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Investment Protection in the UK-Japan Comprehensive Economic Partnership Agreement (CEPA)

More than it Seems

David COLLINS*

- I Introduction
- II Main Investment Liberalisation Provisions
- III Additional Investment Provisions
- IV Exceptions
- V Dispute Settlement
- VI Conclusion

I Introduction

The Comprehensive Economic Partnership Agreement (CEPA) between the United Kingdom (UK) and Japan went into force on 1 January 2021. Conclusion of a Free Trade Agreement (FTA) between the world's third and fifth largest economies was a key moment for global economic relations. The CEPA is also the UK's first new trade

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The article reviews the investment provisions of the UK-Japan Comprehensive Economic Partnership Agreement (CEPA) contained in the agreement's services and investment liberalisation chapter. Although CEPA does not contain standard investment protections found in conventional investment treaties, there are numerous advantageous commitments on investment liberalization, enhancing market access by removing some of the key legal barriers to the entry of foreign firms. Further progress in promoting Foreign Direct Investment (FDI) between the parties, for example by the inclusion of investor-state dispute settlement (ISDS), currently missing from CEPA, may be forthcoming in future negotiations or will be achieved when the UK accedes, with Japan's likely support, to the Comprehensive Progressive Agreement on Trans-Pacific Partnership (CPTPP).

deal as an independent nation following its exit from the European Union (EU) at the end of 2019, although it is substantially similar to the earlier Japan-EU Economic Partnership Agreement (JEEPA). The CEPA consists of 24 Chapters covering conventional trade matters such as tariff reductions on goods, the minimization of non-tariff barriers like health and safety regulations, disciplines on trade remedies, intellectual property and regulatory cooperation.

As with most modern FTAs, the CEPA also has a chapter on investment. However, unlike equivalent chapters in new or second-generation FTAs as well as classic Bilateral Investment Treaties (BITs), the investment provisions of the CEPA are fairly weak. The investment commitments in the CEPA do not set out conventional investment protection standards – instead they aim to liberalize market access for investment much in the manner as the agreement does for services. The lack of clear articulation of investment protection standards is thought to suggest that the CEPA can only serve as an *accord de principe*, mirroring the characteristics of a framework agreement.¹⁾ Some view the omission of fuller investment protections as a missed opportunity for both parties.²⁾

Still, the agreement does achieve much in the way of investment liberalisation, exceeding that available under the World Trade Organization (WTO) and in some cases the JEEPA. This article will examine the investment provisions of the CEPA, found in Chapter 8 on ‘Services and Investment Liberalisation.’ It will note where the agreement essentially restates protections which already exist under WTO rules and where, in many places, these are improved upon, reducing some of the major barriers associated with Foreign Direct Investment (FDI). Along with the UK-EU Trade and Cooperation (TCA) finalized in late 2020, the CEPA provides some assurance for Japanese investors who had been understandably apprehensive about maintaining access not only to the UK’s market but as a route into the EU from their base in the UK.

1) Naimeh Masumy and Munia El Harti Alonso, ‘The UK-Japan CEPA Investment Protection Standards: A Glass Half Full?’ Kluwer Arbitration Blog (25 February 2021).

2) Minako Morita Jaeger and Yohannes Ayele, ‘The UK-Japan Comprehensive Economic Partnership Agreement: Lessons for the UK’s future trade agreements’ Sussex Blog, Briefing Paper 50 (December 2020).

II Main Investment Liberalisation Provisions

The distinction between investment liberalisation and protection must be drawn in order to appreciate the significance of the investment provisions contained in the CEPA. Liberalisation concerns the removal of legal barriers to market entrance placed on foreign firms whereas protection typically involves formal safeguards for foreign firms already present in the host state which may suffer from targeted attacks by the government in the form of excessive regulations. It is the latter elements, captured by such standards as Fair and Equitable Treatment and Full Protection and Security as well as guarantees against expropriation without compensation, which are missing from the CEPA, and which distinguishes it from conventional investment treaties. Investment liberalisation, as in market access, is provided for in Article 8.7 as follows:

A Party shall not maintain or adopt, with regard to market access through establishment or operation by an entrepreneur of the other Party or by a covered enterprise, either on the basis of a territorial subdivision or on the basis of its entire territory, measures that:

(a) impose limitations on: (i) the number of enterprises, whether in the form of numerical quotas, monopolies, exclusive rights or the requirements of an economic needs test; (ii) the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (iii) the total number of operations or the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; (iv) the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; or (v) the total number of natural persons that may be employed in a particular sector or that an enterprise may employ and who are necessary for, and directly related to, the performance of the economic activity in the form of numerical quotas or the requirement of an economic needs test; or

(b) restrict or require specific types of legal entity or joint venture through which an entrepreneur of the other Party may perform an economic activity.

Those familiar with WTO law will recognise that this section has been copied, virtually verbatim, from Article XVI of the WTO General Agreement on Trade in Services (GATS) in relation to trade in services, of which Mode 3 commercial presence constitutes FDI. The significance of these obligations must not be understated. The kinds of quantifiable restrictions noted above represent serious impediments to firms seeking to internationalize. Article 8.7 b), which does not appear in GATS, is particularly important because it precludes the formation of business partnerships which might lack genuine commercial purpose, and which could ultimately lead to the harmful transfer of intellectual property or other trade secrets.

In addition to market access, the CEPA investment chapter achieves the liberalisation of foreign investment through guarantees against discrimination on the basis of an enterprise's nationality – a common feature in most traditional BITs. The National Treatment obligation is found in Article 8.8:

1. Each Party shall accord to entrepreneurs of the other Party and to covered enterprises treatment no less favourable than that it accords, in like situations, to its own entrepreneurs and to their enterprises, with respect to establishment in its territory.

2. Each Party shall accord to entrepreneurs of the other Party and to covered enterprises treatment no less favourable than that it accords, in like situations, to its own entrepreneurs and to their enterprises, with respect to operation in its territory.

Article 8.8.1 also facilitates market access in that it enables the establishment of a foreign firm (the setting up of business) on equal legal footing to that of a local one. Coverage of the establishment stage under National Treatment is rare in investment treaties which normally only protect investments once they have entered the host state and begun trading. Article 8.8.2 grants what might accurately be termed 'protection' because it speaks of the 'operation' of an enterprise, meaning the ongoing business of an already present firm – the more conventional scope of National Treatment in historic BITs. Under this provision, any regulations affecting the running of foreign businesses must be

no more onerous than those affecting domestic businesses, as long as they are in like situations.

Also on non-discrimination as a component of liberalisation, Article 8.9 contains the investment chapter's Most Favoured Nation (MFN) provision:

1. Each Party shall accord to entrepreneurs of the other Party and to covered enterprises treatment no less favourable than that it accords, in like situations, to entrepreneurs of a third country and to their enterprises, with respect to establishment in its territory.
2. Each Party shall accord to entrepreneurs of the other Party and to covered enterprises treatment no less favourable than that it accords, in like situations, to entrepreneurs of a third country and to their enterprises, with respect to operation in its territory.
3. Paragraphs 1 and 2 shall not be construed as obliging a Party to extend to entrepreneurs of the other Party and to covered enterprises the benefit of any treatment resulting from:
(a) an international agreement for the avoidance of double taxation or other international agreement or arrangement relating wholly or mainly to taxation; or (b) existing or future measures providing for recognition of qualifications, licences or prudential measures ...

The comments above regarding the establishment and operation stage respectively apply equally to the MFN provision, with the repeated observation that guarantees against non-discrimination in the establishment stage are rare in BITs, illustrating the advantage of the CEPA to prospective investors. While the exclusion of MFN from double taxation treaties is a common feature of investment agreements, reference to mutual recognition agreements is less typical. Discounting the application of MFN for arrangements to recognize certain kinds of qualifications is necessary to facilitate these negotiations typically occur on a sectoral basis and involve the input of relevant professional bodies. Since qualifications are often highly jurisdiction-sensitive (for example for legal services providers³⁾) it would be difficult to extend such recognition to service suppliers from other countries automatically through the CEPA. Lastly, it should be noted with respect to MFN, as well as National Treatment and Market Access, that the CEPA

takes a negative list approach to services liberalisation, unlike GATS's positive list format; the list of services which cannot satisfy the UK and Japan's commitments in these areas are listed as a reservation in an Annex to the agreement.

III Additional Investment Provisions

One of the most important safeguards for UK and Japanese investors under the CEPA is in Article 8.10 on senior management in which it is stated that parties 'shall not require a covered enterprise to appoint individuals of any particular nationality as executives, managers or members of boards of directors.' This obligation, found in some modern FTAs but less so in older generation BITs, can be instrumental in ensuring the smooth functioning of an international business under the direction of the most experienced leaders, irrespective of their nationality. Many countries maintain such restrictions, listing them in their GATS Schedule of Specific Commitments.⁴⁾

CEPA's prohibition of performance requirements, which are conditions placed on firms in order for them to be permitted to trade within the host state's territory, are extensive, going well beyond those contained in the WTO Trade-Related Investment Measures Agreement (TRIMs) and most BITs which tend merely to replicate the TRIMs. It is worth repeating CEPA Article 8.11 in its entirety:

1. A Party shall not impose or enforce any of the following requirements or enforce any commitment or undertaking, in connection with the establishment or operation of any enterprise in its territory:

(a) to export a given level or percentage of goods or services;

3) See further, David Collins, *The Public International Law of Trade in Legal Services* (Cambridge University Press, 2018).

4) E.g. The Canadian province of Ontario requires that the majority of directors of Ontario corporations must be resident Canadians, GATS/SC/16 Canada - Schedule of Specific Commitments, 8.

- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services supplied in its territory, or to purchase goods or services from natural or juridical persons or any other entity in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such enterprise;
- (e) to restrict sales of goods or services in its territory that such enterprise produces or supplies by relating those sales in any way to the volume or value of its exports or foreign exchange inflows;
- (f) to restrict exportation or sale for export;
- (g) to transfer technology, a production process or other proprietary knowledge to a natural or juridical person or any other entity in its territory;
- (h) to locate the headquarters of such enterprise for a specific region or the world market in its territory;
- (i) to hire a given number or percentage of its nationals;
- (j) to achieve a given level or value of research and development in its territory;
- (k) to supply one or more of the goods produced or services supplied by the enterprise to a specific region or to the world market exclusively from its own territory;
- (l) to adopt: (i) a rate or amount of royalty below a certain level; or (ii) a given duration of the term of a licence contract; with regard to any licence contract in existence at the time the requirement is imposed or enforced, or any commitment or undertaking is enforced, or with regard to any future licence contract freely entered into between the enter-

prise and a natural or juridical person or any other entity in its territory, if the requirement is imposed or enforced or the commitment or undertaking is enforced, in a manner that constitutes a direct interference with that licence contract by an exercise of non-judicial governmental authority of a Party.

With these controls in place, foreign firms are able to trade in the manner which they see fit for the purposes of profit maximization, serving the market in a manner that is free from the distortions associated with some of the policies above, such as mandatory local content use.⁵⁾ Perhaps most noteworthy of these prohibitions is g) on technology transfer. While the UK and Japan are both technologically advanced economies, 'forced' technology transfer imposed by host state governments can be significantly damaging to a firm's competitive position. While technology transfer is encouraged by the WTO for investors operating in developing countries,⁶⁾ in the context of two developed countries, it is a practice which is counterproductive to fostering increased FDI.⁷⁾

The next section of Chapter 8 considers the equally important topic of investment incentives, which are essentially unregulated by international law.⁸⁾ Article 8.11.2 prohibits the UK or Japan from conditioning an investment incentive (designed to attract the foreign firm into the host state's territory, such as a tax break) on the recipient firm engaging in various kinds of trade-distortive conduct.

A Party shall not condition the receipt or continued receipt of an advantage, in connection with the establishment or operation of any enterprise in its territory, on compliance with any of the following requirements:

- (a) to achieve a given level or percentage of domestic content;

5) David Collins, *Performance Requirements and Investment Incentives under International Economic Law* (Elgar, 2015).

6) Trade Related Aspects of Intellectual Property (TRIPS) Agreement, art 66.2.

7) Julia Ya Qin, 'Forced Technology Transfer and the US-China Trade War: Implications for International Economic Law' (2019) 22:4 *Journal of International Economic Law* 743.

8) Collins, above n 5.

(b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from natural or juridical persons or any other entity in its territory;

(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such enterprise;

(d) to restrict sales of goods or services in its territory that such enterprise produces or supplies by relating those sales in any way to the volume or value of its exports or foreign exchange inflows;

(e) to restrict exportation or sale for export.

These kinds of conditions are rightly considered economically harmful because they compel the investor to engage in commercial practices which would be otherwise against its interest, advantaging domestic companies in the process and ultimately harming consumers. In contrast, investment incentives which are benign are expressly permitted by Article 8.11.3:

Nothing in paragraph 2 shall be construed as preventing a Party from conditioning the receipt or continued receipt of an advantage, in connection with the establishment or operation of any enterprise in its territory, on compliance with a requirement to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

These kinds of conditions are considered to be socially beneficial because they can address economic under-performance of certain regions, unemployment and spur the development of new technologies, which while possibly non-profit generating in the short term, could yield significant positive externalities for society at large over time.

Some additional advantages are accorded to foreign investors under other parts of the CEPA, including the latter part of Chapter 8 on services which permits the entry and stay of natural persons for business purposes.⁹⁾ This enables foreign firms to hire

the best individuals rather than those which are available in the host state. This aspect of the CEPA is one which exceeds that of the JEEPA. For example, the definitions of ‘intercorporate transferees’ and ‘investors’ are clarified in the CEPA with specific references to UK law and Japanese law. Under the CEPA, the UK also expanded its schedule of ‘Business visitors for establishment purposes, intra-corporate transferees, investors and short-term business visitors’¹⁰⁾ and matched Japan’s commitment for visa procedures to take no longer than 90 days.¹¹⁾ It can be expected that these commitments should help encourage FDI between the parties.

Additionally, CEPA Chapter 9 on Capital Movements contains a provision which states that each party shall allow, with regard to transactions on the capital and financial account of the balance of payments, the free movement of capital for the purpose of liberalisation of investments and other transactions.¹²⁾ Without this provision, which is common to most BITs, foreign firms would not be able to send their profits back to their shareholders in the home state, rendering the purpose of internationalization futile. Since both the UK and Japan have liberal policies towards capital movement it is unlikely that this obligation would ever be needed but its presence is telling in that it underscores the parties’ commitment to a fully open economy.

IV Exceptions

Preservation of signatories’ ability to enact public policy regulations which may otherwise interfere with foreign investment is outlined in Article 8.1.2.

For the purposes of this Chapter, the Parties affirm their right to adopt within their territories regulatory measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer

9) CEPA art 8.20.

10) CEPA Annex III, Schedule of the United Kingdom.

11) CEPA Annex 8-C.

12) CEPA art 9.2.1.

protection or the promotion and protection of cultural diversity.

Such 'right to regulate' provisions are now common in investment chapters of modern FTAs¹³⁾, essentially capturing the customary international law Police Powers Doctrine¹⁴⁾, which enables states to take actions which would otherwise be construed as wrongful where there is a legitimate reason, such as the safeguarding of public health. Clearly the UK and Japan, both currently recovering from the Covid-19 pandemic, recognize that there are social concerns which have greater importance than increases in FDI.

The services and investment chapter further contains General Exceptions (Art 8.3) which expressly incorporates Article XX of the General Agreement on Tariffs and Trade (GATT) and then goes on to repeat the familiar General Exceptions provisions of the GATS, almost verbatim in Art 8.3.2:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on establishment or trade in services, nothing in [the investment chapter] shall be construed as preventing a Party from adopting or enforcing measures which are:

- (a) necessary to protect public security or public morals or to maintain public order;
- (b) necessary to protect human, animal or plant life or health;
- (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Chapter including those relating to: (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on contracts; (ii)

13) E.g. the Canada-EU Comprehensive Economic Partnership Agreement art 8.9.1.

14) Catharine Titi, 'Police Powers Doctrine and International Investment Law' in Filippo Fontanelli, Andrea Gattini and Attila Tanzi (eds) *General Principles of Law and International Investment Arbitration* (Brill, 2018) 323-343.

the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts.

A footnote to this section clarifies that the public security and public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society, which replicates language of the customary international law defence of necessity outlined in Article 25 of the Articles on Responsibility of States for Internationally Wrongful Acts of 2001. This exception has particular urgency as countries continue to grapple with Covid-19.

Lastly on exceptions, CEPA's investment chapter also contains a Denial of Benefits clause. Article 8.13 enables a party to deny the benefits of the chapter to an investor of the other party if the investor is owned or controlled by a natural or juridical person of a third country and the denying party adopts measures with respect to the third country that are related to the maintenance of international peace and security, including the protection of human rights. Again, this provision reflects the parties' prioritisation of humanitarian causes over the promotion of FDI.

V Dispute Settlement

There is no special dispute settlement mechanism provided for investments in the CEPA – a departure from the classic BIT and indeed the investment chapters of many modern FTAs, such as the Canada-EU Comprehensive Economic and Trade Agreement (CETA).¹⁵⁾ In particular, there is no Investor-State Dispute Settlement (ISDS) – the procedure by which investors can bring legal claims directly against host states through international arbitration without instigating diplomatic protection. ISDS is now highly controversial, with many commentators observing that it illegitimately restrains judicial sovereignty and that large compensation awards by investment tribunals inflict a chilling effect on regulation which may serve a public purpose.¹⁶⁾ The lack of ISDS in

15) CETA Chapter 8, Section F.

the CEPA reflects the UK's reluctant to establish a policy on the use of ISDS, quite possibly because it is so contentious. It is noteworthy that ISDS is also absent from the JEEPA.

The UK (and Japan's) unwillingness to take a stance on ISDS is captured in Article 8.5.3 of CEPA, which sets out a procedure by which the parties may agree to commit to ISDS at some point in the future:

If, after the date of entry into force of this Agreement, a Party signs an international agreement with an investment chapter that contains provisions for investment protection or provides for investor-to-state dispute settlement procedures, the other Party, after the date of entry into force of that agreement, may request that the Parties review this Section... Such a review shall be conducted with a view to the possible inclusion within this Agreement of such provisions that could provide for the improvement of the investment environment. Unless the Parties otherwise agree, any such review shall be commenced within two years from the date of the request and shall be concluded within a reasonable period of time.

Apprehension over the imposition of the ISDS procedure through back-handed means is addressed in the investment chapter's MFN provision (Art 8.9.4) which clarifies that it does not include investor-to-state dispute settlement procedures provided for in other international agreements. This effectively prevents an investor from claiming that ISDS found in another of the parties' treaties¹⁷⁾ constitutes 'better treatment' thereby activating it in the context of a CEPA investment claim.

While the lack of ISDS in the CEPA does mean that the investment commitments are not enforceable by either Japanese or UK investors, at least in international tribunals, this does not mean that they are not enforceable in international tribunals by the parties themselves. CEPA's general state-to-state arbitration procedure, outlined in

16) One of the first authors to observe this was Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007). Much of the subsequent deluge of literature on the topic is a derivation of his thesis.

17) E.g. UK-Hong Kong art 8 (30 July 1998).

Chapter 22, applies to the investment chapter. It is worth recalling here that use of state-to-state mechanisms for the bringing of investment claims, in contrast to direct claims by investors, is often cited as a progressive step in the resolution of international investment disputes.¹⁸⁾

VI Conclusion

The CEPA contains a number of provisions designed to help encourage FDI between the UK and Japan by eliminating some of the main barriers to entry of foreign firms and by ensuring non-discrimination in the application of laws. There are also robust commitments to prohibit performance requirements and other distortive conditions on investment incentives. As with most FTAs, there are wide exceptions for public policy, as to be expected of the liberally minded parties in the modern progressive era. Still, the lack of a full investment protection regime along the lines of a conventional BIT coupled with the absence of the ISDS render the CEPA something of a missed opportunity for the UK and Japan to enact a genuinely comprehensive agreement, setting the direction of travel for the UK's future trade policy. These shortcomings are in contrast to some of the more ambitious new generation FTAs, such as the Comprehensive Progressive Trans-Pacific Partnership (CPTPP), an 11-nation trade agreement of which Japan is a founding member and which the UK aspires to join. CEPA's limited coverage for investment more closely resembles the approach adopted by the UK in the UK-EU Trade and Cooperation Agreement (CPA) which also lacks substantive protections and ISDS¹⁹⁾, suggesting that this may be the model which the UK adopts for investment chapters of its future FTAs, such as those with Australia and New Zealand. For those who remain highly critical of ISDS and the pro-investor slant of international in-

18) See e.g. Nathalie Bernasconi-Osterwalder, 'State-State Dispute Settlement in Investment Treaties' International Institute for Sustainable Development (October 2014).

19) See e.g. David Collins, 'Foreign Investment under the UK-EU Trade and Cooperation Agreement: Mitigating Punctuated Equilibrium in Legal Economic Dis-Integration' (2021) 18:1 Manchester Journal of International Economic Law 50-69.

vestment law generally, the light-touch approach of the CEPA to investment protection may be a welcome move towards progressivism.

Rather than a deliberate policy aversion to strong investment protections, the limited investment protections offered by the CEPA may indicate that the parties intend to review the CEPA to include investment protection in the future, or otherwise may pave the way for the parties to negotiate a separate investment treaty at a later stage.²⁰⁾ In this regard it is noteworthy that Article 8.4 establishes a Committee on Trade in Services, Investment Liberalisation and Electronic Commerce for the purposes of cooperation, anticipating future progress in these vital areas. It is important to acknowledge that should the UK succeed in its ongoing accession negotiations to the CPTPP, which seems likely,²¹⁾ then UK and Japanese investors will benefit from the full investment protections contained in that instrument, precluding the need to rely on the investment chapter of the CEPA and rendering future discussions in that area moot.²²⁾

While some commentators have derided the UK in particular for its lack of ambition in the investment elements of the CEPA²³⁾, the non-inclusion of strong investor protections in the UK-Japan CEPA, in line with a conventional BIT, may equally reflect the high level of mutual trust between the two parties. It may be that the UK and Japan simply do not believe that each other's investors are at risk of undue interference by their respective governments and that, should this take place, their domestic judicial systems are more than adequate to respond to any associated grievances. It goes without saying that both countries have highly skilled and independent courts committed to the rule of law²⁴⁾ as well as belief in the principles of free markets and benefits of open competition. There is no need to fix what isn't broken.

20) Masumy and El Harti Alonso, above n 1.

21) A ministerial side letter to CEPA essentially confirms Japan's 'firm determination' to support the UK's accession to the CPTPP.

22) For example, the CPTPP contains Fair and Equitable Treatment and Full Protection and Security standards of protection: Art 9.6.1.

23) E.g. Lance J. Miller, Edward Mears and Keitaro Uzawa, 'UK-Japan CEPA' DLA Piper (7 December 2020) and Morita Jaeger and Ayele above n 2.

24) The UK and Japan rank 16th and 15th respectively out of 139 countries in the World Justice Project's Rule of Law Index 2021: <<https://worldjusticeproject.org/rule-of-law-index/>>.