# THE ASIA-PACIFIC ARBITRATION REVIEW 2016


Published by Global Arbitration Review
in association with

Nagashima Ohno & Tsunematsu

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The international journal of commercial and treaty arbitration

www.globalarbitrationreview.com

# Japan

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### On the verge of the TPP deal

It was more than half a century ago when Germany introduced a policy to use international investment agreements (IIAs) to facilitate foreign investment by German companies and entered into the first bilateral investment treaty (BIT) with Pakistan. Following the German initiative, the International Centre for Settlement of Investment Disputes (ICSID), an institution that offers a forum to resolve disputes between investors and host states, was founded. Since then the use of IIAs to promote foreign investment has become increasingly widespread, not only among developed countries but also developing countries. Consequently, as of 2014 there are more than 3,000 IIAs around the globe.[1]

Originally, IIAs were mainly promoted by European countries and the US, which is represented by the fact that the top 10 most frequent home states of investors filing investment treaty claims (as of the end of 2014) are either European states or the US (with one exception being Turkey). IIAs are no longer the privilege of European countries and the US and they have become important tools for Asian countries such as China and Korea in making their investors competitive in overseas markets. Now, both China and Korea enjoy more than 100 bilateral investment treaties (BITs) respectively. In terms of the number of BITs and free trade agreements (FTAs), Japan has been far behind with only 21 BITs and 14 FTAs in effect. However, in the last few years, the Abe administration has been striving to increase the number of FTAs and BITs to support foreign investment by Japanese companies, particularly in emerging markets. The aim is to stimulate Japan's economy by tapping into such emerging markets. The result of such efforts is shown below.

| Japanese BITs that have come into force since 2014 | |
|---|---|
| Mozambique | 29 August 2014 |
| Myanmar | 7 August 2014 |
| China and Korea | 17 May 2014 |
| Iraq | 25 February 2014 |
| Kuwait | 24 January 2014 |
| Papua New Guinea | 17 January 2014 |
| **Japanese FTAs that have come into force since 2014** | |
| Australia | 15 January 2015 |
| **Japanese BITs executed since 2014** | |
| Ukraine | 5 February 2015 |
| Uruguay | 26 January 2015 |
| Kazakhstan | 23 October 2014 |
| **Japanese FTAs executed since 2014** | |
| Mongolia EPA | February 2015 |

One of the most ambitious attempts of the Abe administration is to conclude within this year the Trans-Pacific Partnership Agreement (TPP), which, once concluded, will cover countries accounting for more than one-third of the world's GDP. Top Japanese and US trade officials plan to meet during the week of 20 April 2015 aiming to resolve major trade issues including those relating to the automobile and agricultural sectors.

### Investor-state dispute settlement provision

The TPP negotiations have generated debate in Japan over the investor-state dispute settlement provision (ISDS), the provision that enables investors of another contracting state to initiate arbitration against a contracting state to resolve investment disputes as defined in BITs and FTAs.

But for the ISDS, even if BITs or FTAs are in force, investors have no choice but to rely on their own government's discretion in exercising diplomatic protection against the host state for its violation of the investors' protection afforded under BITs/FTAs. On the other hand, the biggest merit of the ISDS is to enable investors to fairly resolve disputes with host states at their own initiative both from a substantive and procedural law perspective. From a substantive law perspective, agreements between investors and host states are often governed by the law of the host state. An investor would not be able to enjoy proper recourse in court litigation or commercial arbitration where national law applies of the host state even if such law itself violated the BIT. However, in investment treaty arbitration under BITs/FTAs, in principle international law, such as BITs/FTAs, is the applicable law. As such, in the investment treaty arbitration under BITs/FTAs, unlike in court litigation or commercial arbitration, investors can obtain proper recourse if the conduct of the host state was in violation of such international law, even when that conduct is in compliance with the national law of the host state.

From a procedural law perspective, if the contract between investors and the host state provides for either the host state's national court or commercial arbitration within the host state to resolve a dispute, then either the local civil procedural code or arbitration act would apply to such proceedings. Therefore, there is a possibility that the judiciary of the host state may improperly intervene in any such judicial or arbitration proceedings for the benefit of the host state. Investment treaty arbitration has incorporated a number of mechanisms to minimise the intervention of host states or third-party state national courts.

Japan's Ministry of Economy, Trade and Industry (METI) has been promoting economic partnership agreements (EPAs) and BITs, including ISDS provisions, if necessary, to facilitate investment in foreign countries, particularly in emerging markets, by Japanese investors. METI has this year announced the publication of 'frequently asked questions' with respect to EPAs/BITs and investment treaty arbitration to help Japanese investors understand FTAs/BITs and the benefits that FTAs/BITs and ISDS can offer Japanese corporates investing overseas.

**ISDS under attack**

Japan has consistently incorporated ISDS into its BITs/FTAs, except for BITs/FTAs with the Philippines and Australia.[2] However, for the first time, ISDS has come under attack in Japan, over recent years in particular in the context of ongoing TPP negotiations. Concerns have been raised not only by non-profit organisations but also by politicians of both the ruling party and opposition parties as well as the Japanese Federation of Bar Associations and some local bar associations.[3] Thanks to the TPP, awareness of and interest in investment treaty protections and arbitration have dramatically increased over the last few years; however, most of the criticism appears to be based on misconceptions of the ISDS and investment treaty arbitration framework. The following are some of the criticisms made in Japan against ISDS.

Restrictions on judicial power

ISDS restricts judicial power because it allows large (and often Western) multinationals to file claims against Japan outside the Japanese judiciary system.

Restrictions on state powers

ISDS also restricts Japan's executive and legislative powers because the language of BITs, which sets the standard of protection for investors, is so ambiguous and general it creates a 'chilling' effect on government bodies causing such bodies to refrain from introducing new laws or regulations or modifying existing laws and regulations, including those the aim of which is to promote public health, security and environmental protection. Because treaties supersede national law, ISDS could hinder Japan's democracy.

Scrutiny of arbitrators

In investment treaty arbitration, arbitrators are chosen by the parties, are not scrutinised and are immune from liability. Some arbitrators represent major companies and yet sit as arbitrators in certain situations, reflecting a potential bias in favour of investors. This concern is an extension of a belief in some Japanese circles that arbitrators in commercial arbitration cannot really be neutral as they sometimes adjudicate cases involving companies they presently or have previously represented as counsel.

No appeal

Arbitration awards are not subject to appeal, and there have been many inconsistent arbitration awards.

Confidentiality of arbitration proceedings

Arbitration proceedings are confidential and such proceedings are not well equipped to resolve disputes involving a state's public interest and public policy.

No need for ISDS in developed countries

ISDS is not necessary when developed countries, such as Japan, are the respondent state as Japan has a modern and independent court and arbitration system which could effectively adjudicate investment disputes.

ISDS for benefit of US investors

In general, investment treaties afford protections to foreign investors that are not available to domestic investors. In particular, the TPP will create an investment environment that favours the United States and United States investors at the expense of Japan's public interest.

**Defending ISDS**

Some of the criticism is based on a lack of understanding, while other parts of the criticism may promote a healthy discussion about further improving investment treaty arbitration. Let us look at how we can respond to those questions one by one.

Restrictions on judicial power

Arbitration does not restrict Japan's judicial power; arbitration supplements such power. Resolving international disputes by way of arbitration is not necessarily unique to investment disputes. Arbitration has and continues to be widely utilised by the private sector to resolve commercial disputes, particularly those with foreign counterparties. More generally, arbitration has been widely used as well by states to resolve not only commercial disputes with the private sector but also state-to-state disputes with other states at institutions such as the International Court of Justice or the Permanent Court of Arbitration. Some state-to-state disputes are resolved at other fora, such as the WTO. When those proceedings are not considered to restrict the judicial power of states, how can investment treaty arbitration be said to restrict the judicial power of the state?

Restrictions on state powers

*No restriction*

In Japan, once a state ratifies a treaty and it comes into force, the treaty supersedes Japan's domestic law to the extent that Japan is obligated to enact law and regulations to implement its obligations under the treaty. This is an inherent feature of all treaties in most countries; it is not unique to investment treaties. In Japan, treaties are not considered to be a restriction on executive or legislative powers because it is the executive branch that negotiates treaties and it is the legislative branch that ratifies the treaties to make them effective.

*'Chilling' effect*

It is true that the standard of protection afforded in investment treaties, such as 'fair and equitable treatment' or 'full protection and security', are somewhat vague. However, this issue is not unique to investment treaties but is seen in other treaties as well (and indeed in Japanese domestic law itself). This is an issue of substantive law, namely how to draft a clear standard of protection in investment treaties; and not an issue of ISDS, a procedural law that enables investors to use arbitration when a state violates the standard of protection. In addition, there have been substantial efforts to clarify the standard of protection afforded in investment treaties, and in the near future the standard of protection may look quite different from those found in traditional treaties.

*Public purposes*

In relation to the concerns raised in Japan that investment treaties may restrict the enactment of new law or regulations or the modification of existing laws and regulations aiming to protect public health or the environment, arbitration awards have been actually taking into account state powers to serve public purposes, such as the protection of public health and the environment. Some criticise certain arbitration awards such as *Metalclad v Mexico*,[4] *SD Myers v Canada*,[5] *Tecmed v Mexico*,[6] but most of those criticisms are based on a misconception of the facts and the rulings in the cases. It is not that the tribunals in those cases found measures to protect public health and the environment in violation of investment treaties. But in the *Metalclad* case, there were inconsistencies as to the authority to grant permit in waste management businesses among

the state government, local government and municipality resulting in substantial damages being sustained by the investors, which were found to be in breach of the fair and equitable treatment (FET) requirement; in the *SD Myers* case, the Canadian government itself questioned the legitimacy of the PCB exportation ban from an environmental perspective; and in the Tecmed case, again the Mexican government requested the relocation of the waste site based on a local protest campaign against the waste site and refused to renew the licence of a waste management business without providing the investor an alternative waste site which the government was required to provide.

## Scrutiny of arbitrators:

### *Independence and impartiality*

Arbitration systems are carefully set up to ensure the impartiality and independence of arbitrators to ensure the fairness and integrity of arbitration systems. Arbitration rules require arbitrators to be independent and impartial throughout the arbitration proceeding. Any justifiable doubt as to the impartiality and independence of arbitrators would be grounds to disqualify or challenge an arbitrator. If justifiable doubt as to the impartiality and independence of an arbitrator is later found after the issuance of the award, such award could be challenged or annulled.

### *IBA guidelines and double-hat issue*

The IBA guidelines on conflict of interests in international arbitration (revised as of 2014) have been a useful reference for arbitrators, parties and institutions to determine the necessary scope of disclosure or disqualification or challenge of arbitrators. With respect to the 'double-hat' issue (ie, the arbitrator is concurrently acting as counsel on a related legal issue for unrelated matters), while conflicts of interest commonly arise from the relationships between arbitrators and the subject matter of the disputes, including parties or party counsel, the IBA Guidelines suggest that there are circumstances that call for disclosure by arbitrators should similar legal issues be dealt with in two separate proceedings in which the arbitrator concurrently acts as counsel even if the subject matter, parties and party counsel are unrelated as between those two cases.

### *Party autonomy*

Unlike for judges, there is no particular system to screen arbitrators except for their impartiality and independence. Party autonomy is a fundamental element of arbitration. In arbitration, each party familiar with the dispute must be able to locate the best arbitrators, and by the same token, it would be best to leave any challenge of arbitrators to the opposing party because the opposing party would be best equipped to consider whether the arbitrators should be challenged. As such, the fact that there is no particular system to screen arbitrators in advance of appointment, unlike for judges, does not undermine the fairness of the system. Rather, leaving such screening primarily to the parties increases the efficiency and fairness of the arbitration system.

## No appeal

### *No appeal is not a bad thing*

The lack of appeal of arbitration awards is one of the great advantages of arbitration as it guarantees quicker and more efficient dispute resolution. Even now, investment arbitration generally takes longer than regular commercial arbitration. For instance, ICSID arbitration, which does not allow appeals, typically takes more than three years before the arbitration concludes, and such lengthy proceedings have been much criticised. If an appeal were to be allowed, the whole process would take even longer and an arbitration system with appeals would not serve the goal to resolve investment disputes efficiently.

### *Basic scrutiny*

While there is no appeal, awards may be challenged in accordance with either the ICSID Convention or the arbitration act of the seat of arbitration. When there are serious procedural irregularities, awards are successfully challenged.

### *Who will fix inconsistencies between awards?*

There are indeed arbitration awards that differ on certain issues, such as the interpretation of the definition of 'investment' or an umbrella clause, or issue of whether or not dispute resolution provisions of other BITs/FTAs may be imported by using a most-favoured nation clause of the applicable BITs/FTAs. Some propose the establishment of an appeal system as a way to resolve inconsistencies. However, significant challenges would need to be overcome if an appeal system was to be introduced. Who will sit as the arbitrators in the appeal? Unless the same or similar members on the appeal body are appointed by the institutions, the appeal body will not properly function to resolve inconsistencies among arbitration awards. On the other hand, if members of the appeal body are to be appointed by the institutions, the very act of appointing the appeal body members will mean that the institutions themselves will be participating in the creation of international investment case law. This goes far beyond the role of the institutions, which is the administration of the procedural framework for investment arbitration. In any event, having appeal body members selected by the institutions entirely undermines the party autonomy of the arbitration system. I hope inconsistencies among arbitration awards will be resolved in the long run by way of accumulation of arbitration awards and tribunals paying due respect to past arbitration awards.

Consistency of awards would be enhanced by limiting the pool of arbitrators in investment treaty cases. However, limiting the pool of arbitrators would produce some serious consequences. Even now, with some exceptions, most arbitrators are European, US or Canadian practitioners. There are quite a few states that must feel underrepresented in terms of region, culture and the development stage of their states within the investment arbitration regime. A truly international regime, however, requires a more diverse and globally representative group of arbitrators. Increasing the number of arbitrators from different regions such as Asian nations may actually increase inconsistency between awards, at least in the short term. However, that is a price which may be worth paying. This is because a more diverse pool of arbitrators with their shared expertise and broader perspectives should actually achieve a more balanced development of investment case law as well as investment arbitration procedure and over the longer term inconsistencies between awards should be resolved as well.

## Confidentiality of arbitration proceedings

In response to a call for transparency in investment treaty arbitration, the situation has substantially improved. While the ICSID Convention has empowered the secretary general to disclose certain arbitration information to the public without the individual consent of the parties, ICSID has been working hard with parties to persuade them to consent to publish arbitration awards as well as arbitration proceedings. UNCITRAL has now introduced new rules for transparency. Once the transparency rules apply,

subject to certain confidentiality exceptions (article 7), hearings are made public, and written statements, transcripts of hearings, decisions, orders and awards of tribunals, among others, are made public.[7] Recent Japanese IIAs provide that the respondent state may publish the arbitration awards. As such, where transparency is concerned, ISDS itself may address such concerns.

### No need for ISDS in developed countries

Some argue that investment disputes may be resolved in the court of the host state so long as the host state is a developed country and its judiciary functions properly. This proposition is not tenable. First, arbitration is a dispute resolution mechanism that involves the least amount of intervention from the sovereign and therefore is best suited to resolve disputes between the state and foreign investors. It is said that even in developed countries such as the US and Germany, states rarely lose in their own national courts. Second, the court system varies from country to country, and investors will be forced to fight in those different court systems, which is too cumbersome. Thirdly, the arbitration system is a dispute resolution mechanism balancing different legal backgrounds, such as common law systems and civil law systems, whereas the court system adopts either the common law system or the civil law system. Investment treaty case law would be best developed by the accumulation of arbitration awards rather than court decisions on investment law in different court systems in different languages.

### ISDS for US investors

Indeed, it appears that this is the real reason for the underlying opposition against the TPP and ISDS. For BITs/FTAs that do not involve the US, none of the above issues appear to have been raised, and Japan's Diet has unanimously approved the ratification of the BITs and FTAs. There is a fear of litigious US investors initiating numerous arbitrations against Japan and impeding Japan's ability to introduce laws and regulations that serve public purposes. In fact, US investors are by far the most frequent users of investment treaty arbitration, and the high cost and lengthy duration of arbitration, particularly investment arbitration, is said to be at least partially caused by the judicialisation or the so-called Americanisation of the arbitration system, ie, importing aggressive US-style litigation tactics into the arbitration system. Those concerns are understandable given the records of home countries of investors: US investors filed investment treaty claims in approximately 130 cases (total as of the end of 2014) and are by far the most frequent user of the ISDS system. However, insisting that the national courts should be utilised to resolve investment treaty disputes would not be persuasive unless the national court system were well suited to resolve such investment treaty disputes. Rather, instead of insisting on abolishing the current investment treaties and investment arbitration system that has contributed tremendously to the establishment of international investment case law, what we should focus on is improving the current arbitration system to address those legitimate and fair concerns.

## Conclusion

Some of the criticisms against investment treaties and ISDS have some merit, particularly those surrounding the tendency of US investors to frequently use investment arbitration. Other concerns, however, are derived from misconceptions of the current system and case law and are compounded by the sometimes emotional broader political debate in Japan about the merits of Japan participating in the TPP. For the legitimate concerns, arbitration practitioners like us are responsible for considering how to improve the system. For the unfounded criticisms, again, arbitration practitioners like us are equally responsible for educating those who are unfamiliar with the current system rather than simply denouncing their lack of knowledge.

## Notes

1 http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=929&Sitemap_x0020_Taxonomy=UNCTAD Home;#6;#Investment and Enterprise;#607;#International Investment Agreements (IIA).

2 In published arbitration awards Japan has never been a respondant state, and there is only one published arbitration case in which an affiliate of a Japanese investor brought an investment treaty case against a member state. *Saluka Investments BV v The Czech Republic*, Partial Award, UNCITRAL, 17 March 2006.

3 Politicians' criticisms against ISDS in the Diet are summarised in 'Myth and Reality of Investment Treaty Arbitration observed in the Diet deliberations' by Prof Shotaro Hamamoto, Horitsu Jiho (2015).

4 *Metalclad Corporation v The United Mexican States*, ICSID Case No. ARB(AF)/97/1.

5 *SD Myers, Inc v Government of Canada*, UNCITRAL, Partial Award, 13 November 2000.

6 *Técnicas Medioambientales Tecmed, SA v The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003.

7 www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf.

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THE ASIA-PACIFIC ARBITRATION REVIEW 2016 ISSN 1753-917X