CHAPTER TITLE: Performance Requirements Prohibitions in International Investment Law

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ABSTRACT:

This chapter explores the way performance requirements have been restricted in international investment law, commencing with a discussion of the investment-oriented aspects of WTO law (the most important of which is the TRIMs Agreement) and continuing with an examination of the prohibition on performance requirements contained in international investment agreements (IIAs). It notes that the established understanding of performance requirements as conditions placed on foreign investors to structure their behaviour in a manner that serves the interest of the host state but which is often discriminatory and harmful to a firm's competitiveness, may need to be expanded as the types of conditions imposed on foreign firms has changed. In particular this chapter draws attention to rules prohibiting forced technology transfer and, even more innovatively, data localization requirements in relation to digital trade. It suggests that the developmental potential of performance requirements must not be ignored as new disciplines governing their use are developed in line with changes to the modern global economy.

KEYWORDS: performance requirements, local content, trade-related investment measure, technology transfer, digital trade, data localization

I Introduction

Host states sometimes impose conditions on foreign investors for them to be granted admission into their territory for the purposes of conducting their commercial activities. If there is an international investment agreement (IIA) in place between the home state of the investor and the host state, the fulfilment of these conditions will also affect the investor's ability to access the legal protections available under that treaty. Many such conditions fall under the general heading of 'performance requirements' and, because they place additional obligations on foreign investors which are typically not borne by domestic ones, their use tends to be highly circumscribed in international investment law as embodied in IIAs and in investment-oriented trade agreements, such as those of the World Trade Organization (WTO).

A largely un-explored topic by legal academics,[1] performance requirements may take the form of a specific business structure, such as a mandatory joint venture with a local partner. More traditionally, performance requirements may specify that the foreign investor must use a given percentage of local products, hire local workers, or engage in knowledge exchange (or more recently, technology transfer) with local firms. Performance requirements are often associated with domestic industries which are the least able to withstand foreign competition from larger, well-resourced multinational enterprises. As tools of economic development, the use of performance requirements is reflected in the concept of 'infant industries,' in which special treatment towards under-developed but promising domestic firms is justified because it is designed to allow the firm to reach maturity and thrive in a globalized market, enhancing the health of the domestic economy in the longer term. Many developed states implemented strategies like this during their process of industrialization in the 20th Century. This is precisely why the prohibition of performance requirements today is associated with some resentment by developing states.[2]

Performance requirements imposed on foreign firms as a condition of entry may further be regarded as an instrument through which the host state can better control the nature of the foreign direct investment (FDI) which it receives, allowing the host state to assert a degree of autonomy over the influence of foreign enterprises in its domestic markets much as it maximizes the overall benefits of FDI to its economy. This is an acute concern for many capital importing states in terms of perennial issues such as the loss of economic sovereignty, dependency and the risk of capital flight associated with FDI. In some cases, performance requirements will be used to structure FDI in a manner that is more socially desirable, for example by requiring the use of environmentally sustainable equipment, as in the energy sector[3], or by hiring workers from disadvantaged groups, as in the extractive sector.[4] Performance requirements are often tied to investment incentives, meaning advantages accorded to foreign investors beyond that which are available to local firms.[5]

This chapter will examine the extent to which performance requirements in their many forms are controlled under international investment law. It will approach the topic in Part II by

[1] E.g. D Collins, *Performance Requirements and Investment Incentives under International Economic Law* (Edward Elgar, 2016)
[2] M Trebilcock, *Understanding Trade Law* (Edward Elgar, 2011) Ch 16
[3] United States – Certain Measures Related to Renewable Energy, Request for Consultations by China, WT/DS563/1, G/L/1258 G/TRIMS/D/43, G/SCM/D120/1 (14 August 2018)
[4] R Roeder, *Foreign Investment Mining Law* (Springer, 2016) at 95-107
[5] See Collins, above n 1

introducing restrictions placed on performance requirements in international trade law where they were originally conceived as trade-related investment measures, essentially tools designed to compel foreign investors to purchase local parts as inputs. Other aspects of international trade law which curtail the use of less-traditional forms of performance requirements will be examined, including those relating to the patentability of intellectual property and conditions imposed on foreign firms bidding for procurement contracts. Part III of this chapter will turn to international investment law itself, exploring the prohibitions on performance requirements contained in IIAs, noting how the concept has expanded to address the controversial issue of technology transfer more directly, which appears in the domestic foreign investment laws of some countries. From here the chapter will move more tentatively into the nascent field of digital trade, suggesting that the understanding of performance requirements must be expanded yet further to encompass rules on data localization and disclosure of source code. It will suggest that efforts to liberalize digital trade through regional trade agreements (RTAs) restricting the imposition of these types of performance requirements are in keeping with the prohibition against local content rules which characterized 20th industrialization but may be antithetical to the developmental agenda of modern international economic law.

II Performance Requirements in International Trade Law

Performance requirements are tightly controlled by international trade law at both the multilateral and bilateral (or regional) level. This section will consider the extent to which they are regulated by the law of the WTO. Coverage of this issue under RTAs tends to fall within the scope of international investment law because disciplines relating to performance requirements in RTAs usually appear in the investment rather than the trade chapters of these instruments. They will be accordingly considered in Part III.

i) Agreement on Trade Related Investment Measures (TRIMs)

The most important sphere of international trade law dealing with performance requirements is the WTO Agreement on Trade Related Investment Measures (TRIMs). The TRIMs Agreement prohibits a range of performance requirements which a host state might otherwise attempt to impose on the admission of foreign investor. More specifically, the TRIMs

Agreement prohibits a sub-set of performance requirements which it terms 'trade-related investment measures' or TRIMs. These are conditions that impact foreign firms by imposing direct or indirect quantitative restrictions on their use of imports or exports. In other words, TRIMs are restrictions on the use of certain kinds of performance requirements as conditions placed on foreign investors. The TRIMs Agreement is therefore primarily intended to control distortions to international trade, not international investment.

The TRIMs provides that no WTO Member may apply a trade-restrictive investment measure that is inconsistent with the GATT's prohibition on Article III National Treatment under (essentially discrimination against a product based on its foreign origin) or on Article XI quantitative restrictions.[6] For example, a requirement that a foreign manufacturer of machinery may be allowed to establish in a host state only if uses raw materials that were mined in that country would be TRIMs-illegal. While 'trade-related investment measures' themselves are not defined under the TRIMs Agreement, an illustrative list of trade-related investment measures is contained in an Annex to the TRIMs Agreement itself. The most important of these are the mandatory use of local materials, a classic trade-distorting measure imposed on foreign manufacturers designed to advantage local producers of parts for assembled products.

The TRIMs Agreement has been the subject of limited jurisprudence under the WTO dispute settlement system, probably because it merely reaffirms the application of GATT Article III.4 (National Treatment for all kinds of regulation) to certain forms of FDI.[7] Furthermore, many developing country Members of the WTO had already adopted an approach to the admission of FDI that was consistent with the TRIMs Agreement by the time it was concluded.[8] Most of the WTO disputes citing TRIMs provisions have been related to the automotive industry which is not surprising given the significant role that the automotive manufacturing sector has played in the economy of many developed countries. Foreign investment in the automotive industry has also traditionally be subjected to conditions imposed by host states such as quantitative restrictions and local content rules, in some cases designed to stimulate the local economy for purely protectionist aims. As will be seen below, the TRIMs Agreement has become relevant more recently in relation to high-technology manufacturing in the pharmaceutical industry.

[6] TRIMs Agreement Art 2 (1) and (2)
[7] Trebilcock, above n 2 Ch 11
[8] V Mosoti, 'Bilateral Investment Treaties and the Possibility of a Multilateral Framework on Investment at the WTO' 26 Northwestern Journal of International Law and Business 95 at 201 (2005-06)

The European Communities (EC), Japan and the US requested consultations through the WTO dispute settlement procedure against Indonesia regarding its allegedly restrictive investment policies towards its automotive sector on the basis of TRIMs Agreement violations.[9] Indonesia provided firms (both local and foreign) with import duty exemptions or reductions on required levels of imports on automotive parts based on the percentage of local content that they used in their manufacturing. It also offered tax and import duty exemptions as incentives to firms based on the degree of local content, effectively constituting a breach of National Treatment against foreign produced components. The Complainants argued that Indonesia's measures were also inconsistent with various provisions of the GATT as well as Article 2 of the TRIMs – the agreement's substantive prohibition on National Treatment and quantitative restrictions being used in conjunction with foreign investment laws. The panel agreed with most of these claims, ruling that the relevant measures implemented by Indonesia constituted local content requirements that were TRIMs-prohibited trade-related investment measures.

The EC and the US brought TRIMS-based proceedings against India through the WTO dispute settlement procedure in response to India's industrial indigenization policies.[10] The EC and the US complained that several regulations instigated by the Indian government in relation to its automobile industry violated GATT National Treatment and the prohibition on quantitative restrictions as well as Article 2 of the TRIMS. The relevant Indian laws required that imports of complete automobiles and of certain parts and components were subjected to a system of non-automatic import licenses. Such licenses would be granted only to approved local joint venture manufacturers. This arrangement obliged manufacturers to conform to specified local content as well as export balancing requirements. The panel ruled that India's imposition of these requirements on automotive manufacturers violated its commitments under the GATT and, having reached this conclusion it decided that it was not necessary to consider whether the measures also violated Article 2 of the TRIMs Agreement. The panel chose not to elaborate on the way in which the TRIMs Agreement would be interpreted, however it did note that the agreement should not be viewed as a more specific version of the GATT and as such it was not compelled to consider the TRIMs before the GATT as in standard dispute settlement practice.

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[9] Indonesia – Certain Measures Affecting the Automobile Industry, Panel Report, WT/DS54/R, (23 July 1998)
[10] India – Measures Affecting the Automotive Sector, Panel Report, WT/DS146/R, (5 April 2002)

Canada faced a complaint under the TRIMs Agreement from the EU in relation to its Feed-in-Tariff program through which it imposed restrictions on the sale and distribution of equipment for renewable energy generation (including wind and solar) facilities.[11] The EU (along with Japan) alleged that Canada accorded less favourable treatment to foreign suppliers of the equipment than it did to local ones, in violation of the National Treatment obligation of the GATT as well as Article 2.1 of the TRIMs Agreement. The measure in question required that the renewable energy equipment had to be supplied with a minimum content (25 per cent for wind and 60 per cent for solar power) from local firms. These were effectively domestic content requirements, affording protection to local producers of this kind of equipment. The Canadian government had maintained that the local content measures were necessary to promote the use of clean energy. The panel upheld the EU's claims under Article 2.1 of the TRIMs, as well as under the GATT, ruling that the measure fell within the type of trade-related investment measure described in Article 1a) of the agreement's illustrative list, namely a local content requirement. The panel considered also whether Canada could rely upon Article III:8 a) of the GATT's National Treatment provision (which excluded government procurement activities from the scope of the national treatment obligation) to justify breach of Article 2.1 of the TRIMs, ultimately ruling that Canada could not do so because the feed-in-tariff programme covered the procurement of electricity that was undertaken with a view to commercial resale, which fell outside the rubric of procurement which contemplated governmental use. The panel's recommendation was appealed to the Appellate Body which upheld the panel's determination that the local content features of the feed-in-tariff measure contravened Article 2.1 of the TRIMs, further confirming that Article III:8 of the GATT was not applicable to the feed-in-tariff measures because they involved commercial sales rather than procurement activities.

Japan recently brought a TRIMs Agreement claim against Brazil in relation to taxes and other charges in the automotive sector and in the electronics / technology sector. Under Brazil's scheme, lower taxes were granted on automobiles which were manufactured in Brazil or which invested in facilities in Brazil. To receive the lower tax treatment, the company must satisfy a set of requirements, including a minimum number of manufacturing activities in Brazil and/or minimum levels of expenditure in Brazil on research and development and capacity-building of actual and potential suppliers. Japan argued that these measures were a violation of

[11] Canada - Certain Measures Affecting the Renewable Energy Generation Sector, Canada - Measures Relating to the Feed-in Tariff Program, Panel Report - WT/DS426/R (19 Dec 2012)

Article 2.1 of the TRIMs Agreement in conjunction with Article 2.2 and with paragraph 1(a) of the agreement's illustrative list, because the tax breaks were TRIMs that were inconsistent with GATT National Treatment and because they required the use of automotive products from domestic sources in order to obtain tax advantages. Regarding Brazil's tax incentives in the electronics / technology sector, again, to receive the special treatment companies must produce relevant products in Brazil in accordance with a particular process involving minimum manufacturing steps to be conducted in Brazil and/or the use of certain raw materials and components to be produced in Brazil. A separate 'digital inclusion programme' required that the electronic goods be produced or developed in Brazil in order to benefit from the tax advantages. Japan argued that these requirements breached Article 2.1 of the TRIMs Agreement in conjunction with Article 2.2 and paragraph 1(a) of the illustrative list of the TRIMs Agreement. This is because the programme and related legal instruments were TRIMs that were inconsistent with GATT National Treatment and because they required the use of products from domestic sources in order to obtain tax advantages.[12] The panel concluded that the programmes in both sectors imposed tax and regulatory discrimination inconsistently with GATT National Treatment, and Article 2.1 of the TRIMs Agreement. The panel further ruled that the Brazilian incentive programs were local content requirements that detrimentally modify the conditions of competition for like imported input products, inconsistently with GATT National Treatment, and Article 2.1 of the TRIMs Agreement.[13] The Appellate Body upheld the panel's findings in relation to the discriminatory treatment of foreign producers, including those which fell within the scope of the TRIMs Agreement.[14]

In August 2018 China requested consultations through the WTO dispute settlement system with the US concerning measures allegedly adopted by the governments of certain US states and municipalities in relation to alleged domestic content requirements in the energy sector. The measures concerned involved rebates and tax credits for energy generated from renewable sources, with additional incentives available for those produced using equipment manufactured within the territory of certain US states. In addition to various other claimed breaches of WTO law, China claims that the measures appear to be inconsistent with Articles 2.1 and 2.2 of the TRIMS Agreement. China asserts that they are in breach of Article 2.1 of the

[12] Brazil – Certain Measures Concerning Taxation and Charges, Request for the Establishment of a Panel by Japan, WT/DS497/3 (18 September 2015)

[13] Brazil - Certain Measures Concerning Taxation and Charges, Report of the Panel, WT/DS497/3 (4 October 2017)

[14] Brazil - Certain Measures Concerning Taxation and Charges, Reports of the Appellate Body, WT/DS497/3/AB/R (13 December 2018)

TRIMs Agreement because the measures appear to be investment measures related to trade in goods that are inconsistent with National Treatment under the GATT. China believes that the incentive packages are in breach of Article 2.2 of the TRIMs Agreement because the measures appear to be investment measures related to trade in goods which are mandatory or enforceable under domestic law and compliance with which is necessary to obtain an advantage. They also require the purchase or use by an enterprise of products of US origin, as provided for in paragraph 1(a) of the TRIMs illustrative list.[15] This case is currently in consultations.

In April 2019 the EU instigated consultations through the WTO dispute settlement with Turkey regarding various measures it imposes concerning the production, importation and marketing of pharmaceutical products. The EU argues that the localisation requirement for the production of pharmaceutical products is inconsistent with Article 2.1 of the TRIMS Agreement. This is because Turkey requires foreign producers to commit to locate their production of certain pharmaceutical products in Turkey. If such commitments are not fulfilled, the pharmaceutical products concerned are excluded from the scheme for the reimbursement of the pharmaceutical products sold by pharmacies to patients operated by Turkey's social security system which covers the vast majority of sales of pharmaceutical products by pharmacies to patients. Consequently, if an imported pharmaceutical product is excluded from the reimbursement scheme, its competitive opportunities in the Turkish market are significantly impaired as compared with domestically produced like products.[16] This dispute is currently in consultations.

iii) Other WTO Agreements

Several of the WTO's other agreements also touch upon performance requirements in relation to foreign investment. Measures resembling performance requirements are found in the Trade Related Aspects of Intellectual Property (TRIPS) Agreement. In particular, the TRIPS Agreement restricts the use of conditions imposed on foreign investors by WTO Members as host states through its provisions on patentable subject matter. The agreement specifies that patents are to be made available without discrimination and whether products are imported or

[15] United States – Certain Measures Related to Renewable Energy, Request for Consultations by China, WT/DS563/1 (16 August 2018)

[16] Turkey – Certain Measures Concerning the Production, Importation and Marketing of Pharmaceutical Products, WT/DS583/1 (10 April 2019)

locally produced.[17] In the absence of this provision a host state would be able to compel foreign investors to use local products or else the benefits of intellectual property protection under the agreement would be unavailable. The EU raised a complaint regarding Turkey's breach of this aspect of the TRIPS Agreement in the pharmaceuticals case noted above. It asserts that Turkey imposes mandatory technology transfer obligations on foreign producers as a condition of the patentability of the pharmaceutical products. This allegedly violates Article 27.1 of the TRIPS Agreement because the technology transfer requirement, which covers patent rights, does not apply to domestic producers of pharmaceutical products. This means that patent protection is not made available without discrimination as to whether products are imported or locally produced. As noted above, this case is currently in consultations.

There are some potential performance requirement issues found in the provisions of the GATT which were designed to assist developing countries, which comprise two-thirds of WTO Membership. GATT Article XVIII contains an 'infant industry' protection for developing countries members, allowing them to impose protective measures to assist in the establishment of an industry which would otherwise be unable to withstand global competition, as mentioned earlier. Although Article XVIII(3), which references support for particular industries, speaks only of tariffs and quantitative restrictions (arguably not performance requirements), Article XVIII(4)a) refers to developing countries' ability to 'deviate temporarily from the provisions of the other Articles of this Agreement' in order to achieve further development. This provision may be construed to permit performance requirements, such as local content or technology transfer rules which might otherwise violate the TRIMs Agreement or the TRIPS Agreement. Together, along with various other aspects of WTO law including GATT Article XXXVII, these provisions reveal the underlying developmental agenda of the WTO – the benefits of globalization should be enjoyed by all countries. Measures such as performance requirements should therefore be approached with a degree of leniency as these may facilitate the participation of lesser developed countries in the global economy.

Some mention should be made of the investment-oriented provisions of the WTO's Government Procurement Agreement (GPA) and related performance requirement controls. The GPA is a plurilateral WTO agreement with 19 signatory parties as well as all EU Member states. It is of relevance to international investment law because of the requirement that locally-established suppliers must not be treated more favourably with respect to procurement rules,

[17] Art 27

essentially a prohibition against discrimination based on whether a foreign supplier has established an investment presence in the signatory state.[18] The GPA also contains provisions which are designed to prevent the use of performance requirements, although that term is not used. Rather, in the context of the GPA, performance requirements take the form of 'offsets.' Offsets are conditions imposed by governments on supplying firms to ensure a degree of local content or local participation. For supplying firms, offsets constitute additional conditions set out in tender documentation that are not directly related to the relevant procurement. Offsets may be viewed as discriminatory in that they provide an advantage to firms using domestic goods and services instead of those which are produced internationally.[19] Article 1 (l) of the GPA defines offset to mean: 'any condition or undertaking that encourages local development or improves a Party's balance-of-payments accounts, such as the use of domestic content, the licensing of technology, investment, counter-trade and similar action or requirement.' Article IV goes on to prohibit offsets in the following manner: 'With regard to covered procurement, a Party, including its procuring entities, shall not seek, take account of, impose or enforce any offset.' The same provision appears in the procurement chapter of some RTAs, notably Chapter 15 of the Comprehensive Progressive Trans Pacific Partnership (CPTPP).[20] There is no caselaw under the GPA with respect to offsets or their prohibition. While the prohibition of offsets should be welcomed by many suppliers from industrialized countries which are able to compete globally, the denial of offset provisions as a way of strengthening the contribution of foreign firms to the economies of host states, especially in the developing world, may be viewed as unequal at best and potentially harmful at worst. It is noteworthy that the prohibition on offsets in the GPA does not apply to developing countries, in the event any accede to the GPA.[21]

A final method by which WTO law circumscribes the use of performance requirements may be found in Members' accession protocols, that of China in particular. Accession protocols apply a specialized system of rules to newly-joining WTO Members, typically designed to cushion the shock of adaptation to the WTO single undertaking and to accommodate countries which do not have market-oriented economies where some of the WTO rules are more problematically applied.[22] In this regard, China's WTO Accession Protocol prohibits

[18] Art IV (2)
[19] D Collins, 'Government Procurement with Strings Attached? The Uneven Control of Offsets by the World Trade Organization and Regional Trade Agreements' 8:2 Asian Journal of International Law 301-321 (2018)
[20] Art 15.4 (6)
[21] Art V.3 b)
[22] D Geraets, *Accession to the World Trade Organization* (Edward Elgar, 2018)

performance requirements under the Article 7 non-tariff measures section (Art 7.3): 'China shall eliminate and cease to enforce trade and foreign exchange balancing requirements, local content and export or performance requirements made effective through laws, regulations or other measures.' This is framed as a fulfilment of the TRIMS: 'China shall, upon accession, comply with the TRIMs Agreement.' Interestingly this does not go as far as impose a restriction on mandatory technology transfer, a concept which will be returned to below. Rather, it is a more conventional prohibition on manufacturing-oriented, trade-distorting measures, as performance requirements have been traditionally understood. Having introduced performance requirements in their trade context, this chapter will now turn to the way in which they are handled in international investment law.

III Performance Requirements in International Investment Law

This section will explore the main aspect of the chapter – the potential for performance requirements to impact on international investment, meaning the location of the facilities of an enterprise from one state into the territory of another state.

i) International Investment Agreements (IIAs)

International Investment Agreements (IIAs) are the dominant source of international investment law in the 21st Century, having displaced customary international law in that role for the most part, although customary international law retains some force in many areas. There are now many thousands of IIAs, with many of the modern agreements consisting of investment chapters in RTAs. Newer IIAs tend to cover more material than their earlier forms and are typically somewhat more nuanced in terms of the balancing of obligations between investors and host states.[23] This is partially true in terms of their approach to performance requirements.

Generally speaking, performance requirements are prohibited in most IIAs. As dedicated obligations within IIAs, prohibitions on performance requirements operate to preclude host states from imposing a range of conditions on foreign investors as a condition of entry or as a condition of enjoying the protections of the IIA. In that sense they accord equality of competitive conditions between national and domestic investors, as captured in the National

[23] CL Lim, J Ho and M Paparinskis, *International Investment Law and Commentary* (Cambridge University Press, 2018) Chapter 3

Treatment provisions found in most IIAs. Performance requirement prohibitions prevent host states from creating a situation in which foreign firms are required to bear more onerous obligations than local ones, even where this might be used as an aid to development or industrialization.

The performance requirement prohibitions found in many older IIAs simply consists of an incorporation of the TRIMs Agreement's prohibitions on the use of classic TRIMs, such as mandatory local content rules.[24] For example The ASEAN Comprehensive Investment Agreement (ACIA) affirms the TRIMs in its provision on performance requirement prohibitions.[25] Some IIAs do not refer to performance requirement prohibitions at all, affording the host state the ability to use them as tools of structuring their inward FDI. Where IIAs are silent on the use of performance requirements, then the TRIMs will govern (at least where the state is a WTO Member). Modern IIAs between developing states (concluded within the last five years) tend not to include any reference to the use of performance requirements, reflecting the long held view that these instruments can help stimulate productivity, or so it is believed.[26]

Wider performance requirement prohibitions in IIAs are sometimes referred to as TRIMs+ obligations because they encompass more conditions than the trade-related investment measures specified in the TRIMs. Such broad prohibitions on admission qualifications for foreign investors are found in numerous RTAs containing investment chapters.[27] For example, the Japan-Singapore Economic Partnership Agreement, contains prohibitions on performance requirements including those which are based on labour and environmental standards.[28] The prohibition on performance requirements in NAFTA was perhaps the first example of an enlarged or TRIMs+ prohibition.[29] It has been retained in the new United States Mexico Canada (USMCA), Article 14.10 of which provides a definitive list of prohibited performance requirements which goes beyond upon the trade-based approach reflected in TRIMs. The provision reads as follows:

[24] E.g. New Zealand – China FTA Art 140 (7 April 2008)
[25] Art 7(2)
[26] E.g. M Richardson, 'The effects of a content requirement on a foreign duopsonist' 31:1-2 Journal of International Economics 143 (1991)
[27] E.g. Korea- Australia FTA Art 11.9 (17 February 2014)
[28] 13 January 2002
[29] Art 1106

1. No Party shall, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement, or enforce any commitment or undertaking:

(a) to export a given level or percentage of goods or services;

(b) to achieve a given level or percentage of domestic content;

(c) to purchase, use, or accord a preference to a good produced or a service supplied in its territory, or to purchase a good or a service from a person in its territory;

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with the investment;

(e) to restrict sales of a good or a service in its territory that the investment produces or supplies by relating those sales in any way to the volume or value of its exports or foreign exchange earnings

(f) to transfer a technology, a production process, or other proprietary knowledge to a person in its territory;

(g) to supply exclusively from the territory of the Party a good that the investment produces or a service that it supplies to a specific regional market or to the world market

(h) (i) to purchase, use, or accord a preference to, in its territory, technology of the Party or of a person of the Party,13 or (ii)that prevents the purchase or use of, or the according of a preference to, in its territory, a technology; or

(i) to adopt:(i) a given rate or amount of royalty under a license contract, or (ii)a given duration of the term of a license contract,

in regard to any license contract in existence at the time the requirement is imposed or enforced, or any commitment or undertaking is enforced, or any future license contract freely entered into between the investor and a person in its territory, provided that the requirement is imposed or the commitment or undertaking is enforced in a manner that constitutes direct interference with that license contract by an exercise of non-judicial governmental authority of a Party. For greater certainty, paragraph 1(i) does not apply when the license contract is concluded between the investor and a Party

Also, like NAFTA, the USMCA continues with a prohibition on the use of performance requirements in conjunction with investment incentives. Much as performance requirements themselves, some believe that investment incentives are ultimately harmful to host states.[30]

The prohibition on technology transfer performance requirements in Article 14.10 is perhaps the most noteworthy in terms of the enlargement of the prohibition beyond that which is addressed in the TRIMs Agreement. It prevents signatory states from imposing, as a condition of investing in its territory, to require an investor from another party 'to transfer a technology, a production process, or other proprietary knowledge to a person in its territory.'[31] Like the USMCA, Article 9.10 of the CPTPP specifies the prohibition of the following measures: 'h) (i) to purchase, use or accord a preference to, in its territory, technology of the Party or of a person of the Party; or (ii) that prevents the purchase or use of, or the according

[30] E.g. Hans Charles, P Oman, A Charlton 'Incentives-based Competition for Foreign Direct Investment: The Case of Brazil' OECD Working Papers on International Investment 2003/01 (March 2003)
[31] Art 14.10 f)

of a preference to, in its territory, a particular technology.' Perhaps best viewed as the opposite of forced technology transfer requirement, this kind of performance requirement compels the foreign investor to use local technology instead of its own.

The China – Hong Kong Closer Economic Partnership Agreement (CEPA) contains prohibition on performance requirements which closely resembles language in the USMCA (again, inspired by NAFTA). Interestingly it also contains a prohibition on technology transfer requirements.[32] This provision is key because it touches on one of the main criticisms that the US has of China's policy towards FDI and which is arguably one of the main drivers of the ongoing 'trade war' between the two economic superpowers. It is also worth noting in relation to China-Hong Kong CEPA the restriction on performance requirements is limited by Art 7.3 (also similar to the USMCA) which states that that parties can impose performance requirements if these have a purpose of training employees or expanding facilities or for the purpose of research and development. These are a narrow set of circumstances relating economic development in underdeveloped areas which would likely have limited impact on China and HK, meaning that the essential prohibition of performance requirements would remain intact. Still, this does disclose sensitivity to the role that performance requirements could play in stimulating sectors of the economy which might be welfare enhancing in the long term were they to receive special treatment in the shorter term.

It would appear as though that prohibitions on technology transfer (as a modern iteration of performance requirements) are becoming standard features of IIAs. It could be argued that technology transfer requirements are justifiable in the case of a developed / developing country IIA because knowledge exchange is thought to be one of the main advantages of FDI to developing countries.[33] It would appear as though the acquisition of technology is one of the main drivers for the signing of IIAs by developing (or emerging countries). Indeed some commentators have suggested that this may be the primary reason for IIAs in the absence of clear evidence that these agreements lead to increases in FDI in terms of pure monetary flows.[34] The restriction on technology-transfer oriented performance requirements must be viewed in light of the obligation which appears in the WTO's TRIPS

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[32] Art 7 vi)

[33] A Kamperman Sanders, 'Incentives and Obstacles for Innovation' in D Prévost, I Alexovicova, J Hillebrand Pohl eds. *Restoring Trust in Trade* (Hart, 2018)

[34] H Peled and MD Harpaz, 'Innovation as a Catalyst in the China-Israel Investment Relationship: The China-Israel BIT (2009) and the Prospective FTA' in J Chaisse, *China's International Investment Strategy: Bilateral, Regional and Global Law and Policy* (Oxford University Press, 2019) at 144

Agreement in relation to the encouragement of technology transfer from developed countries to developing ones (another example of an investment-oriented trade regulation). The relevant article of TRIPS Agreement reads:

> Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base.[35]

It could be argued that denying host states the capacity to structure the admission requirements placed on foreign investors so as to encourage the dissemination of technological innovations undermines one of the central advantages of FDI, as well as arguably one of the principles of WTO law and investment treaties, namely the achievement of development of the world's lesser developed states through the more equal distribution of the benefits of economic globalization.

There have been a handful of investment arbitration cases which have dealt with the imposition of performance requirements in violation of IIA provisions, most of which related to claims brought under NAFTA. In *Mobil Investments Canada and Murphy Oil v Canada*[36] the tribunal determined the provincial government's imposition of a requirement on foreign investors to spend several million CDN dollars per year in research and development as well as education and training was a breach of NAFTA's prohibition on performance requirements. The tribunal in *CPI v Mexico*[37] held that an excise tax that was imposed by Mexico on drinks using sweeteners that were not made from sugar cane effectively forced suppliers to switch from foreign corn syrup sugars to local cane based ones. As such it violated NAFTA's prohibition on performance requirements. *Cargill v Mexico*[38] was a dispute instigated by a US sugar company because of alleged tax-based mistreatment at the hands of the Mexican government. Here the tribunal held that Mexico breached its obligations under NAFTA through the imposition of a production tax which amounted to a performance requirement. It determined that Mexico conditioned the tax advantage on the use of domestically produced

[35] Art 66.2
[36] ICSID Case No. ARB(AF)/07/4 (20 February 2015)
[37] Corn Products International, Inc. (Claimant) v United Mexican States (Respondent) ICSID Case No. ARB(AF)/04/1 - Decision on Responsibility (15 January 2008)
[38] Cargill, Incorporated (Claimant) v United Mexican States (Respondent) ICSID Case No. ARB(AF)/05/2 (Award) (18 September 2009)

cane sugar instead of corn syrup based sugar for the very purpose of affecting the sale of local sugar. In *ADF v United States*[39] a Canadian construction company argued that the US imposition of a domestic content requirement violated the performance requirement prohibition of NAFTA. ADF was obliged to purchase only US steel and either to fabricate that steel in the US itself or to subcontract the fabrication to US steel fabricators rather than to its Canadian parent. The tribunal denied the claim, noting that the investor knew that the relevant state authority was not subject to NAFTA's prohibition on performance requirements (because it was an exempted procuring entity) and as such was permitted to enact local content requirements in government construction contracts.

One of the few non-NAFTA investment arbitrations which considered performance requirements was *Lemire v Ukraine*.[40] In this dispute the claimant argued that the host state's requirement that the investor, a radio broadcaster, play 50 per cent songs that had Ukrainian content violated the prohibition of performance requirements found in the IIA between the US and Ukraine. Rejecting the investor's claim, the *Lemire* tribunal held that Ukraine had the right to safeguard its national identity. The tribunal went on to explain that the performance requirement prohibition in the US-Ukraine IIA should be interpreted according to its object and purpose, which was linked to the overall purpose of improving economic cooperation between the parties, which was not incompatible with protecting Ukraine's cultural heritage.

There have been other investment arbitration disputes in which performance requirements were discussed in terms of their status as conditions imposed on licensing arrangements.[41] In most of these cases the tribunal rejected the claims of the investors that the non-renewal of licenses based on the failure to fulfil these conditions entitled the investor to be paid damages. Such performance requirements concerned matters such as the productivity and output of the investing firm as a contractual obligation and would likely not have been caught by conventional performance requirement prohibitions in the relevant IIA.

Although this chapter was not intended to address the issue of investment incentives, often used alongside performance requirements, some comments should be made regarding the potential of this strategy to draw tax matters into the realm of international investment law.

[39] ADF Group Inc. (Claimant) v United States of America (Respondent) ICSID Case No. ARB(AF)/00/1 (Award) (9 January 2003)
[40] ICSID Case No. ARB/06/18 (28 March 2011)
[41] CMS Gas Transmission Co v Argentina (ICSID Case No ARB/01/8), Award, (12 May 2005) and Gemplus SA, SLP SA and Gemplus Industrial SA de CV v United Mexican States (ICSID Case Nos ARB(AF)/04/3 and ARB(AF)/04/4)), Award, (16 June 2010)

Generally, IIAs do not apply to tax measures, as tax tends to be handled through dedicated treaty instruments. This means that host countries appear to retain total discretion to exercise their tax incentive policies irrespective of the obligations they have made in their IIAs. Still, many countries do not appreciate that the prohibition of performance requirement provisions found in most IIAs do restrict certain forms of tax incentives that are contingent on host states imposing performance requirements on investors as a condition of entry or receipt of favourable treatment under domestic laws. For example, Article 21 The US Model BIT of 2012 notes that measures relating to taxation are in fact covered by the prohibition on performance requirements found in Article 8 of the same agreement. In other words, tax-oriented performance requirements are often illegal in many IIAs.[42] The capacity of performance requirement prohibitions in IIAs to curtail tax-oriented investment incentives is particularly important given the observed links between a state's tax regime and its capacity to attract FDI. Several studies have shown that the location of FDI tends to be affected by the average tax rate of the host country.[43]

ii) Domestic Foreign Investment Laws

Many states maintain foreign investment laws, enacted as domestic statutes, which can have a significant impact on the activities of foreign investors who will be required to satisfy these rules as a condition of entry. They may have an even greater impact than an applicable IIA. Few, if any, of these statutes refer to performance requirements directly by that term, however some of the more economically important varieties of performance requirements are sometimes mentioned. For example, the new Foreign Investment Law of the People's Republic of China[44] lacks a provision on performance requirements, however it does mention 'technology transfer,' which as noted earlier, falls within the umbrella of performance requirements in some IIAs. The relevant provision of the Chinese statute states as follows (translated into English):

> …The State encourages technological cooperation to be conducted in the course of foreign investment and on the basis of the principle of voluntariness and business rules. The conditions for technological cooperation are to be

[42] D Collins and TJ Park, 'Interaction of Tax incentives and Performance Requirements in Bilateral Investment Treaties: Its Role in Implementing Right Institutions in Developing Countries' 41:1 Fordham International Law Journal 207-226 (2017)

[43] G Wamser, 'Foreign (In)Direct Investment and Corporate Taxation' 44 Canadian Journal of Economics / Revue Canadienne d'économique 1497 (2011)

[44] 15 March 2019

determined through consultation by the various parties to the investment on the basis of equality and the principle of fairness. Administrative organs and their employees *must not force the transfer of technological* [sic] through administrative measures.[45] [emphasis added]

This provision was likely designed to assuage some of the concerns raised by developed states, including the US and the EU, in relation to their FDI activities in China. It is unclear what is meant by the phrases 'business rules', 'technological cooperation' or the 'principle of fairness.' It would appear to suggest that although foreign investors will never be forced to transfer their technology, they may well be asked to do so. It may be that failure to respond affirmatively to such requests may carry informal consequences. This article will now proceed from its discussion of the more conventional understanding of performance requirements to that which may be contemplated by some of the emerging rules covering digital trade.

IV Digital Trade Rules as Performance Requirements

The rules on digital trade have become the focus of intense discussion in recent years as the global digital economy has grown enormously. So far, the WTO has failed to develop multilateral disciplines on this vital aspect of global commerce and some RTAs have filled the gap. While it is impossible to discuss the issue in any depth here, the legal framework governing digital trade is highly relevant to this chapter in that some of the nascent rules appear to contemplate performance requirements. Indeed some of the core legal principles in the sphere of digital trade represent the coming of age of performance requirements, conditionally perceived as impediments to global production in manufacturing. A study by the OECD showed that performance requirement-related issues (such as local content or technology transfer requirements) were reported by a relatively small number of firms (6 per cent) engaging in digital trade, ranking just ahead of intellectual property issues but well below the major concerns of non-discriminatory information flow and consumer protection.[46] Another study by the US International Trade Commission (USITC) on digital trade identified data localization requirements as one of the chief barriers to digital trade.[47]

[45] Art 22

[46] 'Digital Trade and Market Openness,' OECD, (9 August 2018) at 33

[47] A Porges and A Enders 'Data Moving Across Borders: The Future of Digital Trade Policy' E15 Initiative (April 2016) at 4

In terms of its coverage of digital trade issues, the CPTPP is among the most innovative RTAs in existence.[48] One of the most important features of the CPTPP's e-commerce chapter relates to the prohibition of data localization rules, which are arguably a form of performance requirement. Data localization laws includes both the explicit prohibition of, and restrictions on, the cross-border movement of data. They include *de jure* restrictions such as local data storage requirements which mandate that the physical storage of data must be in data centres within the local geographical territories of a state, or local content or production requirements. They also consist of *de facto* restrictions like privacy and data protection laws.[49] Since they compel private parties engaged in digital trade to establish a business presence in a particular territory or to include a local element as an aspect of their handling of data, these measures are rightly described as performance requirements, effectively requiring the foreign firm to engage in a certain kind of conduct. Forced data localization rules may be justified on the basis of security and data protection – they may also impose unfair, protectionist burdens on foreign firms.

In this regard, Article 14.13 of the CPTPP on Location of Computing Facilities reads as follows:

1.The Parties recognise that each Party may have its own regulatory requirements regarding the use of computing facilities, including requirements that seek to ensure the security and confidentiality of communications.

2. 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.

3.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.

These broad prohibitions on data localization should help provide certainty to businesses seeking to optimize investment decisions, allowing the investors to locate in certain countries only when it is profitable to do so, preventing the costs of redundant data centres. 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. Economies of scale and comparative

[48] Y Abe and D Collins, 'The CPTPP and Digital Trade: Embracing E-Commerce Opportunities for SMEs in Japan and Canada' Transnational Dispute Management (December 2018)
[49] N Sen, 'Understanding the Role of the WTO in International Data Flows: Taking the Liberalization or the Regulatory Autonomy Path?' 21:2 Journal of International Economic Law 323 (2018)

advantage in the data intensive industries are relatively concentrated in countries with superior digital infrastructure, which tend to be developed economies. This dominance can be further entrenched through data localization measures.[50] Still, data localization requirements remain common around the world, possibly evincing smaller economies' attempt to catch up in terms of the establishment of digital infrastructure.

It is important to recognize that the general prohibition on data localization in the CPTPP is subject to certain exceptions including government data and financial services data. The governmental data exception is essentially non-commercial, allowing signatory governments to retain the rights for data localization for government data that it holds or that is held by third parties under contract. There financial services data exception carves out a wide area of commercial activity on the basis of national security and consumer protection. Clearly the object of some data localization measures is to secure compliance with specific policy objectives relating to particular types of data. In this sense, a framework for future rule-making in the area of digital trade requires an understanding of different types of data to ascertain which ones require more regulatory autonomy in line with national policy objectives.[51] These debates, which are beyond the focus of this chapter, should be viewed in line with the historic parallel with traditional performance requirements as aids (or barriers to) industrialization.

Another feature of digital trade rules which may be construed as performance requirements (prohibitions) are those which relate to the mandatory disclosure of source code. Article 14.17 of the CPTPP is illustrative in this regard. It reads:

> 1.No Party shall require the transfer of, or access to, source code of software owned by a person of another Party, as a condition for the import, distribution, sale or use of such software, or of products containing such software, in its territory.
>
> 2.For the purposes of this Article, software subject to paragraph 1 is limited to mass-market software or products containing such software and does not include software used for critical infrastructure.
>
> 3.Nothing in this Article shall preclude:(a) the inclusion or implementation of terms and conditions related to the provision of source code in commercially negotiated contracts; or (b)a Party from requiring the modification of source code of software necessary for that software to comply with laws or regulations which are not inconsistent with this Agreement.
>
> 4.This Article shall not be construed to affect requirements that relate to patent applications or granted patents, including any orders made by a judicial authority in relation to patent disputes, subject to safeguards against unauthorised disclosure under the law or practice of a Party

[50] Ibid
[51] Ibid

This aspect of the CPTPP effectively prevents technology transfer as it relates to a specific kind of digital trade. Although this provision does not reference investment directly, it is highly likely that the protection of source code in this manner will be of vital importance to foreign investors. Forced disclosure of source code as a condition of entry could severely impair the profitability of a foreign firm, much as it could advantage local firms seeking to gain a foothold in a fast-moving global market.

It is clear that rules on digital trade, including those which might be termed performance requirements, are in need of much further discussion and, much like the original local content rules of conventional performance requirements, sensitivity in terms of their role as developmental tools. It may be that some digital trade performance requirements are effective instruments for developing states to gain ground in this important sphere of economic activity. Data localization and requirements to transfer technology could assist the establishment of digital infrastructure, for example, making such host states more attractive to foreign investors operating in these sectors. Commentators have accordingly suggested that the digital trade agenda, as taken up by the WTO, must keep in mind the developmental objective at the heart of its role in global governance. As with most aspects of economic liberalization, the drivers of the digital trade agenda have been the developed countries. In 2016, the US proposed a set of rules designed to liberalize digital trade, covering issues such as the enabling of cross-border data flows, basic non-discrimination principles, and the prevention of data localization and forced technology transfer.[52] Japan followed shortly thereafter with a report outlining common digital trade provisions in its recent FTAs.[53] An EU-led group that included Canada, Chile, South Korea and Cote d'Ivoire submitted an even more comprehensive report on their aims for a liberalized global framework for digital trade. Each of these reflect the approach in the CPTPP to varying degrees.[54] Some commentators feel that these proposals could consolidate the dominance of developed countries and their multinational enterprises over the 21st century

[52] General Council, Work Programme on Electronic Commerce. Non-Paper from the USA, JOB/GC/94, (4 July 2016)

[53] General Council, Work Programme on Electronic Commerce. Reinvigorating Discussions on Electronic Commerce. Circulated at the request of Japan, JOB/GC/96/Rev 1, (14 July 2016)

[54] General Council, Work Programme on Electronic Commerce, Trade Policy, the WTO, and the Digital Economy, JOB/GC/97, (14 July 2016)

digital economy, much as the US did with intellectual property rights and services in the Uruguay round.[55]

V Conclusion

This chapter presented performance requirement prohibitions in three interrelated legal contexts: international trade law under the WTO, international investment law under IIAs and digital trade rules under new RTAs. These settings each evince an attempt to restrict the protectionist, discriminatory element of some performance requirements, whether classic local content TRIMs, forced technology transfer requirements or modern restrictions on international data flows. The chapter has attempted to illustrate that the traditional understanding of a performance requirement must be recalibrated to reflect changes in the world economy away from assembly line manufacturing to patentable technology and ultimately to today's most valuable commodity, data itself. With performance requirements coming of age in the era of digital trade, this chapter has suggested that it is important to keep in mind the developmental focus behind performance requirements, recognizing that they are sometimes implemented to ensure that foreign investment is structured in a manner which best serves the interests of host states, even though it may yield distortive outcomes in certain contexts. Although the nature of the commodities to which performance requirements are applied has transformed, their underlying purpose has not, and rules designed to control their usage must remain as responsive as ever to these needs if they are to serve the interests of the modern economy as they did in the past.

[55] 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 (2018)