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## The CPTPP and Digital Trade: Embracing E-Commerce Opportunities for SMEs in Canada and Japan by Y. Abe and D. Collins

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# The CPTPP and Digital Trade: Embracing E-Commerce Opportunities for SMEs in Canada and Japan

by Yoshinori Abe\* and David Collins\*\*

## **Abstract**

*One of the most innovative features of the CPTPP is its material on digital trade, especially its chapter on e-commerce which contains a number of provisions aimed at enhancing this vital sector of the economy by eliminating distortive trade barriers such as restrictions on data transfer and data localization requirements. Such provisions should be important to the CPTPP's two largest parties: Canada and Japan, both of which are highly advanced economies seeking to enhance their digital trade capacity across the Pacific Rim. This paper explores the main features of the CPTPP concerning digital trade from the perspective of Small and Medium Sized Enterprises (SMEs) in Canada and Japan. Such businesses have a poor track record of e-commerce uptake and may be disadvantaged relative to their larger competitors which enjoy dominance in the online marketplace. Whether or not the CPTPP will assist these businesses while striking the right balance between an open internet and safeguarding of issues such as privacy is a matter of some debate.*

## **I. Introduction**

Transferring data across international borders is an essential enabling technology for e-commerce, underpinning much international trade in goods and services. The use of cloud-based storage by many service providers has further intensified this process, as data is often situated in a location other than that of the seller or buyer. Digital trade is quickly becoming a vital component of the economies in many countries, especially those which have already achieved an advanced stage of development. While companies of all sizes are engaged in digital trade, in some countries Small and Medium-sized Enterprises (SMEs) have yet to realize the growth potential in using the internet for trading overseas.

International legal commitments facilitating digital trade have become key features of modern FTAs. Chief among these is the CPTPP, which has emerged as a model “modernized” mega-regional trade agreement containing extensive material on digital trade among its 11 parties of significance not only to large multinationals but also to the vitally important SME sector.

This article will examine some of the key provisions of the CPTPP dealing with digital trade from the perspective of the agreement's two largest signatories, Canada and Japan. It will also consider the extent to which the agreement addresses some of the issues present in these two developed countries relating to the engagement of their SMEs with the opportunities of expanded access to foreign markets through digital trade. Since Japan and Canada share common goals with respect to technology and innovation as tools to spur economic growth, the extent to which trade agreements like the CPTPP enable SMEs is a subject deserving of attention. The liberalization of digital trade through trade agreements is not without controversy. Controlling data in a highly networked economy represents a difficult if not intractable policy challenge. In one sense there are benefits in terms of privacy, security and even in technological innovation deriving from greater control over data. On the other hand,

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there is a need to supporting open networks and the free flow of data because this underpins e-commerce and has the potential to drive innovation. From a non-economic perspective, open data is also linked to the promotion of pro-democracy norms. Removing barriers to digital trade through international treaties can narrow the policy flexibility considerably. This is why achieving an appropriate balance between safeguarding privacy and security while promoting a competitive, innovative economy must be viewed as a priority for trade negotiators.<sup>1</sup>

This article will begin by outlining some of the background relating to digital trade in international trade agreements, including the conspicuous lack of progress at the WTO. It will then present a profile of the role of SMEs in the digital economies of Canada and Japan, drawing attention to the reality that these enterprises tend to have low levels of engagement with this kind of commerce. From there the article will explore the main features relating to digital trade contained in the CPTPP which have the potential to impact on the activities of Canadian and Japanese SMEs, notably its chapter on e-commerce. Brief conclusions will be offered in the final section.

## **II. Background on Digital Trade in International Trade Agreements**

Before exploring the key digital trade aspects of the CPTPP and considering their potential impact on SMEs in Canada and Japan, it is apposite to consider the history and context of digital trade provisions in international trade agreements.

At the multilateral level the starting point with respect to progress in digital trade occurred in the 1990s when World Trade Organization (WTO) Members agreed not to impose customs duties on electronic transmissions. The Declaration on Global Electronic Commerce was adopted to ensure that e-commerce between WTO members would not be subjected to unnecessary trade barriers. Four WTO agencies currently implement the WTO Work Programme on E-Commerce, originally adopted in 1998. Together these bodies supervise all trade-related issues linked to E-Commerce at a multilateral level. The term “electronic commerce” or “e-commerce” is understood to mean the production, distribution, marketing, sale or delivery of goods by electronic means.<sup>2</sup> It is somewhat narrower than “digital trade” which tends to include intellectual property and in some cases services generally. It is worth adding that the market access commitments of the plurilateral Information Technology Agreement (ITA), which has been signed by 82 WTO members, has begun to lower barriers to trade in the equipment which facilitates digital trade, such as laptops, tablets and monitors. Seventy-one WTO Members, including Canada and Japan, issued a Joint Statement on Electronic Commerce at the eleventh Ministerial Conference to initiate exploratory work towards future WTO negotiations on trade-related aspects of electronic commerce, with participation open to all WTO members.<sup>3</sup> It is hoped that this will result in a meaningful output in the form of a draft text.

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<sup>1</sup> M Geist, ‘Data Rules in Modern Trade Agreements: Toward Reconciling an Open Internet with Privacy and Security Safeguards’ Centre for International Governance and Regulation (4 April 2018)

<sup>2</sup> Declaration on Global Electronic Commerce, WT/MIN(98)/DEC/2 (25 May 1998)

<sup>3</sup> Joint Statement on Electronic Commerce, WT/MIN(17)/60, 13 December 2017. Five meetings have been held as of 19 July 2018. See, [http://www.meti.go.jp/english/press/2018/0719\\_001.html](http://www.meti.go.jp/english/press/2018/0719_001.html)

Despite the above, generally speaking there has been a disconcerting lack of progress at the WTO regarding digital trade strategy.<sup>4</sup> Failure to address these issues at the WTO's Ministerial Convention in 2017 suggests that there is limited support across WTO membership for a multilateral agreement on digital trade. More comprehensive General Agreement on Trade in Services (GATS) specific commitments by members for digital services are needed. Progress at the global level may be achieved more readily under the Trade in Services Agreement (TiSA), a plurilateral agreement for services under negotiation among some of the WTO's leading developed countries including Canada and Japan. The issue would then become whether each treaty party would be willing to extend on a preferential basis to other signatories commitments on digital trade that it would not do so for the broad membership of the WTO. Some have further suggested that there should be a specialized plurilateral Digital Economy Trade Agreement which would address key e-commerce issues, such as access to networks, data protection and privacy. Such an initiative may be more plausible in the event that negotiations for the TiSA do not progress.<sup>5</sup>

One of the difficulties associated with WTO negotiations on digital trade was the fact that many WTO Member States (two thirds of which are developing) lack the technological capacity to take full advantage of this kind of commerce, meaning that it was less of a priority for them. Although it may not yet have migrated to global trade rules, digital trade is unquestionably an important issue for many highly developed countries, including Canada and Japan. Most provinces and territories of Canada have enacted legislation governing e-commerce, allowing for the legal recognition of information and documents as well as contracts which are communicated and signed electronically.<sup>6</sup> Risks of uncontrolled digital trade have been addressed domestically in Canada by the federal Personal Information Protection and Electronic Documents (PIPEDA) and federal Protecting Canadians from Online Crime Act<sup>7</sup> which regulate how private parties use information and also contains material on cybersecurity.<sup>8</sup> In Japan, since the Civil Code, the Consumer Contract Law, and other related laws and regulations apply to e-commerce activities, the Ministry of Economy, Trade, and Industry issued the Interpretative Guidelines on Electronic Commerce and Information Property Trading in 2002 and has revised it several times, aiming at reorganizing the interpretations of the Civil Code and other relevant laws.<sup>9</sup> The Act on the Protection of Personal Information governs the use of personal information by entities conducting e-commerce. Article 24 of the Act, for example, restricts provision by a business operator of personal information to a third party in a foreign country.<sup>10</sup>

Some countries have emphasized the excessive regulation of digital trade as a barrier to the free flow of commerce pointing to measures such as mandated server localization, as well as stringent consumer protection and intellectual property rights. For example, the US proposed the banning of digital customs duties to enable cross-border data flows as well as the prohibition of localization barriers. In contrast, India has cautioned that many countries do not understand the implications of negotiating binding rules on digital trade in terms of the risk this

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<sup>4</sup> Panel Report, US Gambling at [3.29] and Appellate Body Report, US-Gambling at [215]: M Burri, 'Designing Future-Oriented Multilateral Rules for Digital Trade' in P Sauve and M Roy eds. *Research Handbook on Trade in Services* (Edward Elgar, 2016) at 341.

<sup>5</sup> M Burri, 'Designing Future-Oriented Multilateral Rules for Digital Trade' in P Sauve and M Roy eds. *Research Handbook on Trade in Services* (Edward Elgar, 2016) at 355

<sup>6</sup> E.g. Electronic Commerce Act (Ontario), 2000, S.O. 2000, c. 17

<sup>7</sup> SC 2014, c. 31

<sup>8</sup> SC 2000, c. 5

<sup>9</sup> [http://www.meti.go.jp/english/press/2018/0727\\_002.html](http://www.meti.go.jp/english/press/2018/0727_002.html)

<sup>10</sup> Act on the Protection of Personal Information, Law number: Act No. 57 of 2003.

may impose to citizens. This is especially so where such rules are permanent instead of subject to renewal on a permanent basis.<sup>11</sup>

As of late 2017, there are thought to be more than 60 FTAs which include material on digital trade, including e-commerce. Developing countries appear to be somewhat less willing to include these types of commitments in their FTAs than developed ones, perhaps reflecting their lack of capacity in this field of economic activity as well as the risk that unbridled flow of information could present to consumers. While the extent of coverage of e-commerce and digital trade provisions in FTAs is highly variable, for the most part the scope has expanded to encompass a broad range of issues, much as one would expect given the increasing importance of digital trade in the global economy.<sup>12</sup>

### **III. Digital Trade and SMEs in Canada and Japan**

This section will provide a brief overview of the role of SMEs in Japan and Canada and their engagement in digital trade.

#### *i) Canada*

A highly advanced, services-focused economy, Canada has the second highest GDP among CPTPP parties after Japan. Canadians are among the heaviest users of the internet and e-commerce has already become a major disrupter in retail, reaching over CDN \$1.2 billion per year in 2017. It is projected that there will be 20 million digital buyers in Canada spending \$50 billion online by 2019 – comprising 10 per cent of all retail purchases in Canada.<sup>13</sup> Roughly two thirds of Canadian e-commerce is international, most of which is to or from the United States. Indeed, Canada is seeking to diversify its trade away from reliance on the US, and the new CPTPP (without the US) is clearly a vital step in this direction. Manufacturing businesses and governmental organizations in Canada have also become increasingly likely to make purchases on the internet, especially for smaller orders. Consumers have shifted towards “click and collect” purchasing and marketing is being done increasingly through social media. Mobile payments have become popular, much as cybersecurity is a growing concern for businesses and consumers alike.<sup>14</sup>

The Canadian government defines an SME as a business established with between 1 and 499 employees. Such firms are a vital component of the Canadian economy in many respects because by this definition more than 99 per cent of all businesses in Canada may be considered SMEs, collectively employing more than 90 per cent of the private labour force in the country. SMEs also account for 27 per cent of Canada’s total research and development expenditure, suggesting that they are highly innovative in their approach to business. Yet only 25 per cent of all exports by value (\$106 billion per year), and only 11 per cent of all SMEs reported any exports whatsoever, suggesting that they do not appreciate the opportunities in global markets. Of those SMEs which did export, the majority exported to only one country – the United States. Asia was the second largest market, especially China. Unsurprisingly, the SMEs which were

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<sup>11</sup> K Suneja, ‘India opposes e-commerce talks at WTO; submits document’ The Economic Times (India) (4 December 2017)

<sup>12</sup> M Wu, ‘Digital Trade-Related Provisions in Regional Trade Agreements: Existing Models and Lessons for the Multilateral Trade System’ Inter-American Development Bank and International Centre for Trade and Sustainable Development (November 2017) at 7

<sup>13</sup> <https://www.export.gov/article?id=Canada-eCommerce> (accessed August 2018)

<sup>14</sup> Key Small Business Statistics, Innovation Science and Economic Development Canada (June 2016)

most actively engaged in innovation were more likely to be those which exported goods and services.<sup>15</sup>

It seems certain that the economic and business benefits of adopting new technologies to enhance digital trade are now well understood by Canadian businesses of all sizes, including SMEs. Yet these vitally important firms have been slow to embrace e-commerce relative to their larger counterparts and with respect to SMEs in other countries, such as the US. Much as they appear reluctant to export, especially beyond the US, digital adoption among SMEs is widely recognized as weak.<sup>16</sup> It is thought that one of the main reasons for this is the lack of skilled workers who can assess and implement technological innovations.<sup>17</sup> Another explanation is that high costs can make investing in digital technologies a challenge for SMEs.<sup>18</sup> Investment in information and communication technologies (ICT) in may Canada generally is lower compared to other countries; Canada's ICT investment as a percentage of gross fixed capital formation was 17 per cent compared to more than 30 per cent in the United States and more than 20 per cent in countries such as Sweden, Denmark and the United Kingdom.<sup>19</sup> Lastly, it is often pointed out that SMEs struggle to adapt to burdensome regulations in foreign markets, again because of their limited resources.<sup>20</sup>

## *ii) Japan*

The Japanese e-commerce market has expanded rapidly. The scale of the domestic B-to-C e-commerce market in 2017 was JPN ¥16.5 trillion, while that in 2010 was JPN ¥7.7 trillion. With respect to the domestic B-to-B e-commerce market, its size reached to JPN ¥317.2 trillion in 2017 which had increased by 9 per cent from the previous year. The digitization of commercial transactions has maintained steady progress in the recent decade. The e-commerce ratio was 5.79 per cent for B-to-C, while it was 29.6 per cent for B-to-B. E-commerce transactions with overseas customers also has increased very quickly. For example, the amount purchased through cross-border e-commerce by US consumers from Japanese business operators in 2017 was JPN ¥712.8 billion which is up by 15.8 per cent from 2016 and the Japanese government forecasts that the amount will reach at JPN ¥1.19 trillion in 2021.<sup>21</sup>

The Small and Medium-sized Enterprise Basic Act provides the definitions of SMEs as follows: 1) for manufacturing industry and others, a company whose capital does not exceed JPN ¥300 million or employees are between 1 and 300; 2) for wholesale trade industry, a company whose capital does not exceed JPN ¥100 million or employees are between 1 and 100; 3) for service industry, a company whose capital does not exceed JPN ¥50 million or employees are between 1 and 100; 4) for retail trade industry, a company whose capital does

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<sup>15</sup> Key Small Business Statistics, Innovation Science and Economic Development Canada (June 2016)

<sup>16</sup> 'Skills in the Digital Economy: Where Canada Stands and the Way Forward' The Information and Communications Technology Council (2016) At 7

<sup>17</sup> <https://www.export.gov/article?id=Canada-eCommerce> (accessed August 2018)

<sup>18</sup> 'Skills in the Digital Economy: Where Canada Stands and the Way Forward' The Information and Communications Technology Council (2016) at 14

<sup>19</sup> 'Skills in the Digital Economy: Where Canada Stands and the Way Forward' The Information and Communications Technology Council (2016) At 7

<sup>20</sup> HK Nordås, 'Services SMEs in International Trade: Opportunities and Constraints' E15 Expert Group on Services, International Centre for Trade and Sustainable Development (ICTSD) (May 2015)

<sup>21</sup> [http://www.meti.go.jp/english/press/2018/0425\\_002.html](http://www.meti.go.jp/english/press/2018/0425_002.html)

not exceed JPN ¥50 million or employees are between 1 and 50.<sup>22</sup> Because these SMEs consist of 99.7 per cent of all business enterprises in Japan and employ more than 70 per cent of the private workers in the country, the SMEs are a vital driving force of the Japanese economy as well.<sup>23</sup> The Small and Medium Enterprise Agency has emphasized the market strategies utilizing ICT, especially indicating that e-commerce enables SMEs to carry on business beyond the restrictions imposed by physical distance. A survey by the Agency revealed that there was a clear trend that the SMEs conducting e-commerce were more engaged in direct exports than those not conducting it. It also showed that SMEs engaging in e-commerce had higher profit ratios than those are not.<sup>24</sup> Thus, for Japanese SMEs the utilization of e-commerce is one of the essential business tools of expanding their market abroad.

### **III. Key Features of the CPTPP's E-Commerce Chapter**

This section will examine some of the aspects of the CPTPP which may impact upon the digital trade related activities of SMEs in Japan and Canada.

#### *i) Scope and Coverage*

Although suspensions apply to certain chapters dealing with financial services and intellectual property, the original text of the e-commerce chapter of the TPP remains intact in the CPTPP. This has been rightly viewed by commentators as an indication that the signatories remain deeply committed to eliminating trade barriers to businesses engaging in many forms of digital commerce with a view to stimulating the growth of that industry.<sup>25</sup> The e-commerce chapter (Chapter 14) contains several rather broad provisions that should help expand growth in this area among the signatories, with possible beneficial impacts on SMEs.

It should be noted that the CPTPP's services chapter (Chapter 10) defines cross-border services (with language drawn from the GATS) as services delivered from one party into another party's territory, services produced in the territory of one party and delivered to a person living in another territory, or services provided by a national of one territory to a party in another territory.<sup>26</sup> With respect to digital trade, the rules governing services encompass both internet service providers and internet users as well as both buyers and sellers. Still, it is unclear whether the CPTPP's main provisions on digital trade found in its e-commerce chapter cover all cross-border information flows by all internet actors, meaning whether they apply to both suppliers and consumers of digital transmissions. Based on the language above, it would appear as though both are covered.<sup>27</sup>

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<sup>22</sup> Art.2(1) of the Small and Medium-sized Enterprise Basic Act. Art 2(5) of the Act also defines "small enterprises" as a company with 20 employees or less for manufacturing industry (with 5 employees or less for commerce or service industry).

<sup>23</sup> The Summary of 2017 White Paper on Small Enterprises in Japan (April 2017) at 1 [http://www.chusho.meti.go.jp/pamflet/hakusyo/H29/download/2017shokibogaiyou\\_eng.pdf](http://www.chusho.meti.go.jp/pamflet/hakusyo/H29/download/2017shokibogaiyou_eng.pdf).

<sup>24</sup> 2009 White Paper on Small and Medium Enterprises in Japan (September 2009), at 82-84 <[http://www.chusho.meti.go.jp/pamflet/hakusyo/h21/h21\\_1/2009hakusho\\_eng.pdf](http://www.chusho.meti.go.jp/pamflet/hakusyo/h21/h21_1/2009hakusho_eng.pdf)>

<sup>25</sup> R Cheng, "Open E-Commerce Data Flows in the New Non-US TPP" Forbes (14 March 2018)

<sup>26</sup> 10.1

<sup>27</sup> Article 14.11 on information flows states that "each party shall allow the cross-border transfer of information by electronic means...when this activity is for the conduct of the business of a covered person." A "covered person" is defined in article 14.1 as an "investment, investor or service supplier." The agreement only mentions "users" in article 14.8, where it recognizes the benefits of protecting users' personal information. Some

Chapter 14 applies to “measures adopted or maintained by a Party that affect trade by electronic means.”<sup>28</sup> In this sense its scope may be much broader than measures that govern or “apply to” trade, and wider than the normal meaning of “electronic commerce”. The breadth of electronic services is confirmed the statement that “measures affecting the supply of a service delivered or performed electronically are subject to the obligations contained in the relevant provisions of Chapter 9 (Investment), Chapter 10 (Cross-Border Trade in Services) and Chapter 11 (Financial Services).”<sup>29</sup> Chapter 14 does not apply to government procurement or information held or processed by or on behalf of a government, or measures related to it.<sup>30</sup> Furthermore, the agreement only applies to “trade by electronic means” and not all processing of information by electronic means. Clearly the CPTPP’s digital trade elements are primarily focused on their commercial impact.

### *ii) Non-Discrimination*

Generally speaking the CPTPP contains language which fosters an open internet, and this should be helpful to SMEs seeking to gain a foothold in markets dominated by large suppliers. Key to this is article 14.4 on non-Discriminatory Treatment of Digital Products which prohibits signatory parties from favouring domestic products and their creators and owners or from discriminating between products or producers from home versus abroad. “Products” here includes computer programs, videos and recordings produced for sale and transmitted electronically. Since these commodities are themselves digital rather than corporeal ones which are merely bought and sold using electronic interactions, this represents what is arguably the treaty’s fundamental facilitator of digital trade.

Importantly, governments are still able to provide subsidies or grants to their own producers or creators. While formal subsidies for SMEs to encourage them to participate in digital trade will most likely be wasteful<sup>31</sup>, SMEs (especially start-ups, meaning companies less than two years old) may be precisely the types of businesses who could benefit from various kinds of assistance programmes, such as information sharing and training in ICT and digital commerce generally. Additionally, the side letters exempt Canada from a clause that prohibits discriminatory rules on foreign audio-video services. Instead, the letters state that Canada “may adopt or maintain discriminatory requirements on service suppliers or investors to make financial contributions for Canadian content development and may adopt or maintain measures that restrict access to online foreign audio-visual content.” This provision could give Canada the power to require foreign producers of digital media to contribute to Canadian content production which could help SMEs operating in the digital entertainment field.

### *iii) Consumer Protection and Privacy*

The CPTPP requires parties to adopt or maintain consumer protection laws for an online environment.<sup>32</sup> Such laws already exist in Canada at the provincial level and in Japan, and are

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information flows are not for the conduct of the business of a covered person. These flows do not involve the exchange of money.

<sup>28</sup> 14.2.2

<sup>29</sup> 14.2.4

<sup>30</sup> 14.2.3

<sup>31</sup> HK Nordås, ‘Services SMEs in International Trade: Opportunities and Constraints’ E15 Expert Group on Services, International Centre for Trade and Sustainable Development (ICTSD) (May 2015)

<sup>32</sup> 14.7

generally robust.<sup>33</sup> Indeed, compliance with the two countries' stringent laws in this regard may be viewed as a significant cost for SMEs.

CPTPP signatories indicated that personal information and privacy is important to maintaining trust online by declaring in the treaty: "Each Party shall adopt or maintain a legal framework that provides for the protection of the personal information of the users of electronic commerce."<sup>34</sup> This is very much in line with developments at the national level throughout the world, notably the EU's recent General Data Protection Regulation. Parties promise to publish information on personal privacy protection and "endeavour to adopt non-discriminatory practices."<sup>35</sup> The countries additionally agreed to develop mechanisms to promote compatibility among different privacy regimes. Conceptions of "privacy", and how to safeguard it, are rooted in culture, legal evolution in terms of human rights and constitutional norms, issues which are beyond the scope of this article. Sharply opposing views are those of Europeans who appear to be more worried about rapacious firms abusing individuals, and Americans whose primary concern is an intrusive government. The Canadian perspective, embodied largely by the federal PIPEDA (mentioned above), is somewhere in the middle.<sup>36</sup> National approaches to the regulation of privacy will inform the content of trade agreements but can only be meaningfully enforced only within national jurisdictions. Growth in international trade and competitiveness in the digital economy depends on uninterrupted flows of information across borders. At the same time individuals must have confidence that their personal information is protected wherever it travels.<sup>37</sup>

Also touching on consumer protection, the CPTPP prohibits unsolicited commercial electronic messages or communications (often known as spam), but it is strangely silent on banning malware, meaning software which is specifically designed to disrupt, damage, or gain authorized access to a computer system. This kind of transmission can have a severely deleterious impact on trade and could also have significant negative effects on human rights, such as that relating to self-expression, privacy and personal security. As such, the non-inclusion of it in the CPTPP has been viewed as an unfortunate omission.<sup>38</sup> The installation of computer programs on another person's computer without the express consent of that person is prohibited in Canada.<sup>39</sup> It is not clear that these rules have no additional relevance to SMEs, other than the reality that SMEs may have fewer resources to safeguard against these online risks.

Article 14.10 builds on recognized principles for internet governance designed to empower consumers. Signatory parties recognize the importance of consumers being able to make their own choices, to connect their own devices to the network and to access information on the practices of their internet access service suppliers. Unfortunately, the CPTPP's language is not binding upon governments. At a very general level this language appears to promote

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<sup>33</sup> E.g. Consumer Protection Act (Manitoba) C.C.S.M. c. C200

<sup>34</sup> 14.8

<sup>35</sup> 14.8

<sup>36</sup> Wolfe at 3

<sup>37</sup> Wolfe at 4

<sup>38</sup> Aronson at 11

<sup>39</sup> An Act to promote the efficiency and adaptability of the Canadian economy by regulating certain activities that discourage reliance on electronic means of carrying out commercial activities, and to amend the Canadian Radio-television and Telecommunications Commission Act, the Competition Act, the Personal Information Protection and Electronic Documents Act and the Telecommunications Act. S.C. 2010, c. 23.

competition, which can only be beneficial to SMEs operating in a market dominated by large entities.

#### *iv) Source Code*

The CPTPP's e-commerce chapter states that governments cannot force suppliers to give up their source codes to foreign governments, even for national security reasons.<sup>40</sup> It prohibits signatory countries from asking software companies for access to their source codes. These provisions have the potential to undermine cybersecurity efforts, however they should provide some assurances to innovative SMEs which have expended significant portions of their budgets on software development.

#### *v) Data Localization*

Perhaps most strikingly, the CPTPP contains broad prohibitions on data localization.<sup>41</sup> Article 14.13 states: "No Party shall require a covered person to use or locate computing facilities in that Party's territory as a condition for conducting business in that territory." Data localization rules require data to be stored within the relevant jurisdiction, so this feature of the treaty should help provide certainty to businesses seeking to optimize investment decisions. While forced localization of technologies and servers may be advantageous in terms of security and data protection, it prevents the cost of redundant data centres, which could be harmfully expensive for SMEs. Since data from around the world is often stored in the US, restrictions on data localization requirements tend to be a key US demand in its trade agreements. Data localization requirements remain common around the world and multinational firms tend to respond to this situation by offering local cloud storage services. Although SMEs have a limited presence in the data storage industry this could change as customers lose faith in large providers such as Google and Amazon.

The general prohibition on data localization is subject to three exceptions: government data, financial services and a general four-step test exception. First, the governmental data exception, which is essentially non-commercial in its ambit, allows the governments to retain the rights for data localization measures for government data that it holds or that is held by third parties under contract. Data localization controls first appeared in Canada in 2004, when the government of the province of British Columbia proposed outsourcing the management services associated with public healthcare. Following extensive criticism from the public the provincial government enacted legislation designed to assuage public concerns by requiring that certain kinds of public data be hosted within the province. The province of Nova Scotia enacted similar legislation soon after. Second, the prohibition on data localization exception for financial services data carves out a broad area of commercial activity, essentially rooted in the logic of national security. Storing financial data overseas could become highly problematic in the event of a war. While primarily aimed at large banks, this exception could become important for SMEs in light of the recent developments in Fintech, a sector which so far has failed to gather momentum in Canada.

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<sup>40</sup> 14.7. With respect to Japan, provisions on source code appeared in the Japan-Mongolia Economic Partnership Agreement (Chapter 9) for the first time and CPTPP/TPP is the second example. The Japan-EU Economic Partnership Agreement also include source code provisions.

<sup>41</sup> The Japan-Mongolia EPA has a provision on the prohibition of data localization (Art. 9.10), while the Japan-EU EPA does not.

The CPTPP's general exception for data localization establishes a four-step test which permits measures that transgress to the restriction on data localization. It states: "Nothing in this Article shall prevent a Party from adopting or maintaining measures inconsistent with paragraph 2 to achieve a legitimate public policy objective, provided that the measure: (a) is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade; and (b) does not impose restrictions on the use or location of computing facilities greater than are required to achieve the objective."

This familiar language is based on Article XX of the WTO's General Agreement on Tariffs and Trade (GATT) and Article XIV of the General Agreement on Trade in Services (GATS). The way in which this analysis is applied is well-recognized by international trade lawyers and one would expect that the dispute settlement tribunals established under CPTPP would be inspired by the relevant GATT/GATS caselaw.<sup>42</sup>

Some commentators express misgivings that the four-step test could impose a regulatory chill on governments contemplating stronger data export limitations. This is especially since WTO general exceptions challenges are very narrowly construed with respondent governments hardly ever being unable to satisfy all four steps, especially the words "disguised restriction on international trade" drawn from the GATT/GATS chapeau. Banning future data localization requirements as well as data transfer restrictions consistent with privacy, security and innovation policy needs is seen by some as a short-sighted position that unnecessarily shackles the capacity of policy makers.<sup>43</sup> It is thought that a balance must be achieved between data localization and data transfers in order to ensure the viability of an open internet and this involves more than simply government or financial data. The approach must ensure that reasonable privacy, security and public policy measures will not be blocked due to the digital trade elements of agreements like the CPTPP. Commentators believe that treaty negotiators should seek to ensure that the general four-step exception can genuinely be used as a tool to reconcile an open internet with domestic privacy, security and innovation policy priorities.<sup>44</sup> It will be interesting to see whether storing data in a foreign jurisdiction be sufficient to satisfy the definition of "investment" or "investor" in the CPTPP's investment chapter, or indeed in any other international investment agreement.

It is unclear whether the general exceptions discussed above would cover measures designed to protect privacy. This material could still be useful to individuals and businesses, such as SMEs creating digital content or media, which are concerned about the trade implications of censorship and filtering.<sup>45</sup> A government choosing to censor or filter the internet could cause rerouting of information flows, acting as a trade distortion. A CPTPP party might be able to challenge such actions if they were they done in a discriminatory manner.<sup>46</sup> Given the evident difficulty in satisfying general exception tests under WTO case law, it would seem that signatory parties of the CPTPP will struggle to point to issues such as privacy and data security as valid impediments to cross border trade in legal services.

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<sup>42</sup> D Collins, "The Line of Equilibrium: Improving Investment Arbitration through the Application of the WTO General Exceptions" 32:4 *Arbitration International* 575-587 (2016)

<sup>43</sup> M Geist, 'Data Rules in Modern Trade Agreements: Toward Reconciling an Open Internet with Privacy and Security Safeguards' Centre for International Governance and Regulation (4 April 2018)

<sup>44</sup> M Geist, 'Data Rules in Modern Trade Agreements: Toward Reconciling an Open Internet with Privacy and Security Safeguards' Centre for International Governance and Regulation (4 April 2018)

<sup>45</sup> Aronson at 10

<sup>46</sup> e.g. CETA Art 28.3(2)

## *vi) Data Transfer*

Returning to some of the consumer protection issues noted above, the CPTPP's e-commerce chapter takes an ambitious approach to international data transfer. Signatory states agree that each party "shall allow the cross-border transfer of information by electronic means, including personal information, when this activity is for the conduct of the business of a covered person."<sup>47</sup> As noted earlier, "covered person" includes a "covered investment" which is defined in the CPTPP's investment chapter (Chapter Nine), an investor of a CPTPP party other than a financial institution, or a service supplier of a party as defined by the CPTPP's services chapter.<sup>48</sup> This strategy should be contrasted with that seen in many FTAs which simply aim to promote regulatory cooperation in this area.<sup>49</sup> Interestingly, Article 8.81 of the Japan-EU Economic Partnership Agreement provides only that "[t]he Parties shall reassess within three years of the date of entry into force of this Agreement the need for inclusion of provisions on the free flow of data into this Agreement." However, since Japan and EU reached an agreement on personal data protection, recognizing each system as equivalent on 17 July 2018, the EPA is likely to include free data flow provisions in the near future.<sup>50</sup>

The data transfer rule is subject to the same general four-step test exception noted above in relation to data localization. Similarly, data transfer restrictions can be used by governments as a restrictive measure which undermines the notion of an internet which is open for the use of global businesses. This is why controls on data restriction may be seen in principal as a positive development for SMEs and indeed all businesses. Still, it is plausible that data transfer restrictions could be used to safeguard the privacy and security of consumers. Several CPTPP countries, including Malaysia, Singapore and Chile, have begun to embrace data transfer restrictions. As noted above, Canada's PIPEDA enshrines a number of restrictions on data transfer for privacy purposes.

## *vii) SMEs and Transparency*

Lastly, it is important to draw attention to the CPTPP's dedicated chapter on SMEs (Chapter 24), which is itself an innovative feature of the treaty. The CPTPP's chapter on SMEs was intended to allow these important businesses to benefit from international trade to a greater extent than before. It achieves this primarily by requiring signatory countries to make available online information about the agreement as well as information designed specifically to assist SMEs in pursuing trade opportunities provided by the CPTPP. This material reflects the reality that SMEs often lack the resources to acquire sufficient information to penetrate foreign markets in contrast to their larger competitors.

The SME chapter includes provisions to ensure that such businesses have access to information in order to enhance their trade opportunities. Each party is required to establish its own publicly accessible website containing information regarding the CPTPP which is of relevance to SMEs.<sup>51</sup> None of the topics mentioned in this provision relates specifically to digital trade or

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<sup>47</sup> 14.11.2

<sup>48</sup> 14.1

<sup>49</sup> Seen in some of Canada's treaties: e.g. Canada-Colombia FTA, art. 1507.

<sup>50</sup> See. Joint Statement by Haruhi Kumazawa, Commissioner of the Personal Information Protection Commission of Japan and Věra Jourová, Commissioner for Justice, Consumers and Gender Equality of the European Commission, [https://www.ppc.go.jp/files/pdf/300717\\_pressstatement2.pdf](https://www.ppc.go.jp/files/pdf/300717_pressstatement2.pdf).

<sup>51</sup> 24.1

the e-commerce chapter, except possibly those relating to intellectual property, which have not been explored in this article. The chapter goes on to establish a committee on SMEs aimed at helping these businesses take advantage of the treaty.<sup>52</sup> Again, none of the activities or topics of interest to this committee appears to engage directly with digital trade or e-commerce issues. Still, such initiatives are of considerable importance considering the opportunities presented by the CPTPP for SMEs seeking to trade with or invest in the CPTPP's developing countries, which may not have the same level of transparency available to businesses aiming to operate in Japan or Canada.

#### **IV. Conclusions**

In many respects the modern global focus on e-commerce in trade negotiations is thought to owe its genesis in the TPP and its successor the CPTPP. Indeed, the e-commerce chapter of the CPTPP represents a watershed in the expansion of digital trade in international agreements. In addition to the material discussed in this article, the 11-nation pact should be celebrated for prohibiting the imposition of customs duties on digital products to ensure that products distributed electronically, such as music, video, e-books, games and software are not disadvantaged relative to their tangible counterparts. The CPTPP's e-commerce chapter includes useful provisions encouraging signatories to promote paperless trading between businesses and government, such as customs forms in electronic format, as well as providing for electronic authentication and signatures for commercial transactions. The agreement also contains commitments designed to simplify customs procedures and to improve transparency with a view to facilitating the expansion of e-commerce. All of these should benefit SMEs exporting abroad in smaller quantities and often with narrower margins than can be achieved at scale by large firms.

The capacity of and Canadian and Japanese SMEs to thrive in the data driven economy will still depend on each country's ability to capture a significant share of global knowledge and data assets which serve as the capital basis for the modern economy. So far Canadian SMEs have shown weak uptake of both communication technologies and export. Governments in both countries may need to improve training and access to financing to ensure that SMEs are able to take advantage of the digital trade provisions in the CPTPP.

Going forward, it is essential for governments to ascertain the extent to which FTAs like the CPTPP facilitate this process. Put more bluntly, the link between economic growth of all businesses and the contents of trade agreements with e-commerce chapters must be more clearly established. Commentators urge that the CPTPP, as with many other FTAs, has not actually been properly evaluated for its impact on digital trade.<sup>53</sup> This is to say nothing of the impact of their e-commerce chapters on SMEs in particular. This is badly needed, especially since these firms play such an important role in the economies of developed countries like Japan and Canada. Such information would further enable critics to assess with greater accuracy the implication of digital trade commitments on broader internet "norms" of open access, free flow of information, inter-operability and multi-stakeholderism.<sup>54</sup>

Although FTAs such as the mega-regional CPTPP are a logical means of addressing international information flows to advance commerce, they may not be the best places to do so

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<sup>52</sup> 24.2

<sup>53</sup> D Curiak, *The Knowledge-Based and Data-Driven Economy: Quantifying the Impacts of Trade Agreements*' Centre for International Governance Innovation, *CIGI Papers No. 156* (6 December 2017) at 11

<sup>54</sup> Aronson at 12

in the absence of policy makers including provisions which are designed to enhance human welfare and internet operability.<sup>55</sup> E-commerce as a trade issue is far from being sufficiently well understood for consistent codification to be possible. It would seem as though the lack of shared understanding at the WTO leads to “experiments” in FTAs like the CPTPP. This has resulted in part in aspirational rather than obligatory language. It is worth remembering that trade agreements are necessarily incomplete, relational contracts.<sup>56</sup> Vague unenforceable material, such as the CPTPP’s references to privacy, may represent the second-best option for negotiators who are learning how the global digital economy is unfolding.<sup>57</sup>

More importantly for the purposes of SMEs, some believe that digital trade provisions of the CPTPP have been designed to protect the first mover endowment and oligopolistic power of large technology multinationals and, in that sense, they are of limited use to smaller players, even in large countries like Canada and Japan.<sup>58</sup> Specifically, there are no substantive or meaningful requirements to protect privacy. Data export limitations and data localisation requirements can only be overcome by a difficulty justification process. Moreover, the treaty’s obligations are enforceable through state to state and in some cases ISDS mechanisms. In some respects these features of the CPTPP embody are precisely those which views which reject data privacy, in other words, the multinational tech companies, would like to achieve.<sup>59</sup> On the other hand, the general trend of liberalizing digital trade in favour of an open internet provided for in the CPTPP should help the boldest Canadian and Japanese SMEs compete on a more level playing field with larger firms which have so far enjoyed dominance.

In order to capitalize on the opportunities provided by the CPTPP’s approach to digital trade, SMEs must obtain the necessary knowledge and skills, designing their business strategies with a view to seizing the opportunities which are presented by the removal of barriers to digital trade around the Pacific Rim. Governmental agencies aiming to foster the advancement of SMEs in advanced countries like Canada and Japan must not only ensure that CPTPP commitments are fulfilled in order to create a fair environment for businesses – they must also engage directly with their SMEs to help them adapt and compete effectively in a new digital global marketplace where dynamism and innovation is essential.

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<sup>55</sup> S Aronson ‘The Digital Trade Imbalance and Its Implications for Internet Governance’ Global Commission on Internet Governance, Paper Series No 25 (February 2016) at 4

<sup>56</sup> R Wolfe, ‘Learning about digital trade: Privacy and e-commerce in CETA and TPP’ European University Institute, Working Papers RSCAS 2018/27 Robert Schuman Centre for Advanced Studies Global Governance Programme-305 (May 2018) at 12

<sup>57</sup> Wolfe at 12

<sup>58</sup> J Kelsey, ‘How a TPP-Style E-commerce Outcome in the WTO would Endanger the Development Dimension of the GATS Acquis (and Potentially the WTO)’ 21:2 *Journal of International Economic Law* 273 (June 2018)

<sup>59</sup> G Greenleaf, ‘Looming Free Trade Agreements Pose Threats to Privacy’ (2018) 152 *Privacy Laws & Business International Report* 23 [2018] UNSWLRS 38 at 5