure as a matter of the domestic law of the State party to the proceedings.
- **Consultations**. While there are similarities with respect to claim initiation procedures, one key difference between the two is that the consultation process, optional under the proposed TTIP process, has been made a mandatory precondition for bringing a claim under the EU-Vietnam FTA. Potential claimants under the EU-Vietnam FTA are required to submit a request for consultations, and only after a subsequent 90-day period has elapsed may the claimant proceed to send a trigger letter notifying the dispute.

The EU-Vietnam FTA can be seen as a further step along the path forged by the TTIP proposal. The key features of the TTIP proposal are present, but, in general, the EU-Vietnam FTA goes slightly further, including additional procedural restrictions that apply principally to investors instead of States.

As in the TTIP proposal, there is a strong emphasis in the EU-Vietnam FTA on controlling the procedural features of ISDS proceedings through treaty text, as opposed to arbitral rulesets.

Ⅳ New models from the Japanese perspective

We turn then to the question of whether the features of this new model might be appropriate for Japan. To reiterate, at present, there has been no indication that Japan might pursue this model, either in its own bilateral treaties or in a future EU-Japan FTA. We might therefore begin by wondering why that would be.

It is clear enough that the Investment Courts model is driven by State (or public) concern that ISDS cedes too much power to claimant investors—that procedural features of the traditional ISDS model make it too easy for investors to win, or to bring claims without fear of public backlash. Leaving aside whether that fear is borne out in practice, the Investment Courts model focuses on changing procedural features of ISDS to reclaim some of that power for States. Thus, the investment courts model

gives States greater control over the composition of the arbitral tribunals that will be deciding cases, and also provides additional procedural tools to States to make the bringing of claims more difficult and costly.

However, the experience of ISDS in Japan has been a bit different from the experience of many other parts of the world. Although many western States have now had to grapple with investor claims, to date, there have been no known ISDS claims brought against Japan.[10] Foreign direct investment into Japan is low, and the Japanese government is stable and sophisticated, making the risk of a claim unusually low.[11] And, on the other hand, Japanese outward investment is high, with Japan being particularly reliant on resources from beyond its borders, and overseas investment in general.[12] Thus, it is natural that Japanese treaty negotiators would be focused on securing treaties that would be useful to Japanese investors abroad, and relatively less concerned with providing overly generous protection to foreign investors in Japan.

These factors may help to explain why the Investment Courts idea has not shown up in any Japanese treaties thus far. Of course, another possibility is that, whatever flaws it might have, the traditional model is not in need of such a drastic procedural overhaul. The introduction of investment courts and appellate procedures would come with the potential for increased costs to States as well, with benefits that would be far from immediate or obvious.

But that does not mean that Japan has nothing to learn from the TTIP and EU-Vietnam FTA proposals. One innovation that may be of particular interest to Japan is the integration of a consultations process (which, as noted above, the EU-Vietnam FTA proposal would make mandatory). Historically, treaty-based requirements that investors negotiate in good faith with the host State have not been given rigid effect, with tribunals routinely finding that technical noncompliance with a waiting period (particularly when negotiations would have been futile) should not render a claim inadmissible. Formalizing consultation requirements could be a way for Japan to deter less meritorious claims against it, while not significantly hurting its own outward investors; in practice, Japanese investors may often prefer to negotiate an amicable solution in any event,[13] so a formal consultations requirement might indeed be a boon to them.

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[10] Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management, pp. 2, 11.

[11] Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management, p. 11.

[12] Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management.

[13] Jonathan T. Stoel, Tomoko Ishikawa and Michael Jacobson, *Japan's Ambitious International Investment Agreement Policy – Laying the Groundwork for Future Disputes?* (2015) 12 (1) Transnational Dispute Management, pp 18-19.

Conclusion

With the TPPA on hold, or perhaps gone, the future of ISDS in Asia has become somewhat less certain than before. It is unlikely that the vacuum created by the current setbacks to the TPPA will persist: something (or perhaps many smaller things) will take the TPPA's place. Japan will be in a strong position to influence the shape of ISDS in the Asia for the future, and should carefully consider whether to hew to the traditional model, adopt features of the new models that have been considered, or forge ahead with something altogether different.