Legal Commentary

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Investment Protection toward Globalization — Brief Comments on Substantive Rule Highlights of RCEP's Chapter on Investment

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On November 15, 2020, China concluded the Regional Comprehensive Economic Partnership Agreement ("**RCEP**") with 14 other Asia-Pacific countries, marking the inception of the world's largest free trade zone. RCEP contains an entire chapter on investment (Chapter 10), which is equivalent to a mini-multilateral investment agreement and provides for protection standards commonly seen in investment protection agreements, such as national treatment, most-favored-nations treatment, fair and equitable treatment, and full protection and security treatment. The chapter does not currently provide for any investor-state dispute settlement mechanism, which the signatories will further negotiate within two years of RCEP entering into force. However, compared with China's third-generation investment protection agreements [e.g. *China-Canada Bilateral Investment Treaty (BIT)*] and the *United States-Mexico-Canada Agreement* ("**USMCA**"), the investment protection standards under RCEP's investment chapter contain certain highlights signaling the careful protection of investments as well as a balancing of interests between the investor and the host state. It is anticipated that the entry into force of RCEP will further contribute to the maintenance of a fair, predictable, and stable business environment in China.

Scope of protected investments

RCEP defines "investment" by specifying its characteristics. Under Article 10.1, subpara. (c), these characteristics include the commitment of capital or other resources, expectation of gains or profits, or assumption of risk. These could potentially be factors to consider when a Party reviews whether their activities constitute an investment. Specifically, this subparagraph specifies:

First, rights under contracts may also constitute an investment. Article 10.1, subpara. (c)(iii)—consistent with the definition of investment under the USMCA—makes explicit reference to revenue-sharing contracts, including, *inter alia*, turnkey, construction, management, and production contracts.

It is worth noting that, unlike RCEP, the definition of investment under USMCA comprises "enterprise" *per se*, meaning that an investor is presumed to suffer losses immediately once the assets of an enterprise

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are expropriated, thus dispensing with the need for the investor to convert the enterprise's loss into a decrease in the value of the enterprise's equity. Article 1 of the *China-Japan-Korea Trilateral Investment Agreement*, concluded in 2012, also provides for enterprises and their branches as a form of investment. In contrast, RCEP makes no such stipulations, only confirming shares as a form of investment without including enterprises *per se*.

Second, as to whether the return on investment constitutes investment, Article 10.1, subpara. (c) of RCEP provides that "*returns that are invested shall be treated as an investment.*" This comes as a subtraction from the *China-Japan-Korea Trilateral Investment Agreement*, which provides that "investment" also covers the amounts yielded by investments, including profits, interest, capital gains, dividends, royalties, and fees, without requiring that such returns be further reinvested.

Third, services may also be entitled to investment protection. Article 10.2, para. 3 of RCEP provides that investment-related services are entitled to protection, *mutatis mutandis*, in accordance with the standard of protection for investments such as the expropriation clause. This provision accords broader protection for investors.

Attribution of conduct of non-governmental bodies

RCEP, on a groundbreaking note, provides for a definition of "*measures by a Party,*" an uncommon move among existing investment treaties. Article 10.1, subpara. (h) lists two types of such measures by a Party. The first refers to measures by the central, regional, or local governments of a Party while the second refers to those by non-governmental bodies in the exercise of powers delegated by such governments. The subparagraph concerns attribution of conduct under international law, whereby conduct of a governmental organ is directly attributable to that state. For non-governmental bodies, Article 5 (which reflects customary international law) of the Articles on Responsibility of States for Internationally Wrongful Acts ("**ARSIWA**")—produced by the International Law Commission—stipulates that conduct of an individual or entities empowered by the law of a state to exercise elements of governmental authority shall be considered as state conduct under international law. RCEP's position on the attribution of conduct of non-governmental bodies is thus consistent with customary international law rules.

Adoption of customary international law standards in the application of fair and equitable treatment ("FET") and full protection and security treatment ("FPS")

Article 10.5, para. 1 of RCEP provides that "*[e]ach Party shall accord to covered investments fair and equitable treatment and full protection and security, in accordance with the customary international law minimum standard of treatment of aliens.*" Customary international law minimum standard of treatment of aliens manifests itself in the third generation Chinese BITs. For example, Article 4 (Minimum Treatment Standard) of the China-Canada BIT of 2012 stipulates that FET and FPS "*do not require treatment in addition to or beyond that which is required by the international law minimum standard of treatment of aliens as evidenced by general State practice accepted as law*," a statement that is also included in RCEP. This means that RCEP does not impose new obligations on the Parties beyond the minimum standard of treatment under customary international law. However, what constitutes the minimum standard of

treatment is beyond a single and unified answer[2], but can only be ascertained through a survey of state practices. As a result, the application of FET and FPS will largely depend on "*a general and consistent practice of States that they follow from a sense of legal obligation*[3]," rather than on an interpretation of the text of the agreement by adjudicators. This, to a certain extent, weakens the interpretative authority of the dispute settlement institution that may be established under RCEP in the future.

Detailed rules on expropriation

Expropriation clauses are indispensable to any investment agreement. Article 10.13 of RCEP provides that a Party shall not engage in expropriation or nationalization except for a public purpose, in a non-discriminatory manner, on payments of compensation, and in accordance with due process of law. On top of this, the expropriation provisions of RCEP embrace the two following characteristics.

First, on the payment of compensation, Article 10.13 specifically provides that the amount of compensation "*shall not reflect any change in value occurring because the intended expropriation had become known earlier.*" This fully takes into consideration the possible decrease in the value of the investment by an early announcement of the decision to expropriate, suggesting more careful protection of investors. That said, land is treated somewhat specially, i.e., a host state must act in accordance with its existing laws and regulations when it comes to payment of compensation for land-related expropriation. The consequence is that the standard of compensation for land-related expropriation is to be determined by municipal, rather than international, law. This may be a provision with "ASEAN characteristics." Article 14 of the ASEAN Comprehensive Investment Agreement, concluded by ASEAN members in 2009 contains a similar statement[4]. Nonetheless, Article 10.13 of RCEP, on the other hand, restricts the host state's right to decrease the amount of compensation by unilaterally amending its laws and regulations. In other words, only those amendments that "*follow the general trends in the market value of the land*" shall be followed.

Second, the characteristics of expropriation have been explicitly spelled out. Article 1 of Annex 10B (Expropriation) explicitly provides that "*[a]n action or a series of related actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in a covered investment.*" This indicates that the essence of expropriation is to deprive the investment of its economic value. An act of the host state will not constitute expropriation if it does not cause any decrease in economic value. It is worth noting that such economic value also comprises a "*property interest,*" which may have a profound impact on the data-driven new economy as data obtained or extracted by an enterprise may constitute a protected investment under RCEP. According to footnote 1 to this provision, "property interest" refers to such property interest as may be recognized under the laws and regulations of a Party. Under PRC law, we observe that PRC courts have recognized in one case [(2018) Zhe 8601 Min Chu No.956][5] that data resources obtained through efforts fall within the protected "*proprietary/property*

[2] *ADF Group Inc v United States of America*, ICSID Case No. ARB(AF)/00/1 (NAFTA), Award, January 9, 2003, at para 180.

[3] *See* Annex 10A of the RCEP (Customary International Law).

[4] *See* ASEAN Comprehensive Investment Agreement, Article 14, *available at* http://investasean.asean.org/files/upload/Doc%2005%20-%20ACIA.pdf, last visited on November 23, 2020.

[5] In this case, the court held: "the company has proven through evidence that it used publicity to attract distributors to issue their non-public intent to participate on a certain website. The company received the brief participation information and manually conducted deep-level verification and obtained, analyzed, and integrated more participation information. Special labels were added to form more complete participation information in the final processing. The company argues

interests" under the *Law against Unfair Competition*. This renders it possible for data owned by investors of other Parties and located in China to be protected under RCEP. Accordingly, Chinese investors—to receive broader protection—should pay attention to whether similar stipulations exist under the laws and regulations of the host state.

Third, explicit rules have been made on indirect expropriation. Article 2 of Annex 10B (Expropriation) refers to "*a series of related actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure,*" which holds fast to the trend of international investment law to regulate indirect expropriation. Reference is made to "creeping expropriation" in investment arbitration practice, with the test being whether the act of the host state has cast a major negative impact on the economic value of the investment or even completely deprives the investment of all its value[6]. An investment arbitral tribunal will also consider the cumulative effect of the acts. If a series of incrementally adopted measures are inter-related and the cumulative effect thereof ultimately has a major negative impact on the economic value of the investment, such measures will also be considered as expropriation[7].

Restrictions on nationality planning of investors

Nationality planning refers to the circumstance where an investor avails itself of the protection under an investment agreement by altering its nationality. For example, a BIT exists between State A and State B, but a company is registered in neither state. The company may establish a subsidiary in State A, through which it makes an investment in State B. The company therefore acquires the identity of an investor of State A, which entitles the company to invoke the BIT between State A and State B. Investment agreements do not generally prohibit nationality planning. However, in *Philip Morris Asia Ltd. v. Australia*, the investor engaged in nationality planning when it was foreseeable that the host state was about to implement intrusive tobacco plain-packaging measures, and instituted arbitration proceedings by reference to the Hong Kong-Australia BIT. The arbitral tribunal deemed such nationality planning to be an abuse of rights[8].

In comparison, Article 10.14 of RCEP directly restricts the entitlement of investors of a non-Party to the investment protection standards under RCEP by altering their nationalities. The article explicitly lists the circumstances whereby a Party may decline to grant benefits under Chapter 10 to a juridical person investor and its investment, including where such a juridical person investor is owned or controlled by persons of a non-Party. This indicates the difficulty for investors of a non-Party to RCEP to obtain protection under RCEP by establishing enterprises in the territories of an RCEP Party, thereby significantly

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that information relating to single distributors, as contained in the database, when accumulated to a large scale, may become a type of resource, element, or property. The database of distributors in this case the product of the company after long-term business operation, to which significant manpower and resources have been devoted. This constitutes the company's core competitive resource, has commercial significance and value, and should constitute the property interests protected by the Law against Unfair Competition."

[6] See *CME Czech Republic BV v Czech Republic*, UNCITRAL, Partial Award, September 13, 2001; *Seismograph Service Corp v National Iranian Oil Co*, IUSCT Case No. 443, Award, March 31, 1989.

[7] See *Compañía del Desarrollo de Santa Elena SA v Costa Rica*, ICSID Case No ARB/96/1, Award, February 17, 2000, at para 76.

[8] *Philip Morris Asia Ltd v Australia*, PCA Case No.2012-12, Award on Jurisdiction and Admissibility, December 17, 2015, at paras 586-588.

restricting the leeway for investors to engage in nationality planning.

National security exceptions

Article 10.15 of RCEP stipulates the national security exceptions for the investment chapter, providing that a host state may resort to measures to safeguard its essential security interests. Such measures may constitute violations of the standards of protection under the investment chapter. If this provision is successfully invoked, the host state would be afforded a viable defense that the act of the state does not constitute a violation of the RCEP provisions. Security exceptions are not uncommon in investment agreements. Such measures typically take the form of non-precluded measures and endow the host state with a self-judging power. This is the case with Article 10.15, which explicitly provides that "*…nothing in this Chapter shall be construed to: … preclude a party from applying measures that it considers necessary for: … the protection of its own essential security interests.*" According to the WTO panel report in *Russia—Measures concerning Traffic in Transit*, language such as "that it considers necessary" by no means denotes that a state can determine with complete discretion as to what constitutes essential security interests. On the contrary, the panel asserted its authority to conduct a review thereon[9]. In particular, the panel held that a state shall act in good faith in making a specific item an essential security interest and shall not use it as a pretext for pursuing purely commercial interests. The restrictive measures that the host state takes shall also bear a minimum level of plausibility to the proffered essential security interest[10]. This case signaled the first time for an international adjudicatory body to make a determination as to issues related to national security, which provides highly valuable reference in applying the essential security interest exception under Article 10.15 of RCEP.

In conclusion, RCEP adopts a strategy of "priority of substance," i.e., to reach an agreement on substantive protective standards and to save for later the negotiation on an investor-state dispute settlement mechanism. Such an arrangement leaves space for formulating remedial measures for investment protection while also showcasing the flexibility and inclusiveness of the agreement.

[9] *Russia—Measures concerning Traffic in Transit*, WT/DSS12/R, Report of the Panel, April 5, 2019, at paras 7.132-7.133. *See* also *Saudi Arabia—Measures concerning the Protection of Intellectual Property Rights*, WT/SD567/R, Report of the Panel, June 16, 2020, which applied the analytical framework adopted in *Russia—Measures concerning Traffic in Transit.*

[10] *Ibid*, at para 7.138.

Important Announcement

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