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THE EU-JAPAN ECONOMIC PARTNERSHIP AGREEMENT: A DIFFERENT KIND OF TREATY?

On 17 July 2018, the European Union and Japan signed the *Agreement between the European Union and Japan for an Economic Partnership* (**EU-Japan EPA**). The EU-Japan EPA provides for wide-reaching economic liberalisation measures between the EU and Japan, most notably in the elimination or reduction of a significant number of tariffs and non-tariff barriers. In this regard, the EU-Japan EPA sends a signal that the EU and Japan remain committed to free trade, in contrast to some other major trading nations where protectionism is on the rise. The EU-Japan EPA is also notable for its approach to investment, containing "*liberalisation*" measures which are framed in language that is quite different to other treaties concluded in recent years. In addition, the absence of any investor-State dispute settlement (**ISDS**) mechanism raises the question of whether traditional ISDS provisions will ever be included in future EU treaties and, if they are not, what steps Japanese investors should take to protect their investments into the EU.

Key issues

- The EU-Japan EPA provides for wide-reaching elimination or reduction of tariffs.
- While the EPA contains some substantive investment protections, these are far narrower in scope than we would ordinarily expect in similar free trade and investment agreements.
- The EU-Japan EPA uses the terms "*entrepreneur*" and "*covered enterprise*" as opposed to "*investor*" and "*covered investment*". This is unusual and has legal consequences.
- The EU-Japan EPA currently contains no investor-State dispute settlement mechanism, although the EU has indicated one may be incorporated in future in the form of an "*investment court*".

OVERVIEW

The EU-Japan EPA is wide-ranging and ambitious in its promotion of free trade. It sets out a blueprint to eliminate or reduce tariffs on an extensive range of goods flowing between Japan and the EU, including food, wine and beer, motor vehicles, medical devices, and pharmaceuticals. The EPA is expected to come into force towards the end of 2019. Prime Minister Abe made the policy goals of this major trade agreement clear when he remarked: "*Japan and the EU are demonstrating our strong political will to fly the flag for free trade against a shift toward protectionism.*"

In addition to provisions on tariffs and other trade barriers, Chapter 8, Section B of the EU-Japan EPA also contains a number of investment protections (or, to use the terminology adopted in the treaty, investment "*liberalisation*" measures). These provisions are designed to increase the flow of foreign investment between the EU trading bloc and Japan. As discussed below, the express protections mainly relate to market access and are far narrower than the protections offered under similar trade and investment agreements. The EU-Japan EPA also contains novel language that signals a shift away from traditional drafting. Crucially, the treaty's investment provisions lack "*teeth*" because the provisions of the investment section are not enforceable via any kind of ISDS mechanism.

THE SCOPE OF THE INVESTMENT LIBERALISATION CHAPTER

Chapter 8, Section B of the EU-Japan EPA is titled "*Investment Liberalisation*". It must be read in conjunction with the preamble to the EPA which records that Japan and the EU intend to strengthen "*trade and investment between them*".

However, discarding the usual language of investment treaties — which provide protection for "*investors*" and "*covered investments*" — the investment liberalisation measures in the EU-Japan EPA apply only to EU and Japanese "*entrepreneurs*" and *"covered enterprises*". Under Article 8.2, "*entrepreneur*" means "*a natural or juridical person of a Party that seeks to establish, is establishing or has established an enterprise in accordance with subparagraph (i), in the territory of the other Party*". Superficially, this definition is similar to the definition of "*investor*" in other EU and Japanese trade and investment treaties. For example, the Japan-India EPA defines an investor as "*a natural person or an enterprise of a Party, that seeks to make, is making, or has made, investments*". But there is a major substantive difference: the definition of "*entrepreneur*" in the EU-Japan EPA relates only to establishment of an enterprise, not to the making of an investment.

The definition of "c*overed enterprise*" makes this limitation explicit. Unlike the broad definitions of investment that feature in other similar treaties, "*covered enterprise*" is defined as "*an enterprise in the territory of* [Japan or the EU] *established* […] *directly or indirectly, by a* [Japanese or EU] *entrepreneur*" (and "*enterprise*" means "*a juridical person or branch or representative office*") (emphasis added). So, the definition is a long way from the usual "*covered investment*", which, for example, is defined widely in the EU-Canada Comprehensive Economic and Trade Agreement (**CETA**) to include not only an enterprise but also, amongst other things, shares, loans, contractual rights, IP, licences and property. A "*covered enterprise*" under the EU-Japan EPA may not extend to these kinds of investments.

The use of these terms reflects what is likely to have been a cautious choice by the EU delegates (with the acceptance of Japan) to avoid using the terms "*investor*" and "*investment*" (so as to dampen the potential for controversy that may arise from the conflation of those terms with ISDS). The terms used in the EU-Japan EPA are also novel from an international investment law perspective. While other investment treaties, such as the Trans-Pacific Partnership Agreement (**TPP11**) make reference to the term "*enterprise*" in the definition of "*investor*" and "*investment*", there is no other treaty that uses the terms "*entrepreneur*" and "*covered enterprise*" in the same way as the EU-Japan EPA.

Further, for the reasons above, it would be difficult to argue that the EU and Japan intended the words "*entrepreneur*" and "*covered enterprise*" to have the same meaning as "*investor*" and "*covered investment*". Consequently, the relatively mature body of international jurisprudence regarding the meaning of the latter terms would arguably not apply to the former. Disputes about whether, for example, an investment in an unincorporated joint venture arrangement with a local business would amount to a "*covered enterprise*" will need to be decided according to the terms of the EU-Japan EPA and in light of its specific context (unless and until these terms are deployed in other treaties).

THE INVESTMENT LIBERALISATION PROVISIONS

The EU-Japan EPA contains the following investment liberalisation measures:

- liberalisation of market access (Article 8.7), which, among other things, prohibits the EU and Japan from imposing restrictions on the number of EU and Japanese businesses operating in the host State. It also prohibits the imposition of shareholding limits and the prescription of particular corporate structures for covered enterprises;
- national treatment for EU and Japanese entrepreneurs (Article 8.8), which requires the EU and Japan to treat foreign entrepreneurs no less favourably than its own nationals;
- a most-favoured nation (**MFN**) clause (Article 8.9), which requires the EU and Japan to treat EU and Japanese entrepreneurs no less favourably than they treat foreign entrepreneurs from other jurisdictions;
- a prohibition on the EU and Japan imposing nationality requirements for senior management and boards of directors of businesses established by EU and Japanese entrepreneurs (Article 8.10); and
- a prohibition on performance requirements (Article 8.11), which includes prohibition on the imposition of export restrictions or requirements to achieve a certain percentage of domestic content (for example to hire a given number of Japanese or EU nationals).

These investment liberalisation measures are relatively limited. Further, Article 8.12 contains a number of exceptions. The investment protections we see in similar trade and investment agreements, such as prohibitions on unlawful expropriation and requirements to accord foreign investors fair and equitable treatment (**FET**) are notably absent (these standard protections are present in almost every other Economic Partnership Agreement signed by Japan and many by the EU).

The absence of these standard protections raises the question of whether they could be imported into the EU-Japan EPA through the MFN clause of the treaty. There is no clear-cut answer to this question. Textually, it is debatable whether rights in other treaties granted expressly to "*investors*" and in respect of "*covered investments*" could be imported into the EU-Japan EPA to protect "*entrepreneurs*" in respect of their "*covered enterprises*".

NO RECOURSE TO INVESTOR-STATE DISPUTE SETTLEMENT

Given that it does not provide substantive investment protections, it is unsurprising that the EU-Japan EPA does not contain ISDS. Nevertheless, it is noteworthy that the light-touch nature of the investment protection chapter has gone hand-in-hand with the complete absence of a dispute resolution mechanism. In other words, where the protections are more powerful, it would make more sense to have greater caution around ISDS risk from the contracting parties. However, in this case, there is comparatively little in the way of protection and nothing in terms of an ISDS mechanism for enforcement.

The current policy of the EU goes a long way to explain the absence of ISDS in this treaty. For example, the European Commission has publicly declared in a factsheet on the EU-Japan EPA that "[f]*or the EU ISDS is dead*". The same fact sheet notes "*a new system — called the Investment Court System, with judges appointed by the two parties to the FTA and public oversight — is the EU's agreed approach that it is pursuing from now on in its trade agreements. This is also the case with Japan*". Perhaps then, the investment protections in this new treaty will be revisited once the investment court system (which in embryonic form is incorporated into the EU-Canada CETA) becomes more of a reality. This is certainly the impression given by the EU's FAQ page on the EU-Japan EPA which states that "[t]*he EU is committed to integrating its new approach to investment protection and dispute resolution — an investment court system — in all its new trade agreements. The investment court system would create a more predictable environment for investors*". Taking this policy into account, insofar as it relates to investment, the investment chapter of the EU-Japan EPA might be viewed as more of an interim arrangement than a final deal.

Nevertheless, it is somewhat surprising that Japan accepted the investment liberalisation provisions in the EU-Japan EPA as they stand. Japan's investment treaties are usually robust, with comprehensive investment protection provisions backed up with an ISDS mechanism. There has not been the same opposition to ISDS in Japan as there has been in the EU. Indeed, Japan has entered into multiple treaties containing ISDS mechanisms in the last few years (examples include Japan's 2015 EPAs with Kazakhstan, Columbia and Ukraine). At the multilateral-level, Japan has also signed up to the TPP11 which contains a comparatively robust investment protection regime.

The majority of Japan's ISDS-inclusive EPAs are with developing (so-called "*southern*") countries. While it is sometimes argued that ISDS provisions are not needed in investment treaties between developed countries (so-called "*north-north*" agreements), multi-national entities such as the EU are less suited to binary north/south classification. The 27 nations within the EU display a wide range in sovereign risk, with some EU countries — particularly newer members — having relatively high sovereign risk. Indeed, a number of EU Member States are currently facing multiple ISDS claims. Some might argue, therefore, that ISDS-backed investment protection is still necessary to promote and protect Japanese investment in the bloc. However, the EU-Japan EPA does not even contain the "*investment court system*" that the EU included in its recent trade and investment agreements with Canada and Vietnam. It is possible that Japan was not ready to accept such a radical, and potentially pro-State, alternative to the existing arbitration-based ISDS framework. Instead Japan may have preferred to effectively leave a placeholder for the issue of investment and focus on the trade aspects of the pact (with investment to be revisited another day). In any event, notwithstanding its entry into the EU-Japan EPA, there is no evidence to suggest that Japan will cease to push for robust ISDS-backed investment protections for its businesses in its negotiations with other countries, southern and northern.

In the meantime, access to enforceable investment protections for Japanese and EU investors investing in each other's territories is limited and this is not likely to change in the near term. As the UK is constantly reminding us, under EU rules it is not possible for EU Member States to separately negotiate trade and investment treaties with third countries such as Japan. That said, there is the Energy Charter Treaty to which Japan, the EU and all its Member States are parties. While the protections of the Energy Charter Treaty are obviously limited to the energy sector, they are broad in application to that sector and generally enforceable through investor-state arbitration. Indeed, at present, there are three separate investment arbitrations being brought by Japanese investors against the Kingdom of Spain under the Energy Charter Treaty, each of which concern Spanish law reforms on renewable

energy generation (there being 40 claims in total against Spain in this regard).

CONCLUSION

While investors may be disappointed by the narrow scope of the investment liberalisation provisions in the EU-Japan EPA, and concerned by the lack of an investor-State dispute settlement mechanism, the absence of such protections is the result of the specific context in which the treaty was negotiated. First, the EU — being a unique supranational entity in its own right — does not find it easy to sign up to treaties allowing for the EU and all its Member States to be sued. Second, despite the breadth of its preamble, trade is the clear focus of the EU-Japan EPA and it seems likely that its conclusion was expedited to send a message to the world (particularly in the context of current US trade policies). Third, the EU cannot proclaim that ISDS is "*dead*" while signing up to a treaty allowing for investment arbitration. Until the concept of the so-called investment court system is more fully developed, the EU and its Member States will not be in a political position to negotiate meaningful investment protections with other countries.

In these circumstances, it is legitimate to question why the EU and Japan bothered to include the "*Investment Liberalisation*" section at all. Only the negotiators concerned know the answer to this question. But based on their respective treaty practises, and considering statements they have each made, it seems reasonable to conclude that the EU (and Japan) are not opposed to investment protection in principle. Rather, it is apparent that, at least in the EU, the issue of ISDS has become so highly politicised that the most that can be achieved in the present environment is to pay lip-service to the rights of foreign investors and extend limited assistance to "*entrepreneurs*". However, if the EU wishes to make those rights meaningful, it will need to hurry up with establishing a workable investment court. In the meantime, what appears to be an interim regime for investment in the EU-Japan EPA, will remain "*toothless*". In this context, Japanese investors need to give careful consideration to how they structure their investments into the EU, so as to ensure they have the ISDS-backed protections that, until recently, have been offered by most trade and investment treaties. This structuring exercise should be carried out at the beginning of the investment, but it may be done later so long as the investor is not already in dispute with its host Government or reasonably expecting such a dispute to arise.

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