

The Myanmar–Japan Bilateral Investment Treaty

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1.0 Introduction

After decades of international isolation, Myanmar is going through a process of political transition toward democracy. As part of the reform process, the Government of Myanmar is attempting to attract more foreign investment to the country and has already taken several steps toward achieving this objective. In 2012, the Government passed a new Foreign Investment Law that partially liberalizes the entry of foreign investment into Myanmar. In 2013, Myanmar acceded to the New York Convention on the Enforcement of Foreign Arbitral Awards. The Directorate of Investment and Company Administration (DICA) has also announced its intention to address some of the impediments to foreign investment identified in the World Bank's 2014 *Doing Business* report.¹ Well-managed foreign investment has the potential to bring lasting benefits to Myanmar. However, in the rush to achieve "quick wins" and responding to pressures from negotiating partners, there is also a risk of making policy choices with unintended consequences that can ultimately be ineffective and counter-productive. It is important for the Government of Myanmar to carefully assess the full range of costs and benefits of policies intended to attract foreign investment.

One policy choice facing the government of Myanmar is the decision of whether to enter into investment treaties with foreign governments and, if so, on what terms. In this, it joins the governments of other developing countries that have signed investment treaties with the goal of attracting new foreign investment. However, existing evidence suggests that investment treaties have been largely ineffective as a tool to attract foreign investment.² The evidence of costs associated with investment treaties, however, is clear. In light of these considerations, some countries have decided to terminate the treaties they have signed in the past. It is reported, for instance, that the Indonesian government has informed the Netherlands in March 2014 of its desire to terminate its investment treaty with that country, as well as its other treaties.

Investment treaties entitle foreign investors to bring claims against a host country to international arbitration. Over the past decade, the number of claims being brought under investment treaties has grown rapidly. Investors have used investment treaties to demand compensation for tobacco-control measures,³ environmental regulations,⁴ delays in domestic court proceedings,⁵ and disputes about the investor's performance of contractual obligations.⁶ Claims regularly run into the billions of U.S. dollars. If an investor is successful in such a claim, the arbitral tribunal will issue a final and binding award requiring the host state to compensate the investor. Even if an investor is not successful, the threat of bringing a claim may pressure a government into modifying or abandoning the measures being challenged. Just how likely a foreign investor is to succeed in any particular claim depends on the precise terms of the treaty in question. For this reason, it is crucial for investment treaties to be drafted and evaluated with the risk of future claims in mind.

¹ Directorate of Investment and Company Administration (DICA). (2014). Meeting on Doing Business Report in Myanmar. Available at www.dica.gov.mm/news.htm

² Organisation for Economic Co-operation and Development (OECD). (2014). *OECD investment policy reviews: Myanmar 2014*. pp. 124-127. Available at <http://www.oecd.org/countries/myanmar/investment-policy-reform-in-myanmar.htm>

³ e.g., *Philip Morris v. Australia*; *Philip Morris v. Uruguay*.

⁴ e.g., *Vattenfall v. Germany I*; *Tecmed v. Mexico*; *Methanex v. U.S.*

⁵ e.g., *White Industries v. India*; *Chevron v. Ecuador I*.

⁶ e.g., *Occidental v. Ecuador II*; *Walter Bau v. Thailand*; *Bayindir v. Pakistan*.

This note examines some of the key legal and policy implications of the Myanmar-Japan Bilateral Investment Treaty (BIT).⁷ This treaty was signed on December 15, 2013 but, at the time of writing, does not appear to have entered into force. Although Myanmar is already a party to a handful of bilateral and multilateral investment treaties,⁸ the Myanmar-Japan BIT is particularly significant for two reasons. The first is that it is the first investment treaty to be negotiated and signed by the transitional government that took power in 2011. As such, it provides insights into how the current Government might approach other investment treaty negotiations over the coming years. The second reason is that the Myanmar-Japan BIT differs significantly from recent ASEAN investment treaty practice (to which Myanmar is a party). For one, the investment protection provisions of the Myanmar-Japan BIT use older-style language, thereby leaving leeway for investment tribunals to limit Myanmar's policy space in a manner that would not be possible under the ASEAN investment treaties. Myanmar also appears to provide more extensive pre-establishment rights to Japan than it provides to ASEAN member states under the ASEAN Comprehensive Investment Agreement (ASEAN CIA), and it could be argued that the rights granted to Japanese investors must now also be extended to investors of the other nine ASEAN states.

⁷ The full name of the treaty is the "Agreement between the Government of Japan and the Government of the Republic of the Union of Myanmar for the Liberalisation, Promotion and Protection of Investment." The treaty is available online at www.bilaterals.org/IMG/pdf/japan_myanmar_bit.pdf.

⁸ Myanmar has existing BITs with China, India and the Philippines that have entered into force. In addition, Myanmar is a party to the ASEAN Comprehensive Investment Agreement, the ASEAN-Australia-New Zealand Free Trade Agreement, the ASEAN-Korea Free Trade Agreement, and the ASEAN-China FTA, all of which contain investment protection provisions and provide for investor-state arbitration.

2.0 Investment Treaties: An overview

The first investment treaty was signed between Germany and Pakistan over 50 years ago. Early investment treaties were almost always bilateral agreements between a developed and a developing country. During the 1990s the number of investment treaties in existence grew rapidly. At the time these treaties attracted little legal or policy attention. Investment treaties were often signed as a symbol of goodwill during Ministerial visits, sometimes simply as a “photo opportunity.” The governments involved did not always realize that the treaties they were signing were legally binding and enforceable, nor did they fully appreciate the significance of each of the various legal provisions contained in them.⁹

From the early 2000s, the number of claims brought against government under investment treaties began to grow sharply. Investors began challenging a range of sensitive government policies, and winning large compensation payouts.¹⁰ Even in cases where governments defended themselves successfully, they were often left with legal costs of many millions of dollars. In response to their experience defending investment treaty claims, both developed and developing countries have revised their investment treaties so as to reduce the risk of future claims. Some countries have ceased signing investment treaties altogether, and have begun a process of terminating their existing treaties.

Investment treaties have three basic features. The first is that they require each state to grant foreign investors from the other state a given level of protection from government conduct that affects their investment. These rights are granted over and above whatever protection foreign investors are entitled to under the national law of the country in question. The second feature is that investment treaties allow any foreign investor falling within the coverage of the treaty to bring a claim against the host state directly to international arbitration. While common in investment treaties, this form of dispute settlement is highly unusual in other international agreements. As a matter of international law, it is rare for a private actor to be able to sue a state directly at the international level; and, as a matter of international arbitration, it is exceedingly rare for a party to agree to the arbitration of an unspecified range of future disputes with unknown class of potential future claimants. A third feature contained in some, but not all, investment treaties is a set of provisions that deal with the conditions under which a foreign investor can make an investment, liberalizing the regime governing entry and establishment of foreign investment. The subsequent sections of this note address each of these three aspects of Myanmar-Japan BIT.

Investment treaties seldom address the obligations and responsibilities of foreign investors. They do not require foreign investors to operate according to international standards concerning environmental impacts, social impacts, human rights or corporate governance. They do not allow host governments or affected communities to bring claims related to the impact of foreign investments to international arbitration. The Myanmar-Japan BIT is typical in this respect. The only provision addressing standards of investor conduct is Article 25. This article precludes Myanmar and Japan from lowering environmental, health and safety, or labour standards in order to attract new investment. However, it does not require foreign investors to comply with internationally recognised standards, or require Myanmar and Japan to ensure that their national laws are consistent with such standards.

⁹ Poulsen, L.S., & Aisbett, E. (2013, April). When the claim hits. *World Politics*, 65(2); Poulsen, L.S. (2013, April). Bounded rationality and the diffusion of modern investment treaties. *International Studies Quarterly* 58(1). p. 12; Vis-Dunbar, D., & Poulsen, L.S. (2009, March). Reflections on Pakistan’s investment-treaty program after 50 years. *Investment Treaty News*. Available at <http://www.iisd.org/itn/2009/03/16/pakistans-standstill-in-investment-treaty-making-an-interview-with-the-former-attorney-general-of-pakistan-makhdoom-ali-khan/>; similarly, *Wintershall Aktiengesellschaft v Argentina*, Award, para. 85.

¹⁰ The largest award to date is the US\$1.7 billion (plus post-judgment interest) awarded by the Tribunal in *Occidental v. Ecuador II*, Award, para. 876.

3.0 Investment Protection Provisions of the Myanmar–Japan BIT

This section reviews some of the key investment protection provisions of the Myanmar–Japan BIT. The main finding is that Myanmar–Japan BIT grants more expansive protections to foreign investors than the recent treaty practice of ASEAN (to which Myanmar is a party), the EU and the United States.¹¹ These provisions restrict the Government of Myanmar’s ability to revise laws and regulations governing foreign investment and significantly increase the likelihood of successful claims against Myanmar under the Myanmar–Japan BIT. The following paragraphs explain these conclusions, focusing specifically on three provisions – Article 13, Article 4(1) and Article 4(2).¹²

Article 13 of the Myanmar–Japan BIT deals with the expropriation of foreign investments. As is common in investment treaties, the first part of Article 13(1) deals with the case of “direct expropriation”—a situation in which the host government takes over ownership and possession of a foreign investor’s investment. Article 13(1) provides that each party to the treaty can only “expropriate or nationalise” a foreign investment of the other party on payment of full compensation. This provision is more permissive than Myanmar’s Foreign Investment Law, which prevents the nationalization of foreign investments that have been authorized by the Myanmar Investment Commission.

Article 13 also requires a government to compensate foreign investors for measures “equivalent to expropriation or nationalisation”—a phrase commonly understood to refer to “indirect expropriations.” This provision goes beyond the protections provided to foreign investment under the Foreign Investment Law. Arbitral tribunals have interpreted equivalent provisions of other investment treaties as requiring the host state to compensate foreign investors for measures that prevent their investments from operating profitably. For example, in the case *Tecmed v. Mexico*, an arbitral tribunal held that the Mexican government’s refusal to extend the operating permit of a hazardous waste processing facility was an indirect expropriation, even though this decision was justified by the investor’s infringement of environmental conditions attached to the permit. Such interpretations are problematic because they ignore the strong public policy justifications for non-discriminatory environmental or other public welfare measures.

In response to concerns raised by decisions like *Tecmed v. Mexico*, recent investment treaties signed by and amongst ASEAN members, as well as many other states, contain language clarifying that legitimate policy measures do not normally constitute indirect expropriation. Similar language is likely to be included in future EU treaties. These new treaties reduce the risk of arbitral tribunals finding that non-discriminatory measures taken in the public interest would amount to indirect expropriation requiring compensation. While the Myanmar–Japan BIT does contain an exception for public health measures (Article 19(1)a), it lacks any general clarification that legitimate regulatory measures do not amount to indirect expropriation. Therefore, the exceptions clause as formulated will not safeguard the state from the possibility of having to pay compensation for legitimate regulatory measures.

Another important provision of the Myanmar–Japan BIT is Article 4(1). This provision requires each state to provide foreign investors of the other state “treatment in accordance with international law, including fair and equitable treatment.” This obligation to provide “fair and equitable treatment” (FET) is perhaps the most controversial provision of investment treaties. It is the provision most often invoked by foreign investors in investor–state arbitration, and the claim with which investors have the best rate of success. The provision could be interpreted in ways that would obligate Myanmar to pay compensation to Japanese investors for legitimate policy measures that would likely not be subject to compensation under the Myanmar constitution.

The meaning of the obligation to provide FET has been fleshed out through arbitral interpretation. Arbitral tribunals have understood the obligation to provide FET as covering a range of situations, including:

¹¹ For an example of ASEAN’s recent investment treaty practice, see the ASEAN Comprehensive Investment Agreement; for the EU’s recent treaty practice, see the draft Canada–EU Trade Agreement; for the United States’ recent treaty practice, see the 2012 U.S. Model Bilateral Investment Treaty.

¹² These are not the only provisions of the Myanmar–Japan BIT that raise legal and policy questions. Other issues include the broad definitions of the terms “investor” and “investment” in Article 1; and the obligation to ensure “effective protection” of intellectual property rights in Article 22.

- Failure to respect a foreign investor’s “legitimate expectations.”
- Failure to provide a stable legal and regulatory framework for foreign investment.
- Conduct that is arbitrary or unreasonable.
- Failure of national courts to meet international standards.

Governments have been held liable under the FET clause in a range of different circumstances. For example, in *MTD v. Chile* an arbitral tribunal held Chile liable for refusing to rezone land acquired by the investor, after having authorized the transfer of capital into Chile for the development of the land. The Tribunal held that the authorization of the transfer of capital created an “expectation” that all the permits necessary for the project to proceed would be granted. The view that the FET standard requires a government to respect an investor’s expectations relating to the viability of a foreign investment poses difficulties for a country like Myanmar. For example, Notification No. 1/2013 under the Foreign Investment Law requires foreign investment in a range of restricted sectors to be approved by both the relevant line Ministry and by the Myanmar Investment Commission. Similarly, Notification No. 11/2013 under the Foreign Investment Law foreign investment in the agricultural sector involving the use of virgin, vacant and fallow land requires a lease approved by the Management Committee for Vacant Fallow and Virgin land as well as ultimate approval by the Myanmar Investment Commission.

In *Occidental v. Ecuador I* an arbitral tribunal held that Ecuador had breached the FET standard by changing the rules governing the refund of value-added tax (VAT) paid under a petroleum contract. The tribunal held that this change violated the investor’s entitlement to a stable legal framework. The view that the FET standard requires a country to maintain a stable legal framework is particular concerning from the perspective of a country like Myanmar. Myanmar is currently in a process of transition that will inevitably involve the review and modification of a whole range of laws and policies that affect foreign investment.

Other countries have responded to concerns relating to the scope of the FET standard by drafting the FET provisions of their investment treaties more precisely. Such clarifications are found in the ASEAN Comprehensive Investment Agreement, the three ASEAN+1 FTAs that contain investment protection provisions and many other treaties, including all of the United States’ recent treaties. The EU has also identified the FET provision as problematic and is trying to address it through clarification and guidance to tribunals. However, such clarifications are not found in the Myanmar-Japan BIT. This increases the risk of successful FET claims against Myanmar.

A third important provision is Article 4(2). This provision requires each state party to the treaty to “observe any obligation it may have entered into with regard to investments.” Such provisions are commonly described as “umbrella clauses.” Arbitral tribunals have disagreed about their implications; one influential view is that they convert any breach of a contract between a foreign investor and the host state into a breach of the treaty requiring compensation.¹³

Umbrella clauses are not contained in the ASEAN CIA, the ASEAN-Korea or the ASEAN-Australia-New Zealand FTAs,¹⁴ or recent U.S. investment treaties (whether they will be included in future EU investment treaties remains subject to negotiations). This provision poses serious risks for a country in Myanmar’s situation. The process of transition currently underway is likely to involve the amendment of the fiscal terms of contracts that were not originally negotiated on an arms’ length basis. The transition process may also include the insertion of additional terms in existing commercial contracts – for example, a requirement to conduct an environmental audit for existing investments. The umbrella clause of the Myanmar-Japan BIT risks making the government of Myanmar liable for any future changes to the contractual arrangements governing Japanese investments.

¹³ e.g., *Eureko v. Poland*, Partial Award.

¹⁴ The ASEAN-China FTA does contain an umbrella clause (art. 18[2]), but this clause is not enforceable through investor-state arbitration, art. 14(1).

4.0 Investment Liberalization Provisions in the Myanmar–Japan BIT

This section reviews the provisions of the Myanmar–Japan BIT governing investment liberalization. The National Treatment provision of the Myanmar–Japan BIT—Article 2(1)—requires each country to accord treatment to the “investment activities” of investors of the other country that is “no less favourable” than the treatment it accord to its own investors. Article 1 (d) defines “investment activities” to include the “establishment, acquisition and expansion . . .” of an investment. In other words, each country is required to allow investors from the other country to make investments on the same terms that it applies to its own investors. This provision is in tension with the basic regime established by the Foreign Investment Law, which imposes special conditions on foreign investment in prohibited and restricted sectors.

The Myanmar–Japan BIT includes two Annexes containing reservations made by each country to the investment liberalization provision of the BIT, including the national treatment provision. These reservations are in the form of a “negative lists.” In other words, Myanmar must allow Japanese investors to make investments on the same terms as Myanmar investors, unless the measure restricting Japanese investment is among the existing non-conforming measures listed in Annex I or the sector in question is subject to a specific reservation listed in Annex II.

Myanmar’s Annexes of reservations appear to be inconsistent with current Myanmar laws that govern foreign investment in prohibited and restricted sectors. For example, according to existing Myanmar laws, tourism is a restricted sector. Recent press reports suggest that DICA will not permit foreign investment in the sector unless the foreign investor enters into a joint venture with a local partner.¹⁵ However, none of Myanmar’s reservations in either Annex to the Myanmar–Japan BIT appear to apply the tourism sector. Thus, the BIT precludes Myanmar from imposing joint venture requirements on Japanese investment in the tourism sector. Similarly, according to Notification No. 1/2013 under the Foreign Investment Law, foreign investment in the production and marketing of seeds is allowed only by the way of a joint venture. However, because there is no corresponding reservation in either Annex to the Myanmar–Japan BIT, Article 2(1) requires Myanmar to allow Japanese investment in this sector on the same terms as local investment. A full comparison of the Annexes to the Myanmar–Japan BIT to the restrictions on foreign investment currently contained in Myanmar’s national laws and regulations may reveal further inconsistencies.

Two further policy concerns arise from the pre-establishment National Treatment obligation of the Myanmar–Japan BIT. First, the “negative list” approach to reservations to Article 2(1) makes it impossible for Myanmar to place new conditions on Japanese investment unless they are covered by an existing exception. In this sense, the treaty “locks in” existing policy settings. Second, most of Myanmar’s existing investment treaties contain “most-favoured-nation” (MFN) provisions. Several of these—for example, Article 3(3) of the Myanmar–China BIT and Article 6(1) of the ASEAN CIA—are drafted in a way that could be interpreted as covering pre-establishment treatment. The practical effect of such provisions is to require Myanmar to extend the concessions granted to Japanese foreign investors to investors covered by Myanmar’s other investment treaties.

The Myanmar–Japan BIT also contains an MFN clause—Article 5. This provision allows Japanese investors to invoke more favourable terms found in any of Myanmar’s past or future investment treaties. This clause applies to both more favourable standards of investment protection, and to more favourable entry and establishment requirements conferred on foreign investors from a third state. Unusually, there does not appear to be any exception to this

¹⁵ Eleven. (2014, February). DICA gives thumbs down to full foreign investment in the tourism sector. Available http://www.elevenmyanmar.com/index.php?option=com_content&view=article&id=5207:dica-gives-thumbs-down-to-full-foreign-investment-in-tourism-sector&catid=35:tourism&Itemid=358

provision for benefits conferred by Myanmar as part of a customs union or regional economic integration. As such, a Japanese investor could argue that any additional concessions that Myanmar makes to ASEAN investors through its membership in the ASEAN Economic Community would need to be extended to Japanese investors.

A third provision of the Myanmar–Japan BIT relating to investment liberalization is Article 6. The provision imposes a wide-ranging prohibition on performance requirements. For example, it prevents a host state from imposing or enforcing a requirement to source a percentage of certain inputs from suppliers within the host state. This provision also precludes the enforcement of contractually agreed terms between the host state and the foreign investor, such as, for example, an agreement to comply with a performance requirement in return for approval of the investment. As with the other provisions of the Myanmar–Japan BIT dealing with investment liberalization, this provision is subject to the reservations listed in the Annexes.

The main policy concern relating to Article 6 is that it could limit Myanmar’s ability to use negotiated performance requirements as a way to maximize the positive spillovers from foreign investment. The use of performance requirements as part of a country’s development strategy has had mixed success. However, well-designed performance requirements—for example, an agricultural processing company’s agreement to source a minimum percentage of its inputs from Myanmar smallholder farmers as a condition for the approval of its investment—can be effective. The Foreign Investment Law suggests that performance requirements are an important part of Myanmar’s development strategy. It requires foreign investors to meet targets for the employment of skilled Myanmar workers and describes the facilitation of technology transfer as one of the “duties” of foreign investors.

Exceptions and qualifications to Article 6 partially address this policy concern. For example, Article 6(1) prohibits performance requirements relating to “executives” or “managers” but does not appear to prevent the performance requirements relating to the employment of skilled workers found in the Foreign Investment Law. Article 6(3) also allows Myanmar to use negotiated performance requirements relating to research and development activities and the training of workers. However, Article 6(2) prohibits the Government of Myanmar from enforcing local content requirements, even if the investor has agreed to use Myanmar suppliers as a condition of approval of its investment.

5.0 Investor-State Arbitration Under the Myanmar-Japan BIT

Article 18 of the Myanmar-Japan BIT contains each state's advance consent to the settlement of investor-state disputes through international arbitration. This provision allows Japanese investors in Myanmar to enforce both the investment protection and the investment liberalization provisions of the treaty through investor-state arbitration. An investor that succeeds in such a claim is normally awarded compensation for any loss suffered as a result of state's breach of the treaty provisions. Article 18(14) clarifies that such an award is both final and binding. This section reviews the main features of the process of investor-state arbitration envisaged by Article 18.

Article 18 attaches few conditions to foreign investors' ability to initiate investor-state arbitration. A Japanese investor in Myanmar is required to allow a three-month period of "consultations" before commencing arbitration. However, the investor is not required to attempt to resolve its dispute by bringing a claim in Myanmar's courts (or through formal mediation) before commencing arbitration. Article 18(4) then gives the investor the right to choose the procedural rules governing that will govern the arbitration. The treaty gives the investor the choice between the ICSID Convention (if both Myanmar and Japan are parties to the ICSID Convention), the ICSID Additional Facility Rules, or the UNCITRAL Rules. Because Myanmar is not yet a party to the ICSID Convention, the choice, in practice, is between the ICSID Additional Facility and the UNCITRAL Rules.

The process of investor-state arbitration has been criticized for resolving disputes that affect the public interest (such as environmental, public health and tax policy) in a private forum that is closed to the public.¹⁶ Partly in response to these criticisms, recent investment treaties provide for a much greater degree of transparency of the arbitral process than was once the case. For example, recent U.S. investment treaties contain mandatory provisions requiring the public disclosure of documents relating to the arbitration. These U.S. treaties also provide for the participation of interested third parties (*amicus curiae*) in arbitral proceedings. Changes to the UNCITRAL Rules governing investor-state arbitration adopted in 2013 (which will only affect investment treaties signed after April 1, 2014, and therefore do not apply to the Myanmar-Japan BIT) provide for a level of transparency comparable to recent U.S. investment treaties; future EU investment treaties are likely to contain similar provisions. The provisions of Myanmar-Japan BIT run counter to this trend. Article 18(12) allows the respondent state to disclose documents relating to the arbitration, but does not provide for mandatory disclosure.

Finally, the scope of investor-state compensation is very broad, covering all sectors, measures, and levels of government. Unlike the ASEAN Comprehensive Investment Agreement and the current EU position, where liberalization provisions may only be challenged in a state-state dispute-settlement process,¹⁷ the Myanmar-Japan BIT subjects liberalization commitments to investor-state dispute settlement, so long as the investor initiating the claim has taken "concrete steps" to make the investment.¹⁸

¹⁶ e.g., Van Harten, G. (2007). *Investment treaty arbitration and public law*. Oxford: Oxford University Press.

¹⁷ e.g., ASEAN CIA (art. 32a).

¹⁸ art. 1 (b); art. 18(1).

6.0 Conclusion

This note outlines some of the legal and policy issues arising from the Myanmar-Japan BIT. The treaty places obligations on Myanmar to protect foreign investment that are significantly more onerous than those found in Myanmar's recent investment treaties, and those found in the recent investment treaty practice of ASEAN, the EU and the United States. Particularly problematic is Article 4, which contains both an unqualified FET obligation and an umbrella clause. In addition, the Myanmar-Japan BIT requires the Government of Myanmar to liberalize the entry of foreign investment in sectors that are still restricted under Myanmar law. All these provisions are enforceable through investor-state arbitration. Because of the inconsistency of these provisions with existing Myanmar law, they expose the Government of Myanmar to a major risk of future investment treaty claims.

Over the coming months, a range of other countries are likely to initiate negotiations for new bilateral investment treaties with Myanmar. It is important for the Government of Myanmar to carefully consider its negotiating position before any such negotiations commence.¹⁹ This process requires an evaluation of the overall costs and benefits of entering into investment treaties, as well as more detailed assessment of the implications of alternative drafting options for common investment treaty provisions.

The text of all the investor-state arbitral awards referred to in this note is available at www.italaw.com.

¹⁹ OECD. (2014). *OECD Investment policy reviews: Myanmar 2014*. p. 126. Available at <http://www.oecd.org/daf/inv/investment-policy/Myanmar-IPR-2014.pdf>

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