

Tearing down the Great Wall – the New Generation Investment Treaties of the People’s Republic of China

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I. Introduction

Although the People's Republic of China (PRC or China) has entered into well over 110 bilateral investment treaties ("BITs"), therefore ranking second only to Germany on a global scale,¹ her investment treaty practice has so far only drawn little attention in international legal scholarship and the international business community. While extensive literature exists on the legal aspects of investing in the PRC,² accounts of the regime established by international investment treaties, which grant protection to foreign investors under international law in China, are scarce.³ This stands in sharp contrast to the analysis of the influence of China's accession to the World Trade Organization (WTO),⁴ although the regime established by international investment treaties is bound to

¹ UNCTAD, *Recent Developments in International Investment Agreements*, p. 4 (2005); available at: http://www.unctad.org/sections/dite_dir/docs/webiteit20051_en.pdf.

² This literature is mainly concerned with commercial aspects of investing in the PRC, such as the intricacies of the domestic legal system for foreign investment, practical aspects of structuring an investment project in China and the influence of domestic reforms on the overall investment climate. See MICHAEL, MOSER (ed.), *Foreign Trade, Investment, and the Law of the People's Republic of China* (1987); GUIGUO WANG, *China's Investment Laws – New Directions* (1988); WEI JIA, *Chinese Foreign Investment Laws and Policies: Evolution and Transformation* (1994); ROBERT STRANGE/JIM SLATER/LIMIN WANG (eds.), *Trade and Investment in China: The European Experience* (1998); JUN FU, *Institutions and Investments: Foreign Direct Investment in China during an Era of Reform* (2001); W. B. GAMBLE, *Investing in China: Legal, Financial and Regulatory Risk* (2002).

³ See for older accounts of BIT practice of the PRC HANS-MARTIN BURKHARDT, *Das deutsch-chinesische Investitionsschutzabkommen*, 30 *Recht der Internationalen Wirtschaft* 28 (1984); LI SHISHI, *Bilateral Investment Promotion and Protection Agreements: Practice of the People's Republic of China*, in: DE WAART/PETERS/DENTERS (eds.), *International Law and Development*, p. 163 (1988); LAWRENCE W. BATES, *Protecting Foreign Investments in China: the Sino-Japanese Bilateral Treaty: Comparison with Earlier BITs and U.S. Positions*, 10 *E. Asian Executive Rep.* 9 (1988); T. NAKAJIMA, *Agreement between Japan and the People's Republic of China concerning the Encouragement and Reciprocal Protection of Investment*, 33 *Jap. Ann. Int'l L.* 228 (1990); JOHN S. MO, *Some Aspects of the Australia-China Investment Protection Treaty*, 25 *J. World Trade L.* 43 (1991); QINGJIANG KONG, *Bilateral Investment Treaties: The Chinese Approach and Practice*, 8 *Asian Yb. Int'l L.* 105 (1998/1999). See for more recent accounts WENSHUA SHAN, *The Legal Framework of EU-China Investment Relations – A Critical Appraisal* (2005) (focussing on aspects of bilateral investment treaties between the PRC and EU-member States); STEPHAN SCHILL, *Der Schutz ausländischer Investitionen in den Investitionsschutzabkommen der VR China*, in: MICHAEL RANFT/CHRISTOPH SCHEWE (eds.), *Chinesisches Wirtschaftsrecht*, pp. 75-88 (2006); CAI CONGYAN, *Outward Foreign Direct Investment Protection and the Effectiveness of Chinese BIT Practice*, 7 *J. World Inv. & Trade* 621 (2006).

⁴ See, for example, DONALD C. CLARKE, *China's Legal System and the WTO: Prospects for Compliance*, 2 *Wash. U. Global Stud. L. Rev.* 97 (2003); LINDSAY WILSON, *Investors Beware: The WTO Will Not Cure All Ills with China*, 2003 *Colum. Bus. L. Rev.* 1007 (2003); KAREN HALVERSON, *China's WTO accession: economic, legal, and political implications*, 27 *B.C. Int'l & Comp. L. Rev.* 319 (2004); VERON MEI-YING HUNG, *China's WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform*, 52 *Am. J. Comp. L.* 77 (2004); HUNG-GAY

have a comparably profound impact on business and investment relations with the PRC. The regime's implications should also not be underestimated in terms of their potential for change of China's domestic legal system and its economic constitution.

Having been traditionally critical towards the protection of foreign investment by international law, a new development took place starting in the late 1990's when the PRC entered into a number of new generation BITs that broke with her long-standing reservations vis-à-vis national treatment for foreign investors and comprehensive investor-State dispute settlement.⁵ This change is prominently marked by the conclusion of BITs with the Netherlands in 2001⁶ and Germany in 2003⁷ that conform, despite some remaining limitations, in all major aspects to what can be considered standard treaty practice in well over 2400 BITs worldwide.⁸ China's change in BIT practice can, however, not only be observed in relation to traditional capital-exporting countries, but also features in recent BITs with developing countries across the globe. China's new generation BITs now offer more effective protection against political risks stemming from undue government interference with the business activity of foreign investors. These changes, it is submitted, constitute a fundamental change in the country's foreign economic policy.

After giving an account of China's ideological struggle with the protection of foreign investments by international law (Part II), the paper analyzes the PRC's new

FUNG/CHANGHONG PEI/KEVIN H. ZHANG (eds.), *China and the Challenge of Economic Globalization: The Impact of WTO Membership* (2006); V. LO/X. TIAN. *Law and Investment in China: The Legal and Business Environment after China's WTO Accession* (2005); Henry GAO/DONALD LEWIS (eds.), *China's Participation in the WTO* (2005); T. L. WALMSLEY ET AL., *Assessing the Impact of China's WTO Accession on Investment*, GTAP Working Paper Series (2003); D. SMITH (ed.), *China and the WTO* (2002); A. YUAN, *China's Entry into the WTO: Impact on China's Regulating Regime of Foreign Direct Investment*, 35 Int'l Law. 195 (2001).

⁵ See for the specifics of the old generation Chinese investment treaties compared to international standards SHISHI (*supra* footnote 3), p. 163, 167 et seq. (1988).

⁶ Agreement on Encouragement and Reciprocal Protection of Investments between the Government of the People's Republic of China and the Government of the Kingdom of the Netherlands, signed Nov. 26, 2001, entered in force Aug. 1, 2004 [all investment treaties cited are available in UNCTAD's online database of international investment instruments at http://www.unctadxi.org/templates/DocSearch_779.aspx].

⁷ Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed on Dec. 1, 2003. The treaty entered into force on November 11, 2005, see German Federal Ministry of Economics and Technology, *Neues deutsch-chinesisches Investitionsförderungs- und -schutzabkommen in Kraft getreten*, press release of Jan. 12, 2006, available at <http://www.bmwi.de/BMWi/Navigation/Presse/pressemitteilungen.did=100772.html>; see also International Institute for Sustainable Development, *Investment Treaty News (ITN)*, Feb. 17, 2006, available at http://www.iisd.org/pdf/2006/itn_feb17_2006.pdf.

⁸ See UNCTAD (*supra* footnote 1), pp. 1 et seq. (2005).

generation investment treaty practice (Part III). In describing the substantive investor's rights granted, the paper shows in particular how the recent treaty practice breaks with former limitations in the country's old generation BITs and transforms them into effective and powerful tools of investment protection. This results from two major innovations of the new generation treaties: the country's acceptance of comprehensive investor-State dispute settlement and the inclusion of national treatment. Part IV concludes by suggesting that China's recent BIT practice can be understood as an important indicator for the evaluation of international investment law by a developing country in the struggle about the appropriate level of investment protection in international economic relations.

II. The PRC's Changing Attitude towards International Investment Protection

Until 1979, the relationship of the PRC towards foreign investment and its protection by international law has been one of resentment and scepticism.⁹ Similar to the Great Wall built in an attempt to protect various dynasties from raids by foreign powers between the 3rd century BC and the beginning of the 17th century,¹⁰ the PRC isolated itself from the international community and shielded itself against foreign economic and political influences by setting up ideological fortifications against foreign investors and their protection by international law.¹¹ In line with its Marxist ideology, notions and concepts of private property and individual economic initiative were vigorously rejected and the phenomenon of foreign investment gradually effaced through confiscation and intricate forms of creeping expropriations without compensation after the communist revolution in 1949.¹²

⁹ KONG (*supra* footnote 3), 8 *Asian Yb. Int'l L.* 105, 107 et seq. (1998/1999). See on the attitude of the PRC towards international law during this era COHEN/CHIU, *People's Republic of China and International Law* (1974); SHAO-CHIUM LENG (ed.), *Law in Chinese Foreign Policy: Communist China and Selected Problems of International Law* (1972).

¹⁰ On the history of the Great Wall see ARTHUR WALDRON, *The Great Wall of China: From History to Myth* (1990).

¹¹ See on the development of the protection of foreign investment by international law RUDOLF DOLZER, *Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht*, 1985, p. 13 et seq.; ANDREAS F. LOWENFELD, *International Economic Law*, p. 391 et seq. (2002).

¹² PAT K. CHEW, *Political Risk and U.S. Investment in China: Chimera of Protection and Predictability?*, 34 *Virg. J. Int'l L.* 615, 623 et seq. (1994) (describing the strategies of the Chinese government to terminate existing foreign investment in the 1950's by "retaliatory confiscation" and "hostage capitalism").

In its foreign policy, the PRC also aligned itself with the broader movement by developing countries to establish a “New International Economic Order” that emphasized the sovereignty of States over their natural resources and denied any substantial protection of foreign investment under international law.¹³ Similar to principles put forward by Latin American States under the Calvo Doctrine,¹⁴ China’s foreign policy was characterized by the *Five Principles of Peaceful Co-existence*, consisting of “mutual respect for each other’s sovereignty and territorial integrity, mutual non-aggression, non-interference in each other’s internal affairs, equality and mutual benefit, and peaceful coexistence”.¹⁵ With respect to foreign investment these principles translated into the position that

“(1) States have the sovereign right to control the entry of FDI and to regulate the activities of foreign investors in their territory;

(2) [t]he right to nationalise foreign property is an inherent attribute of national territorial sovereignty, and the exercise of this fundamental right is not subject to any pre-condition such as ‘public purpose, due process and compensation’, and

(3) State contracts or concessions are to be observed, subject to the sovereign power of host countries to mandate re-negotiation, revision or even unilateral modification on the basis of changed circumstances or public interest”.¹⁶

Yet, after 30 years of self-imposed isolation, China’s attitude towards foreign direct investment radically changed in 1979. The country became eager to attract foreign investment in order to boost its economic, social and technological progress and announced its “open-door policy”. Correspondingly, its foreign policy was altered and henceforth enshrined in “‘three guiding principles’ of international economic co-operation and exchange, i. e. the principles of sovereignty, equality and mutual benefit,

¹³ See KONG (*supra* footnote 3), 8 Asian Yb. Int’l L. 105, 109 (1998/1999). More generally on the politics and economics connected with the New International Economic Order see JAGDISH N. BHAGWATI, *The New International Economic Order: The North-South Debate* (1978); JEFFREY A. HART, *The New International Economic Order: Conflict and Cooperation in North-South Economic Relations, 1974-77* (1983); see also THOMAS W. WAELDE, *A Requiem for the “New International Economic Order”*, in: HAFNER/LOIBL (eds.), *Liber Amicorum: Professor Ignaz Seidl-Hohenveldern*, p. 771 et seq. (1998).

¹⁴ On the Calvo Doctrine and its ideological backdrop more generally, see SHEA, *The Calvo Clause – A Problem of Inter-American and International Law and Diplomacy* (1955); OSCHMANN, *Calvo-Doktrin und Calvo-Klauseln* (1993); ZAGEL, *Auslandsinvestitionen in Lateinamerika*, pp. 71 et seq. (1999); LIPSTEIN, *The Place of the Calvo-Clause in International Law*, 22 Brit. Ybk. Int’l L. 139 (1945).

¹⁵ Kong (*supra* footnote 3), 8 Asian Yb. Int’l L. 105, 109 (1998/1999).

¹⁶ *Id.*

and reference to international practice”.¹⁷ While these principles may appear as a simple prolongation of the earlier policy, the reference to international practice already illustrated the PRC’s willingness to engage with the habits of the international community and to pay greater respect to international standards developed for the protection of foreign investment.¹⁸

Attracting foreign investment to the PRC became a full success. Since 1979, the country has emerged as the world’s largest importer of foreign investment in the developing world.¹⁹ Inflows of foreign direct investment in mainland China rose to over US\$ 60 billion in the year 2004, totalling to an aggregate foreign direct investment stock of US\$ 245 billion.²⁰ The country’s size as a domestic market, the availability of cheap labor and her rapid rates of economic growth account for her attractiveness as a destination for foreign investment.²¹ Tax incentives further add to attracting foreign investors.²² In addition, China’s accession to the WTO in December 2001 resulted in lowering trade barriers and granted greater access for Chinese products to foreign markets and is, thus, likely to incite further growth of export-oriented foreign direct investment. Furthermore, the liberalization of the trade in services under the General Agreement on Trade in Services (GATS) provides foreign investors with “greater opportunities for participation in

¹⁷ *Ibid.*, at 110 *et seq.*

¹⁸ *Ibid.*, at 111.

¹⁹ On the history of foreign investment in China, see OWEN D. NEE, JR., *Shareholder Agreements and Joint Ventures in the PRC*, p. 3 *et seq.* (2005); see also on the development of foreign investment in China YI LI, *Legal and Financial Framework of Promoting FDI in Capital-Importing and Capital-Exporting Countries - China*, in: BRADLOW/ESCHER (eds.), *Legal Aspects of Foreign Direct Investment*, p. 281, 282 *et seq.* (1999); S. L. SHIRK, *How China Opened its Door: The Political Success of the PRC's Foreign Trade and Investment Reforms* (1994).

²⁰ UNCTAD, *World Investment Report 2005* (2006), Annex table B.1, p. 306 for data on FDI flows and Annex table B.2, p. 310 for data on FDI stock, available at http://www.unctad.org/en/docs/wir2005_en.pdf. (figures excluding Hong Kong and Macao).

²¹ See PAT K. CHEW, *Political Risk and U.S. Investment in China: Chimera of Protection and Predictability?*, 34 *Virg. J. Int'l L.* 615, 621 (1994); see also YIGANG PAN, *The Inflow of Foreign Direct Investment to China: The Impact of Country-Specific Factors*, 56 *J. of Bus. Research* 829, 833 (2003) (concluding that “a substantial proportion of the FDI in China has been aimed at tapping China’s domestic market”). According to an UNCTAD survey, China is considered to range as the most attractive global business location both among experts as well as transnational corporations; see UNCTAD (*supra* footnote 20), p. 34 (2006).

²² ZHAODONG JIANG, *China's Tax Preferences to Foreign Investment*, 18 *NW. J. Int'l. L & Bus* 549 (1998); SAMUEL TUNG/STELLA CHO, *The Impact of Tax Incentives on Foreign Direct Investment in China*, 9 *J Int'l Accounting* 105 (2000); MAUGUE, *Tax Incentives in the People's Republic of China: Who Benefits*, 5 *Tulane J. Int'l & Comp. L.* 155 (1997).

a wider sphere of commercial activities, such as banking, insurance, foreign trade, transportation, tourism, telecommunications, accounting, and legal services”.²³

At the same time, the PRC is emerging as an increasingly important exporter of foreign investment, notably in Asia and Africa.²⁴ Although her total outflow of foreign direct investment into other developing countries only amounted to an estimated aggregate of approx. US\$ 39 billion in 2004,²⁵ the PRC disposes of significant foreign investment stakes abroad. For instance, China is reportedly the single most important foreign investor in Sudan’s oil industry.²⁶ Parallel to the increase in economic power, the political weight of the PRC in the international arena will abound – and so will its influence on international law.²⁷ In the context of Sudan’s Darfur crisis, for example, her major investment in the country is probably one of the crucial factors for China’s hesitance in regard of a Security Council resolution against Sudan.²⁸

Realizing the need of foreign investors for predictability and protection of their investment, China’s reservations with regard to international law slowly crumbled. In order to promote foreign investment inflows into China, as well as to protect investment by Chinese companies abroad, the PRC has not only introduced a vast number of

²³ K.X. LI/KEVIN CULLIVANE/CHENG JIN, *The Application of WTO Rules in China and the Implications for Foreign Direct Investment*, 4 J. World Inv. 343, 360 (2003); see for influence of the WTO accession on China foreign investment regime also ANYUAN YUAN, *China’s Entry into the WTO: Impact on China’s Regulating Regime of Foreign Direct Investment*, 35 Int’l Law. 195 (2001); QINGJIANG KONG, *Towards WTO Compliance – China’s Foreign Investment Regime in Transition*, 3 J. World. Inv. 859, 878 (2002).

²⁴ See more generally on the PRC emerging role as a capital exporter KEVIN G. CAI, *Outward Foreign Investment: A Novel Dimension of China’s Integration into the Regional and Global Economy*, 160 The China Quarterly No. 160, 856 (1999) (concluding that China’s outward foreign investment will “mak[e] the country even more completely and irreversibly integrated into the global community”, at 880). See also CONGYAN (*supra* footnote 3), 7 J. World Inv. & Trade 621, 631 *et seq.* (2006) (explaining the change in China’s BIT practice as a function of its desire to promote and protect outward foreign direct investment).

²⁵ UNCTAD, *World Investment Report 2005*, Annex table B.1, p. 310; FDI toward flows in 2004 were approx. US\$ 1.8 million, see *idib.*, par. 306.

²⁶ See PETER S. GOODMAN, *China Invests Heavily In Sudan’s Oil Industry*, Washington Post Foreign Service, December 23, 2004, available at <http://www.washingtonpost.com/wp-dyn/articles/A21143-2004Dec22.html>. More generally on outbound foreign investment MITCHELL SILK/RICHARD MALISH, *Are Chinese Companies Taking Over the World?*, 7 Chic. J. Int’l L. 105 (2006).

²⁷ See for the implications of China’s rise to a political and economic world power ERIC A. POSNER/JOHN YOO, *International Law and the Rise of China*, 7 Chic. J. Int’l L. 1 (2006); RANDALL PEERENBOOM, *The Fire-Breathing Dragon and the Cute, Cuddly Panda: The Implications of China’s Rise for Developing Countries, Human Rights, and Geopolitical Stability*, 7 Chic. J. Int’l L. 17 (2006).

²⁸ See STÉPHANIE GIRY, *China’s Africa Strategy – Out of Beijing*, The New Republic Online, Oct. 11, 2004, available at <http://www.tnr.com/doc.mhtml?i=20041115&s=giry111504>.

domestic laws,²⁹ she also started – parallel to the change in foreign policy – concluding bilateral investment treaties soon after initiating its open door policy for foreign investment. In 1982 the PRC signed its first BIT with Sweden.³⁰ Subsequently surging to well over 110,³¹ BITs are now in existence with almost all capital-exporting countries, like Germany, Japan, France or the United Kingdom as well as with a large number of developing and transition economies in Asia, Africa, Eastern Europe and South America. Notably, there is however no bilateral investment treaty with the United States after initial negotiations were terminated after the Tiananmen incident.³² Although the PRC, unlike many developed countries, does not use a model template for its BIT negotiations,³³ the high number of treaties already concluded and the efforts to negotiate further such

²⁹ See YI LI (*supra* footnote 19), p. 281, 288 et seq. (1999); QINGJIANG KONG, *Foreign Direct Investment Regime in China*, Heidelberg J. of Int'l L 872 (1997).

³⁰ Agreement on the Mutual Protection of Investments between the People's Republic of China and the Kingdom of Sweden, signed March 29, 1982.

³¹ As of June 2005 the country has concluded a total of 113 BITs of which 87 have entered into force. See the list of BITs by country available under <http://www.unctad.org/Templates/Page.asp?intItemID=2344&lang=1> search term "China".

³² CHEW (*supra* footnote 21), 34 Virg. J. Int'l L. 615, 660 et seq. (1994). See further on the proposed BIT between the U.S. and China TIMOTHY A. STEINERT, *If the BIT Fits: The Proposed Bilateral Investment Treaty Between the United States and the People's Republic of China*, 2 J. Chin. L. 359 (1988); ROGER W. SULLIVAN, *Do We Really Need a BIT?*, 15 China Bus. Rev., No. 6 at 9 (Nov.-Dec. 1988); MARK R. WEINER/SHAO YING, *The Need for a Bilateral Investment Treaty Between the United States of America and the People's Republic of China*, 2 Int'l Legal Persp. 33 (1990). OPIC guarantees were, however, available to U.S. investors until Congress discontinued the program in 1990 after the Tiananmen incident, see CHEW (*supra* footnote 21), 34 Virg. J. Int'l L. 615, 668 et seq. (1994), On OPIC special China program see HENRY R. BERGHOEF, *OPIC in China*, China Bus. Rev. 44 (Sept.-Oct. 1984); ANTHONY F. MARRA, *OPIC Programs in China and Problems Faced by Investors*, 3 China Law Reports 170 (1986); Overseas Private Investment Corporation, 1987 Annual Report 26 et seq.; MARSHA A. COHAN, *OPIC Programs in China: An Update*, East Asian Exec. Reports (Apr. 15 1989) at 8.

³³ KONG (*supra* footnote 3), 8 Asian Yb. Int'l L. 105, 114 (1998/1999).

agreements³⁴ merit the assertion that China has established a bilateral investment treaty program that is comparable to those of traditional capital-exporting countries.³⁵

Initially, China's BIT practice was, however, characterized by a certain hesitance with regard to two standards of international investment protection. It was not until the PRC started entering into her new generation BITs that comprehensive investor-State dispute settlement as a mechanism to resolve disputes concerning alleged violations of an investment treaty and national treatment for foreign investors became part of the Chinese standard practice. While the earlier BIT practice can be explained in view of China's traditional scepticism vis-à-vis international law and the political call for the primacy of State sovereignty, the recent change was arguably brought about by the continuous exposure to the needs and requirements of the global economy and China's increasing engagement with the international community. Both China's desire to further attract foreign investment as well as its interests in protecting its own investors abroad have influenced a fundamental change of China's earlier position on foreign investment protection. While negotiations with the U.S. about a BIT were still ongoing, for example, national treatment and the inclusion of a comprehensive investor-State dispute settlement mechanism soon crystallized as the most contentious points and stalled the negotiating process as these features were considered as essential on behalf of the U.S.³⁶ Today, by contrast, both standards of investment protection feature in the PRC's new generation treaty practice.

³⁴ See for example on the PRC's negotiation with the Association of South-East Asian Nations (ASEAN) to establish the China-ASEAN Free Trade Area CHUN HUIPING, *China-ASEAN Investment Negotiations—The Substantive Issues*, 7 J. World Inv. & Trade 143 (2006). On the negotiation between the PRC and Canada of an investment protection agreement CLIFF SOSNOW, *Canada-China Investment Protection Agreement - A Significant Stepping Stone to Deeper Economic Co-Operation*, available at http://www.bilaterals.org/article.php?id_article=3342 (Dec. 21, 2005). Further China and Australia are negotiating a Free Trade Agreement that is intended to contain provision on the protection of investment, see International Institute for Sustainable Development, *Investment Treaty News (ITN)*, July 4, 2006, available at http://www.iisd.org/pdf/2006/itn_july4_2006.pdf. See also on China's announcement to negotiate further bilateral and regional free trade agreements *China to Advance Bilateral and Regional Free Trade Negotiation*, People's Daily, Sept. 16, 2006.

³⁵ Cf. also CONGYAN (*supra* footnote 3), 7 J. World Inv. & Trade 621, 634 *et seq.* (2006) (emphasizing the use of BITs as an instrument to promote and protect outward foreign direct investment from the PRC).

³⁶ See CHEW (*supra* footnote 21), 34 Virg. J. Int'l L. 615, 661 (1994); STEINERT (*supra* footnote 32), 2 J. Chin. L. 359, 433 *et seq.*, 452 *et seq.* (1988).

III. The Content of the PRC's New Generation BITs

BITs are a specific type of international treaty that provides for substantive as well as procedural protection for foreign investors against so-called political risk.³⁷ Unlike investment insurances or merely maintaining good relations with the host government,³⁸ these treaties offer direct legal protection against political risk safeguarding *inter alia* against direct and indirect expropriation or unfair and inequitable treatment. Most importantly, and in stark contrast to the traditional concept of international law as a law between nations, the ground-breaking innovation of most investment treaties is the fact that they provide the foreign investor with a direct right to initiate arbitration and to claim damages against the host State in an international forum.³⁹ This removes disputes with the host State from the imponderability of recourse to domestic courts that, in particular in developing countries, are often biased or not sufficiently independent from the host State's government.

BITs do not, however, protect against the business risk that is inherent in any investment project. Their object and purpose is, as generally enshrined in the preambles of the treaties, the "promotion and protection of [foreign] investment";⁴⁰ they intend to "create favourable conditions for investments in both States and to intensify the co-operation between nationals and companies in both States with a view to stimulating the

³⁷ On the connection between international investment treaties and the reduction of political risk see also NOAH RUBINS/STEPHAN KINSELLA, *International Investment, Political Risk and Dispute Resolution*, p. 1 et seq. (2005). For a general account of BITs see Rudolf DOLZER/MARGARETE STEVENS, *Bilateral Investment Treaties* (1995); ANDREAS F. LOWENFELD, *International Economic Law*, p. 474 et seq. (2002); Muthucumaraswamy Sornarajah, *The International Law of Foreign Investment*, p. 315 et seq. (2nd ed. 2004); GEORGIO SACERDOTI, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 *Recueil des Cours* 251 (1997).

³⁸ Investment or political risk insurances are available on the private insurance market, from government-sponsored entities, such as the Overseas Private Investment Corporation (OPIC) in the U.S., and the Multilateral Investment Guarantee Agency (MIGA), a political risk insurance set up pursuant to an international treaty under the auspices of the World Bank. See JENNIFER M. DELEONARDO, *Are Public And Private Political Risk Insurance Two Of A Kind?*, 45 *Va J. Int'l L* 737, 738 (2005). Good personal relations with the host government also play a major role for business success in China, see RAJIB N. SANYAL/TURGUT GUVENLI, *Relations Between Multinational Firms and Host Governments: The Experience of American-owned Firms in China*, 9 *Int'l Bus. Rev.* 119 (2000). YING QIU, *Personal Networks, Institutional Involvement, and Foreign Direct Investment Flows into China's Interior*, 81 *Economic Geography* 261 (2005).

³⁹ CHRISTOPH SCHREUER, *Paradigmenwechsel im Internationalen Investitionsrecht*, in: WALDEMAR HUMMER (ed.), *Paradigmenwechsel im Völkerrecht zur Jahrtausendwende*, p. 237 (2002) (describing the advent of investor-State arbitration as a "change in paradigm in international investment law").

⁴⁰ Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed on Dec. 1, 2003.

productive use of resources”.⁴¹ Although the exact wording may differ from treaty to treaty, the content of most BITs, including those of the PRC, is surprisingly uniform. In addition, differences between BITs are leveled by the principle of the most-favored-nation clauses usually endorsed by them.⁴²

A. The Scope of Application of China’s Investment Treaties

BITs apply to the only to the protection of covered investments. The notion of investment in Chinese BITs is usually broad and exhibits little differences across the various treaties.⁴³ It regularly encompasses

“every kind of asset invested by investors of one Contracting State in accordance with the laws and regulations of the other Contracting State in the territory of the latter and in particular, though not exclusively, includes (a) movable and immovable property as well as any other property rights such as mortgages, liens and pledges; (b) shares, stock, debentures and any other form of participation in a company; (c) claims to money, or to any performance under contract having an economic value associated with an investment [...]; (d) intellectual property rights, including copyrights, patents, industrial designs, trademarks, trade names, technical processes, know-how and goodwill; (e) business concessions conferred by law or under contract permitted by law, including concessions to search for, cultivate, extract or exploit natural resources”.⁴⁴

This wide definition of investment secures that all essential rights and interests necessary for engaging in economic activities in China are covered by the substantive protection of the investment treaty, including interests in joint ventures, contractual rights and intellectual property rights. Similarly wide is the definition of the foreign investor that

⁴¹ Agreement between the People’s Republic of China and the Government of the Kingdom of Denmark Concerning the Encouragement and the Reciprocal Protection of Investments, signed April 29, 1985.

⁴² For a discussion of MFN clauses see *infra* III.C.2.

⁴³ See for an in-depth account of the notion of investment under international investment agreements in general NOAH RUBINS, *The Notion of “Investment” in International Investment Arbitration*, in: HORN (ed.), *Arbitrating Foreign Investment Disputes*, 283 (2004).

⁴⁴ See Art. 1(1) of the Agreement between the Government of the Republic of Trinidad and Tobago and the Government of the People’s Republic of China on the Reciprocal Promotion and Protection of Investments, signed July 22, 2002.

can rely on the treaty's protection. It encompasses citizens and juridical persons incorporated in the home State of one of the contracting parties.⁴⁵

Frequently, the treaties also accord protection to investors whose investment is not effectuated directly in the host country, but structured by means of one or several subsidiaries. The 2003 Sino-German BIT, for example, also covers "indirect" investments, thereby protecting holding constructions where the investment is not directly held by the mother company but effectuated via one or several subsidiaries.⁴⁶ Similarly, the BIT between China and Argentina stipulates:

"If natural or juridical persons of a Contracting Party have an interest in a juridical person which was established within the territory of a third State, and this juridical person invests in the other Contracting Party it shall be recognized as a juridical person of the former Contracting Party."⁴⁷

The protection of indirect investments enables to structure investment projects in a way that allows combining the protection under a Chinese BIT with advantages stemming from the legislation of a third-State, in particular tax benefits. It also permits corporate structuring via third-country subsidiaries in order to bring an investment under the protection of international law in case no BIT exists between the investor's home State and the PRC. This is particularly important for U.S. investors who do not benefit directly from BIT protection of their Chinese investment. By using a subsidiary that is incorporated in a State that has entered into a BIT with China, they are able to enjoy the protection of an investment treaty.

⁴⁵ See, for example, Art. 1(2) of the Sino-German BIT, signed Dec. 1, 2003.

⁴⁶ Art. 1(1) of the Sino-German BIT.

⁴⁷ Art. 1(2) of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Argentina on the Promotion and Reciprocal Protection of Investments, signed Nov. 5, 1992. The Treaty, however, requires that the home State of the subsidiary renounces its right under general international law to exercise to exercise diplomatic protection on behalf of the subsidiary. This has to be viewed against the backdrop of the *Barcelona Traction* decision of the ICJ that only allowed the home State of the subsidiary to exercise diplomatic protection for a violation of the rights of the corporation and denied the espousal of rights of the shareholders. See *Barcelona Traction, Light and Power Company, Limited* (Belgium v. Spain), Judgment of Feb. 05, 1970, ICJ Reports 1970, p. 2, 34 et seq. Furthermore, even in the absence of such explicit provisions arbitral tribunals in international investment disputes tend to accept the protection of indirect investments, including those without controlling shares. See only *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of Aug. 3, 2004, par. 137 (concerning the standing of indirect shareholders absent an explicit treaty provision to this effect); *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction of June 17, 2003, par. 48 (concerning standing of a minority shareholder); see also STANIMIR A. ALEXANDROV, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals – Shareholders as "Investors" under Investment Treaties*, 6 J. World Inv. & Trade 387 et seq. (2005).

An important limit exists, however, with respect to the temporal applicability of BITs with the PRC. Their scope of application is limited to post-establishment measures. Unlike the BITs concluded by the U.S.,⁴⁸ State measures restricting the establishment of an investment in China are not subject to the rights conferred under a BIT.⁴⁹ Instead, the admission of foreign investment is in the discretionary power of the PRC.⁵⁰ Notwithstanding China's obligations under the WTO, investment treaties therefore leave States unrestricted in subjecting foreign investors to pre-establishment approval or excluding them from specific sectors of the economy.

B. Dispute Settlement Mechanism under Chinese BITs

By far the most important provisions in international investment treaties concern the procedural protection offered to foreign investors. BITs traditionally provide not only for State-to-State dispute settlement but also for investor-State arbitration. Compared to traditional means of enforcing public international law through diplomatic protection granted by the investor's home State,⁵¹ this empowerment of private investors has

⁴⁸ See KENNETH J. VANDEVELDE, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 Mich. J. Int'l L. 621 (1993); KENNETH J. VANDEVELDE, *A Brief History of International Investment Agreements*, 12 U.C. Davis J. Int'l L. & Pol'y 157 (2005).

⁴⁹ Concerning the establishment of foreign investment in China, a representative clause is, for instance, contained in the BIT between China and Uruguay that provides in its Art. 2 that "[e]ach Contracting Party shall encourage investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations".⁴⁹ Similarly, according to the Sino-Britain BIT investment shall be admitted "subject to its right to exercise power conferred by its laws". See Art. 2(1) of the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China Concerning the Promotion and Reciprocal Protection of Investments signed May 15, 1986.

⁵⁰ WENSHUA SHAN, *Legal Framework*, p. 119.

⁵¹ In case of an alleged violation of the rights of a foreign investor, traditional international law only allowed the investor's home State to grant diplomatic protection. The dispute was exclusively a dispute between States. See BORCHARD, *The Diplomatic Protection of Citizens Abroad or the Law of International Claims* (1916). Classical international law thus mediated the investor through an inter-State prism, see OPPENHEIM, *International Law*, § 20 (2nd ed. 1912). See also the classical expression of this view in *The Mavrommatis Palestine Concessions* (Greece v. Britain), Judgment No. 2 of August 30, 1924, 1924 P.C.I.J. (ser. A) No. 2, at 12: "*In the case of the Mavrommatis concessions it is true that the dispute was at first between a private person and a State – i.e. between M. Mavrommatis and Great Britain. Subsequently, the Greek Government took up the case. The dispute then entered upon a new phase; it entered the domain of international law, and became a dispute between two States. [...] It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from whom they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights – its right to ensure, in the person of its subjects, respect for the rules of international law. The question, therefore, whether the*

accurately been described as a “change in paradigm in international investment law”.⁵² Instead of depending on the discretion of its home State to grant diplomatic protection,⁵³ most BITs provide the covered investors with a unilateral right to initiate arbitral proceedings against the host country which usually gives general and advance consent to arbitration.⁵⁴

In standard international practice, investor-State arbitration is most often conducted under the rules of the International Centre for Settlement of Investment Disputes (ICSID).⁵⁵ The specificities of ICSID arbitration are the finality of its awards and their automatic recognition in the Convention’s member States. Unlike awards in international commercial arbitration, ICSID awards are only subject to Convention-specific annulment proceedings,⁵⁶ not, however, to domestic review according to the law in force at the arbitration’s situs. Furthermore, the enforcement State is prevented from invoking its public policy (*ordre public*) against the enforcement of an ICSID award.⁵⁷ Instead, member States have to “recognize an award [...] as binding and enforce [it]

present dispute originates in an injury to a private interest, which in point of fact is the case in many international disputes, is irrelevant from this standpoint.”

⁵² CHRISTOPH SCHREUER, *Paradigmenwechsel im Internationalen Investitionsrecht*, in: WALDEMAR HUMMER (ed.), *Paradigmenwechsel im Völkerrecht zur Jahrtausendwende*, p. 237 et seq. (2002).

⁵³ Generally, no internal obligation of a State exists to pursue claims against a foreign State on an international level. See e. g. on the legal situation in Germany RAINER HOFMANN, *Grundrechte und grenzüberschreitende Sachverhalte*, 1994, p. 107 et seq. with further reference to literature and judicial decisions. On the situation in the UK see *Abbasi v. Secretary of State for the Home Department*, English Court of Appeal, [2002] E.W.C.A. Civ. 1598. Ultimately, this discretion is the expression of the difference in the legal relation between the investor and the host State, on the one hand, and the relationship between the two States.

⁵⁴ See on the specificities of the consent to arbitration under modern investment treaties BARTON LEGUM, *Emerging Fora for International Litigation (Part 1): The Innovation of Investor-State Arbitration Under NAFTA*, 43 Harv. J. Int’l L. 531 (2002).

⁵⁵ The Centre was established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) in 1966, 575 U.N.T.S. 159. China signed the ICSID Convention on Feb. 9, 1990. It entered in to force on Feb. 6, 1993. For a list of contracting States see <http://www.worldbank.org/icsid/conState/c-States-en.htm>. Being ratified by 142 States as of today, including China, most foreign investors are able to avail themselves of the investor-State dispute settlement mechanism if they feel that the PRC violated provisions of the relevant bilateral investment treaty.

⁵⁶ See Art. 52 ICSID Convention.

⁵⁷ CHRISTOPH SCHREUER, *ICSID Convention: A Commentary*, Art. 54 par. 71 (2001). This differs from international commercial arbitration enforced pursuant to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York on 10 June 1958, 330 U.N.T.S. 38 (“New York Convention”) where Art. V allows the enforcement state to invoke its *ordre public* in order to deny enforcement of an arbitral award.

within its territory as if it were a final judgment of a court in that State”.⁵⁸ Investment treaty arbitration provides for recourse to adjudication before an international and independent forum and is therefore particularly salient for investors in countries where the domestic judicial system is underdeveloped, politically biased, or corrupt.⁵⁹

1. *The Limited Scope of Investor-State Arbitration in the PRC’s Old-Generation BITs*

Initially the PRC has been hesitant to consent to investor-State arbitration as a means to settle disputes under its BITs.⁶⁰ The first BIT with Sweden did not contain investor-State dispute provisions at all. According to an accompanying letter of the Swedish Government, this was due to the fact that China had not become a party of the ICSID Convention. The Contracting Parties had, however, agreed that upon the PRC’s accessions to the Convention, the BIT would “be supplemented with a supplementary agreement on a binding system for the settlement of disputes within the framework of the

⁵⁸ Art. 54(1) ICSID Convention. The only loophole enabling States to refuse recognition and enforcement of an ICSID award is State immunity (see Art. 55 ICSID Convention). See on State immunity as a bar to enforcement of ICSID awards comprehensively SCHREUER (*supra* footnote 57), Art. 55.

⁵⁹ This does, however, not exclude that the domestic legal system actually offers possibilities for foreign investors to challenge conduct by the host state. See on possibilities for foreign investors to challenge the acts of administrative agencies in the PRC, for example, DAVID L. WELLER, *The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action*, 98 Colum. L. Rev. 1238 (1998).

⁶⁰ International Arbitration between foreign investors and Chinese partners, by contrast, is frequently used in business relations with China. It poses, however, its own respective problems. See for example GE LIU, *International Commercial Arbitration in China: History, New Developments, and Current Practice*, 28 J. Marshall L. Rev. 539 (1995); CHARLES KENWORTHY HARER, *Arbitration Fails to Reduce Foreign Investors’ Risk in China*, 8 Pac. Rim L. & Pol’y J. 393 (1999); GEORGE O. WHITE III, *Navigating the Cultural Malaise: Foreign Direct Investment Dispute Resolution in the People’s Republic of China*, 5 Transactions: Tenn. J. Bus. L. 55 (2003); JINGZHOU TAO, *Arbitration Law and Practice in China* (2004); JEROME A. COHEN/NEIL KAPLAN/PETER MALANCZUK/DANIEL R. FUNG/WANG SHENG CHANG, *Arbitration in China: A Practical Guide* (2004); Marie Kidwell/James Brown, *China: A Perspective on International Arbitration in China, Recent Developments and CIETAC Arbitration*, 20 Const. L. J. 253 (2004); ARTHUR ANYUAN YUAN, *Enforcing and Collecting Money Judgments in China from a U.S. Judgment Creditor’s Perspective*, 36 Geo. Wash. Int’l L. Rev. 757 (2004); JIAN ZHOU, *Judicial Intervention in International Arbitration: A Comparative Study of the Scope of the New York Convention in U.S. and Chinese Courts*, 15 Pac. Rim L. & Pol’y 402 (2006). See also various contributions on arbitration in China in the Proceedings of the 17th ICCA Conference, hosted by the China International Economic and Trade Arbitration Commission (CIETAC) on 16-18 May 2004 in Beijing, China, ALBERT JAN VAN DEN BERG (ed.), *New Horizons in International Commercial Arbitration and Beyond* (2004); HEYE, *Forum Selection for International Dispute Resolution in China – Chinese Courts vs. CIETAC*, 27 Hastings Int’l & Comp. L. Rev. 535 (2004); CARLOS DE VERA, *Arbitrating Harmony: ‘MED-ARB’ and the Confluence of Culture and Rule of Law in the Resolution of International Commercial Disputes in China*, 18 Colum. J Asian L 149, fn. 126 (2004); JIAN ZHOU, *Arbitration Agreements in China: Battles on Designation of Arbitral Institution and Ad Hoc Arbitration*, 23 J. Int’l. Arb. 145 (2006).

International Centre for Settlement of Investment Disputes”.⁶¹ Yet, even before the PRC signed the ICSID Convention on Feb. 9, 1990,⁶² it started agreeing to investor-State dispute settlement by *ad hoc* tribunals in a number of pre-1990 BITs. The treaties, however, contained only a limited consent to investor-State arbitration; they exclusively allowed for investor-State disputes concerning the amount of compensation due in case of expropriation.⁶³

A typical clause concerning *ad hoc* settlement of disputes between an investor and a Contracting Party can, for example, be found in the Sino-Singaporean BIT. Its Art. 13(3) provides:

“If a dispute involving the amount of compensation resulting from expropriation, nationalization, or other measures having effect equivalent to nationalization or expropriation, [...] cannot be settled within six months after resort to negotiation [...] by the national or company concerned, it may be submitted to an international arbitral tribunal established by both parties.”⁶⁴

Even after China’s accession to ICSID, it retained her limited consent to investor-State arbitration. Upon ratification of the Convention, she notified the ICSID Secretariat that “the Chinese government would only consider submitting to the jurisdiction of ICSID disputes over compensation resulting from expropriation or nationalization”.⁶⁵

Given that expropriations increasingly constituted a negligible political risk and instead other forms of host State misconduct, such as violations of judicial and

⁶¹ See the letter dated March 20, 1982 of Sweden’s ambassador to the PRC, available at http://www.unctad.org/sections/dite/ia/docs/bits/china_sweden.pdf.

⁶² It entered in to force on Feb. 6, 1993; see <http://www.worldbank.org/icsid/conState/c-States-en.htm>.

⁶³ WENSHUA SHAN, *Legal Framework*, p. 200. In addition, the covered investments did not benefit from the considerable advantages of the ICSID Convention; see *supra* footnotes 55-59 and accompanying text.

⁶⁴ Art. 13(3) of the Agreement between the Government of the People’s Republic of China and the Government of the Republic of Singapore on the Promotion and Protection of Investments, signed Nov. 21, 1985.

⁶⁵ See FRESHFIELDS BRUCKHAUS DERINGER, *Resolving Disputes in China through Arbitration*, p. 53 (2006), available at <http://www.freshfields.com/publications/pdfs/2006/14706.pdf>. This notification is, however, not a reservation to the ICSID Convention in the technical sense of Art. 19-23 of the Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331. Instead, it constitutes a notification under Art. 25(4) ICSID Convention, according to which “[a]ny Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).” See Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, in: ICSID (ed.), *ICSID Convention, Regulations and Rules*, p. 35, 46 (2006), available at http://www.worldbank.org/icsid/basicdoc/CRR_English-final.pdf.

administrative due process, negatively affected foreign investors across the globe,⁶⁶ China's limited consent to investor-State arbitration vitiated the effectiveness of the dispute settlement mechanism. In addition, the limited access to ICSID arbitration in China's early BITs decreased their value as an investment protection tool. Overall, the limited scope of the PRC's consent to investor-State arbitration in its old generation BITs therefore compromised their effectiveness as mechanisms for investment protection, since home States are often reluctant to grant diplomatic protection, in particular for small or medium-sized investment projects. If at all, protection under China's old generation BITs against undue government measures could only be obtained before domestic courts⁶⁷ that are hardly a sufficient bulwark against governmental interferences in view of the lack of judicial independence and the existence of corruption in the PRC court system.⁶⁸

2. *Investor-State Dispute Settlement in Recent Treaty Practice*

The unsatisfactory situation caused by the limited scope of investor-State dispute settlement changed fundamentally with the advent of China's new generation BITs. Beginning in the late 1990's, the PRC started agreeing to comprehensive dispute settlement provisions. It consented, like under the BIT with Botswana, to international arbitration for "any dispute between an investor of one Contracting Party and the other Contracting Party" either under the ICSID Convention or before an *ad hoc* tribunal.⁶⁹ This broad clause allowed investors not only to resolve disputes concerning the amount of

⁶⁶ See MINOR, *The Demise of Expropriation as an Instrument of LDC Policy, 1980-1992*, 25 J. Int'l. Bus. Stud. 177, 180 (1994).

⁶⁷ This option is explicitly mentioned by most old generation BITs. See, for example, the Art 9(2) of the Agreement between the Government of the People's Republic of China and the Government of the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment (providing that "[i]f any dispute cannot be settled amicably through negotiations within five months of the date of resort to negotiations as specified in paragraph 1 of this Article then an investor of one Contracting Party may submit the dispute to the competent court of the Contracting Party accepting the investment").

⁶⁸ On the problem of corruption in the Chinese judiciary see, for example, BERNSTEIN/XIAOBO, *Taxation without representation in Rural China*, p. 109 *et seq.* (2003); see also HRIC, *The Wuhan Court Bribery Case*, Human Rights Forum no. 1, 2005, p. 30 (describing several bribing techniques in China). More generally on the problem of corruption in the judiciary see BUSCAGLIA/DAKOLIAS, *An Analysis Of The Causes Of Corruption In The Judiciary*, 30 Law & Pol'y Int'l Bus. 95 (1999), DAKOLIAS/THACHUK, *The Problem Of Eradicating Corruption From The Judiciary: Attacking Corruption In The Judiciary: A Critical Process In Judicial Reform*, 18 Wis. Int'l L.J. 353 (2000).

⁶⁹ Art. 9 of the Agreement between the Government of the Republic of Botswana and the Government of the People's Republic of China on Promotion and Protection of Investments, signed June 12, 2000. The first comprehensive dispute settlement mechanism was included in Art. 9 of the 1998 China-Barbados BIT.

compensation in expropriation cases, but to invoke all substantive rights granted in the applicable BIT.⁷⁰

As remaining access-restrictions to investor-State dispute arbitration, the new generation treaties only require the investor to eschew a waiting period of six months and to exhaust China's new Administrative Review Procedure. The purpose of this administration-internal review mechanism is to determine whether the conduct of administrative agencies was legal and appropriate under Chinese law. It does, however, not involve court proceedings and is thus different from the exhaustion of local remedies.⁷¹

While one may wonder whether the review procedure is an effective remedy against undue conduct of the Chinese administration, it does not obstruct the effectiveness of investor-State dispute settlement under the PRC's new generation BITs. Yet, it is interesting to speculate about the motives behind this procedural requirement. Given that the introduction of the Administrative Review Procedure in 1999 and its appearance in China's BITs in 2000 coincide, it seems probable that the PRC's intention behind requiring the investor to submit to this procedure as a prerequisite for international arbitration was to strengthen the effectiveness of this newly created domestic remedy and the domestic institutions in charge of it.⁷² The compulsory recourse to this local remedy may thus be less motivated by suspicion vis-à-vis international arbitration, but driven by the desire to build domestic institutions that can correct the eventual failure of public authorities in dealing with foreign investors. Ultimately, this endeavour should, therefore, benefit foreign investors in China if the reviewing agencies engage in a close scrutiny of administrative conduct.

It is interesting to note, that the introduction of comprehensive investor-State dispute settlement in China's BIT practice did not occur first in a treaty with a traditional

⁷⁰ Some of the clauses are even broad enough to apply to any investment dispute between a covered investor and the PRC, independent from the violation of substantive rights under the pertinent BIT. They would thus allow to bring treaty claims and contract claims. Cf. JÖRN GRIEBEL, *Die Einbeziehung von "contract claims" in internationale Investitionsstreitigkeiten über Streitbeilegungsklauseln in Investitionsschutzabkommen*, 4 *Zeitschrift für Schiedsverfahren/German Arbitration Journal* 306 (2006).

⁷¹ See Law of the People's Republic of China on Administrative Reconsideration, adopted at the 9th Meeting of the Standing Committee of the Ninth National People's Congress on April 29, 1999. See on the Administrative Review Procedure ALBERT CHEN, *An Introduction to the Legal System of the People's Republic of China*, p. 228 et seq. (2004).

⁷² Compare in this respect SUSAN D. FRANCK, *Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law*, Transnational Lawyer 2006 (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=882443 (analyzing an often-raised argument against investment treaty arbitration as bypassing and thus weakening domestic courts and institutions).

capital-exporting country but was introduced in a number of South-South BITs with other developing countries.⁷³ This could suggest that in relation to these countries the PRC is behaving like a traditional capital-exporting country that attempts to secure its investment abroad without much probability of being involved as respondent in any investor-State dispute.⁷⁴ The same pattern of dispute settlement provisions was, however, also introduced in China's recent BITs with capital-exporting European States, namely the BIT with the Netherlands in 2001 and the BIT with Germany in 2003. These treaties also contain comprehensive investor-State dispute settlement procedures. The Sino-German BIT, for example, provides in Art. 9 "that any dispute concerning investments [...] shall, at the request of the investor of the other Contracting State, be submitted for arbitration".⁷⁵ Limitations are only contained in the accompanying protocol that requires foreign investor to submit the dispute to the Administrative Review Procedure. Yet, it opens recourse to international arbitration if "the dispute still exists three months after he [i. e. the investor] has brought the issue to the review procedure".⁷⁶ Providing therefore for effective enforcement of investor's rights, China's new generation BITs "mark another significant step forward"⁷⁷ in the country's integration into the international economy and enhance the protection of foreign investors in the PRC significantly.

C. Substantive Investors' Rights Conferred under BITs

China's BITs also developed in terms of the substantive protection offered to foreign investors. While the PRC was traditionally hesitant to one of the standard guarantees in international investment protection, namely the guarantee of national treatment, its new generation BITs also increasingly conform to international standards in this respect. The other investor's rights, such as the protection against direct and indirect expropriation, fair and equitable treatment, full protection and security, and the right to transfer and repatriate profits, by contrast, remained largely unchanged. Yet, due to the

⁷³ See further the treaties with Barbados, Benin, Botswana, Bosnia and Herzegovina, Brunei, Burma, Cyprus, Ivory Cost, Djibouti, Guyana, Jordan, Latvia, Mozambique, North Korea, Kenya, Sierra Leone, Trinidad and Tobago, Tunisia and Uganda.

⁷⁴ In this sense CONGYAN (*supra* footnote 3), 7 J. World Inv. & Trade 621, 646 *et seq.* (2006); critical with respect to this change in China's BIT practice AN CHEN, *Should the Four Great Safeguards in Sino-Foreign BITs be Hastily Dismantled?*, 7 J. World Inv. & Trade 899 (2006).

⁷⁵ See Art. 9 of the Sino-German BIT; parallel Art. 10 of the Sino-Dutch BIT.

⁷⁶ See Ad Article 9 of the Protocol to the Sino-German BIT.

⁷⁷ WENSHUA SHAN, *Legal Framework*, p. 215.

introduction of comprehensive investor-state dispute settlement, they are now readily enforceable by foreign investors and do not remain in the realm of inter-state relations.

1. National Treatment

National treatment is one of the core guarantees regularly endorsed in international BIT practice.⁷⁸ It aims at creating a level playing field between local and foreign investors as a prerequisite for equal competition. It requires the host State to accord equal treatment to foreign investors without discriminating on grounds of nationality.

a) Limited National Treatment in China's Old Generation BITs

Initially, China's old generation BITs were reluctant to include national treatment. At the most, they contained provisions similar to the one found in the Sino-British treaty that provides that

*“either Contracting Party shall to the extent possible, accord treatment in accordance with the stipulations of its laws and regulations to the investment of nationals or companies of the other Contracting Party the same treatment as that accorded to its own nationals or companies”.*⁷⁹

The reference to domestic law and the limitation of the obligation to accord national treatment “to the extent possible” limited this guarantee of national treatment considerably. In essence, the framing of this provision reduced its normative content to undertake good will efforts to adopt equal treatment of foreign investors and remained largely symbolic.⁸⁰

Only few older Chinese BITs contained national treatment provisions that went beyond the language of the Sino-British Treaty. Art. 3(2) of the BIT with Japan from

⁷⁸ DOLZER/STEVENS, *Bilateral Investment Treaties*, p. 63 *et seq.* (1995).

⁷⁹ Art. 3(3) of the Sino-Britain BIT, signed on May 15, 1986 (emphasis added). Similar clauses are contained in several Chinese BITs. See, for example, Art. 3(3) of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Iceland Concerning the Promotion and Reciprocal Protection of Investments, signed on Mar. 31, 1994; Art. 3(2) of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Slovenia Concerning the Encouragement and Reciprocal Protection of Investments, signed Sept. 13, 1993.

⁸⁰ KONG (*supra* footnote 3), 8 *Asian Yb. Int'l L.* 105, 124 (1998/1999); WENSHUA SHAN, *Legal Framework*, p. 153; WENSHUA SHAN, *National Treatment for Foreign Investment Enterprises and the Conditions for Its Implementation*, 5 *Social Sciences in China* 128, 132 (1998).

1988, for example, contained a somewhat broader national treatment clause, according to which

“[t]he treatment accorded by either Contracting Party within its territory to nationals and companies of the other Contracting Party with respect to investments, returns and business activities in connection with the investment shall not be less favourable than that accorded to nationals and companies of the former Contracting Party.”⁸¹

While some commentators considered this clause as a “milestone” in China’s investment treaty practice,⁸² the Sino-Japanese national treatment provision was, however, significantly limited by the treaty’s Additional Protocol.⁸³ Art. 3 of the Protocol explicitly provides that with respect to national treatment

“it shall not be deemed ‘treatment less favourable’ for either Contracting Party to accord discriminatory treatment, in accordance with its laws and regulations, to national and companies of the other Contracting Party, in case it is really necessary for the reason of public order, national security or sound development of national economy.”⁸⁴

Especially the exceptions for “public order” and “sound development of national economy” allow considerable leeway for the PRC to uphold existing and to introduce new discriminations of Japanese investors. In addition, it is likely that an arbitral tribunal would consider both exceptions as self-judging and, accordingly, defer to the host State’s margin of appreciation in evaluating whether a specific discrimination aimed at upholding public order or at furthering economic development. This is particularly true with respect

⁸¹ See Art. 3(2) of the Agreement between Japan and the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, signed August 27, 1988. The scope of Art. 3(2) is further specified in Art. 3(3), defining business activity as including *inter alia* the maintenance of branches and other establishment necessary for the business activity, the control and management of companies, the employment and discharge of personnel and the making and performance of contracts. The Agreed Minutes that are part of the BIT further specify that national treatment refers to the purchase of raw materials, power and fuel, marketing of products, obtaining loans, etc.

⁸² In this sense ROBERT T. GREIG/CLAUDIA ANNACKER, *How Bilateral Investment Treaties Can Protect Japanese Investors*, 32 *Journal of the Japanese Institute of International Business Law* 1607 (2004) footnote 7, available also at http://www.cgsh.com/files/tbl_s47Details/FileUpload265/443/CGSH_HBilateral_Investment_Treaties_English.pdf.

⁸³ Critical as to whether this is a substantial concession of behalf of the PRC KONG (*supra* footnote 3), 8 *Asian Yb. Int’l L.* 105, 124 (1998/1999); SHAN, *Legal Framework*, p. 154 et seq. (2005).

⁸⁴ A similar framing of national treatment is reportedly also contained in the BIT between China and the Czech and Slovak Republic, see JIAN ZHOU, *National Treatment in Foreign Investment Law: A Comparative Study from a Chinese Perspective*, 10 *Touro Int’l L. Rev.* 39, 122 (2000).

to economic development that involves policy considerations that are difficult to scrutinize by arbitral tribunals in view of their close connections to the host State's sovereignty.⁸⁵

The reasons for China's hesitance with respect to national treatment are not completely clear. Besides the fact that foreign investment has always taken a route different from local entities in China, the reasons for not according national treatment to foreign investors presumably derive from the need to create a system that allows for foreign investment while at the same time upholding structures of a socialist planning economy.⁸⁶ In particular, the desire to uphold existing privileges of state-owned enterprises and to protect them against competition by foreign investors may have been the PRC's central objection to national treatment.⁸⁷ At the same time, the lack of national treatment was often not a significant disadvantage for foreign investors given that the domestic laws governing foreign investment in China are in many regards more favorable to foreign investors than to domestic private investors.⁸⁸ Still, regulatory disadvantages persist compared to state-owned enterprises.⁸⁹ In addition, foreign investors *de facto* often receive less favourable treatment in domestic courts and administrative proceedings.⁹⁰ Finally, not including national treatment in its investment treaties left the PRC at liberty to grant new privileges to domestic actors and to discriminate against foreign investors.

b) National Treatment in China's New Generation BITs

Parallel to including comprehensive investor-state dispute settlement provisions, the PRC also started agreeing to national treatment in its new generation BITs on a

⁸⁵ Concerning the exception to national treatment for public order, the situation may be slightly different by providing some possibilities for an independent and not self-judging assessment. Compare in this respect *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award of May 12, 2005, par. 353 et seq., considering the exceptions from BIT obligations under Art. XI of the U.S.-Argentina BIT as not self-judging. Art. XI reads: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests."

⁸⁶ WENSHUA SHAN, *Legal Framework*, p. 163 et seq.; YASHENG HUANG, *One Country, Two Systems: Foreign-invested Enterprises and Domestic Firms in China*, 14 *China Econ. Rev.* 404 (2003).

⁸⁷ See ZHOU (*supra* footnote 84), 10 *Touro Int'l L. Rev.* 39, 48, 114 et seq. (2000) (mentioning "subsidies and special preferential treatment" for state-owned enterprises).

⁸⁸ See WENSHUA SHAN, *Legal Framework*, p. 164 et seq.; YASHENG HUANG, *One Country, Two Systems: Foreign-invested Enterprises and Domestic Firms in China*, 14 *China Econ. Rev.* 404, 416 (2003).

⁸⁹ HUANG, 14 *China Econ. Rev.* 404, 409 et seq. (2003).

⁹⁰ Zhou (*supra* footnote 84), 10 *Touro Int'l L. Rev.* 39, 118 (2000).

broader basis. Starting in late 2001 with the BIT with the Netherlands, the PRC increasingly often includes general national treatment in its BITs.⁹¹ The 2003 Sino-German BIT, for instance, provides that

“[e]ach Contracting Party shall accord to investments and activities associated with such investments by the investors of the other Contracting Party treatment not less favourable than that accorded to the investments and associated activities by its own investors.”⁹²

At the same time, China’s new generation BITs still contain some restrictions to full national treatment. Above all, they include a so-called “grandfather clause” either directly in the treaty or in an additional protocol that provides

“do[es] not apply to

- (a) any existing non-conforming measures maintained within its territory;
- (b) the continuation of any such non-conforming measure;
- (c) any amendment to any such non-conforming measure to the extent that the amendment does not increase the non-conformity of these measures.

The People’s Republic of China will take all appropriate steps in order to progressively remove the non-conforming measures.”⁹³

These provisions allow China to uphold existing measures that do not conform to national treatment, while prohibiting the introduction of new discriminations or privileges for domestic economic investors (so-called “standstill”). In addition, the provision illustrates that the PRC is willing to continuously abandon non-conforming measures (so-

⁹¹ Yet, at least one earlier BIT contained a national treatment provision for Chinese investors in Peru but not vice versa. See Ad Articles 3 and 5 of the Agreement between the Government of the Republic of Peru and the Government of the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, signed on June 9, 1994.

⁹² See Art. 3(2) of the Sino-German BIT.

⁹³ Ad. Art 2 and 3 of the Sino-German BIT. Similar provisions on national treatment, including the “grandfather clause”, are also contained in other new generation BITs, such as the BIT with the Netherlands (see Art. 3(3) of the Sino-Dutch BIT), Bosnia and Herzegovina (see Art. 3(1) and Ad Art. 3 of the Agreement between the People’s Republic of China and Bosnia and Herzegovina on the Promotion and Protection of Investments, signed on June 26, 2002) and the Slovak Republic. The PRC and the Slovak Republic agreed in an Additional Protocol to the earlier treaty between China and the Czech and Slovak Republic to extend the national treatment provision in Art. 3(1). See Additional Protocol between the Government of the Slovak Republic and the Government of the People’s Republic of China to the Agreement between the Government of the Czech and Slovak Federal Republic and the Government of the People’s Republic of China for the Promotion and Reciprocal Protection of Investments; national treatment is, however, subject to a “grandfather clause” in Art. 3(4) of the Treaty.

called “rollback”).⁹⁴ Notwithstanding these limitations to national treatment, the inclusion of broader national treatment in its new generation BITs undoubtedly constitutes a major development in the PRC’s BIT practice and reiterates the PRC’s commitment to competitive structures that are at the basis of a market-economy.

National treatment will allow foreign investors to rely on more favorable provisions that apply only to domestic investors even if the overall package of the legal framework for foreign investors may be more favorable to the foreigner. National treatment may thus allow foreign investors to cherry-pick from the various regimes that apply to foreign investors on the one hand and domestic investors on the other.⁹⁵ Possibly, national treatment can also be used to strike down differences in treatment between different sectors of the economy. Indeed, some arbitral decisions point in this direction,⁹⁶ while others handle national treatment more restrictively and only allow for a sector-specific comparison between foreign and domestic investors.⁹⁷ Ultimately, further developments and clarifications in the jurisprudence of investment tribunals in this context will have to be awaited.

While one may be inclined to explain the change in the PRC’s foreign investment policy in terms of the negotiating power of its contracting parties, in particular Germany and the Netherlands, it seems that the reasons have to be sought elsewhere, in particular since broader national treatment is now also included in the BITs with other developing countries like Bosnia and Herzegovina. Possibly, China’s interest in protecting its own investment ventures abroad may have lead to including national treatment as a general principle into its new generation investment treaties.⁹⁸ In this context, the PRC’s dual

⁹⁴ The terms “standstill” and “rollback” are used to designate the comparable principles governing non-discrimination under the OECD’s Code of Liberalisation of Capital Movements and the OECD’s Code of Liberalisation of Current Invisible Operations. See OECD, *OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations – User’s Guide*, p. 10 (2003), available at <http://www.oecd.org/dataoecd/14/13/1935919.pdf>.

⁹⁵ Compare *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of Aug. 3, 2004, par. 108-120 (allowing the parallel case of “cherry-picking” under the most-favored-nation clause).

⁹⁶ See *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award of July 1, 2004, par. 167 *et seq.*; *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision On Liability of Oct. 3, 2006, par. 164 *et seq.*

⁹⁷ *Methanex Corporation v. United States of America*, UNCITRAL, Final Award of Aug. 3, 2005, Part IV - Chapter C Rdnr. 25; *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award of May 12, 2005, par. 285 *et seq.*

⁹⁸ This becomes particularly clear with respect to the asymmetric national treatment provision in the Sino-Peruvian BIT, see *supra* footnote 91. Differently CONGYAN (*supra* footnote 3), 7 J. World Inv. & Trade 621, 641 (2006) (suggesting that the inclusion of national treatment is mainly a function of negotiating pressure from developed countries).

position as a capital-importer, as well as an emerging capital-exporter, arguably leads to a trade-off between its interests as a host country consisting in upholding its sovereignty and regulatory leeway to the greatest possible extent and its interests as a home State in protecting its foreign investors abroad.

Another reason for China's fundamental policy change may be seen in her accession to the WTO,⁹⁹ itself constituting a regime that relies on non-discrimination and national treatment as one of its core principles.¹⁰⁰ Finally, the development towards comprehensive national treatment is also closely connected with China's economy increasingly assuming structures of a market economy that fundamentally relies on competition as a mechanism to allocate resources efficiently. This is paradigmatically illustrated by the introduction of a provision in the Chinese Constitution in 1993 that henceforth classifies the country's economic system as a "socialist market economy".¹⁰¹

2. *Most-Favored-Nation Treatment*

The change in China's BIT practice does, however, also have repercussions on its existing and more restrictive old generation BIT because of the principle of most-favored-nation (MFN) treatment contained in all Chinese BITs. Under MFN treatment the Contracting Parties enter into an obligation to

"treat investments and activities associated with investments in its own territory [...] on a basis no less favourable than that accorded to investments and activities associated with investments of nationals of any third country".¹⁰²

MFN treatment thus aims at creating equal competitive conditions for all foreign investors independent from their nationality.¹⁰³

⁹⁹ WENSHUA SHAN, *Towards a Level Playing Field of Foreign Investment in China*, 3 J. World Inv. 327, 328 (2002); K.X. LI/KEVIN CULLIVANE/CHENG JIN, *The Application of WTO Rules in China and the Implications for Foreign Direct Investment*, 4 J. World Inv. 343, 347 *et seq.* (2003); KONG (*supra* footnote 23), 3 J. World. Inv. 859, 878 (2002).

¹⁰⁰ See Art. III GATT; Art. XVII(1) GATS; Art. 2 TRIMS. The international trade regime even requires its Members to integrate non-discrimination between foreign and national products into the domestic legal order, Art. XVI(4) WTO.

¹⁰¹ The provision was originally introduced in Art. 15 of the Constitution of the PRC. Meanwhile it can be found in Art. 7.

¹⁰² Art. 3(c) of the Agreement between the Government of Australia and the Government of the People's Republic of China on the Reciprocal Encouragement and Protection of Investments, signed July 11, 1988.

¹⁰³ See on the MFN treatment standard in investment law UNCTAD, *Most-Favoured-Nation Treatment Series on issues in international investment agreements* (1999); MARIE FRANCE HOUDE/FABRIZIO PAGANI, *Most-Favoured-Nation*

a) Extending the Substantive Protection of Old Generation BITs

On the basis of an MFN clause a foreign investor is able to invoke benefits that the host State extended to investors from a third State, for example through more favourable BIT provisions.¹⁰⁴ The MFN clause in China's BITs therefore has considerable weight since her new generation investment grant broader protection to foreign investors. For instance, by means of the MFN clause contained in the Sino-British BIT,¹⁰⁵ a U.K. investor can benefit from the more comprehensive national treatment obligation contained in the 2003 Sino-German BIT.

b) Extending the Procedural Protection of Old Generation BITs?

Yet, the operation of an MFN clause is not limited to substantive investor's rights. In arbitral practice, the MFN clause has also been interpreted so as to encompass more favorable conditions concerning the dispute settlement mechanism under BITs. In the ICSID case *Maffezini v. Spain*, for example, the Tribunal held that, by means of the MFN clause, the foreign investor was not bound by a waiting period contained in the BIT between Argentina and Spain but could rely on more favorable conditions in another Spanish BIT that allowed initiating investor-State arbitration more quickly.¹⁰⁶ The main reason for the Tribunal to extend MFN treatment to investor-State arbitration was that the procedural rights were "inextricably related to the protection of foreign investors".¹⁰⁷

While the operation of the most-favored-nation clause to circumvent restrictions concerning the admissibility of an investor-State claim has been uniformly confirmed in subsequent arbitral jurisprudence,¹⁰⁸ it is contentious whether it can also broaden the

Treatment in International Investment Law, OECD Working Papers on International Investment 2004/2, p. 2, available at <http://www.oecd.org/dataoecd/21/37/33773085.pdf>.

¹⁰⁴ See on the extension of substantive investor's rights by means of MFN treatment *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award of May 25, 2004, para. 100 *et seq.*, 197 *et seq.*; and *Pope & Talbot Inc. v. Canada*, UNCITRAL(NAFTA). Award on the Merits of Phase 2 of 10 April 2001, paras. 105 *et seq.*

¹⁰⁵ See Art. 3(1) of the Sino-British BIT, signed May 15, 1986.

¹⁰⁶ *Emilio Augustin Maffezini v. Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction of Jan. 25, 2000, par. 38 *et seq.*

¹⁰⁷ *Maffezini v. Spain*, par. 54 *et seq.*

¹⁰⁸ See *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of Aug. 3, 2004, par. 32 *et seq.*; *Gas Natural SDG, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction of June 17, 2005, paras. 24 *et seq.*; *Suez, Sociedad General de Aguas de Barcelona, S.A. (AGBAR) and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Jurisdiction of August 3, 2006, paras. 52 *et seq.*; *Suez, Sociedad General de Aguas de Barcelona, S.A.*

jurisdiction of a tribunal. In view of the PRC's limited consent to investor-State arbitration in its old generation BITs, the question, therefore, arises whether investors can rely on MFN treatment in old generation treaties in order to bring disputes that do not concern the amount of compensation for expropriation but relate to the violation of other substantive rights, such as fair and equitable treatment, as covered by the consent in China's new generation BITs.

In the ICSID case *Plama v. Bulgaria*, the Tribunal declined such a request by a Cypriot investor.¹⁰⁹ While the arbitration clause in the Cyprus-Bulgaria BIT only allowed – like China's old generation BITs – *ad hoc* arbitration concerning the amount of compensation for expropriation, other Bulgarian BITs provided for comprehensive investor-State dispute resolution. Unlike the *Maffezini*-decision, the Tribunal held that in order to benefit from the broader consent in subsequent BITs, the basic treaty's MFN clause must explicitly encompass investor-State dispute settlement. It emphasized that “the reference must be such that the parties' intention to import the arbitration provision of the other agreement is clear and unambiguous.”¹¹⁰ This doctrinal approach mirrored the more restrictive jurisprudence on binding non-signatories to an arbitration clause in the context of commercial arbitration between private parties.¹¹¹

Although the decision has been approved by subsequent tribunals,¹¹² it is questionable whether its argument is sustainable in investment treaty arbitration. The main reason for being skeptical in this respect is that the provisions on investor-State dispute settlement are arguably the most important rights accorded to foreign investors because they effectively allow enforcing compliance with the host State's obligations

(*AGBAR*) and *Interaguas Servicios Integrales del Agua, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Jurisdiction of May 16, 2006, paras. 52 *et seq.*; *AWG Group Ltd. v The Argentine Republic*, UNCITRAL, Decision on Jurisdiction of August 3, 2006, paras. 52 *et seq.*; *Suez, Sociedad General de Aguas de Barcelona, S.A. (AGBAR) and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Jurisdiction of August 3, 2006, paras. 52 *et seq.* (all cases allowing the foreign investor to circumvent an 18 month waiting period by relying on the more favourable provisions in another treaty).

¹⁰⁹ See *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of Feb. 8, 2005, par. 183 *et seq.*

¹¹⁰ *Plama v. Bulgaria*, par. 200; see also par. 218.

¹¹¹ See on this Varady/Barcelo/von Mehren, *International Commercial Arbitration*, p. 188 (2006).

¹¹² *Telenor Mobile Communications A.S. v. The Republic of Hungary*, ICSID Case No. ARB/04/15, Award of Sept 13, 2006, par. 81 *et seq.* Another decision to the same effect was reportedly rendered under the Belgian-Russian BIT that contained a similarly narrow arbitration clause as the one common in China's old generation BITs. See International Institute for Sustainable Development, *Investment Treaty News*, Aug. 23, 2006, available at: http://www.iisd.org/pdf/2006/itn_aug23_2006.pdf.

under an international investment treaty for substantive rights that fall short of any legal effect without enforcement mechanism.¹¹³ It would, thus, appear to be surprising if States that agree to most-favored-nation treatment would not include the most important investor's right, i. e. the right to initiate investment arbitration. To be sure, in light of the existing precedents, the operation of the MFN clause in this context will also become an issue for future investor-State disputes with the PRC. The solution will depend on whether arbitral tribunals extend the reasoning in *Maffezini* to issues of jurisdiction or whether the *Plama* award will establish itself as the relevant line of argument.¹¹⁴

3. *Fair and Equitable Treatment*

While national and MFN treatment constitute relative standards that depend on the treatment accorded to a reference group, fair and equitable treatment is an absolute standard that grants protection independent of the host State's treatment of its own nationals. Absent any clear and unequivocal definition, the exact content of fair and equitable treatment has, however, not been authoritatively determined. In particular, there is a vivid debate as to whether this treaty standard is equivalent to the international minimum standard of treatment under customary international law or whether it constitutes a free-standing treaty obligation that can be interpreted and applied independently.¹¹⁵ In the practice of arbitral tribunals, the standard is regularly specified on a case-by-case basis.¹¹⁶

¹¹³ Cf. *Gas Natural v. Argentina*, par. 49, where the Tribunal held: "We remain persuaded that assurance of independent international arbitration is an important – perhaps the most important – element in investor protection. Unless it appears clearly that the state parties to a BIT of the parties to a particular investment agreement settled on a different method for resolution of disputes that may arise, most-favored-nation provisions in BITs should be understood to be applicable to dispute settlement."

¹¹⁴ See also on the recent controversy surrounding the effect of the MFN standard, following the decision in *Maffezini v. Spain* as a mechanism to extend the procedural protection offered by more favorable BITs JÜRGEN KURTZ, *The MFN Standard and Foreign Investment: An Uneasy Fit?*, 6 J.W.I.T. 861 (2004); RUDOLF DOLZER/TERRY MYERS, *After Tecmed Most-Favoured-Nation Clauses in International Investment Protection Agreements*, 19 ICSID Rev-F.I.L.J. 49 (2004); DAN H. FREYER/DAVID HERLIHY, *Most-Favoured-Nation Treatment and Dispute Settlement in Investment Arbitration: Just how 'Favoured' is 'Most-Favoured'?*, 20 ICSID Rev-F.I.L.J. 58 (2005); TEITELBAUM, *Who's Afraid of Maffezini? Recent Developments in the Interpretation of Most Favored Nation Clauses*, 22 J. Int'l Arb 225 (2005); STEPHEN FIETTA, *Most Favoured Nation Treatment and Dispute Resolution Under Bilateral Investment Treaties: A Turning Point?*, 8 Int'l Arb. L. Rev. 131 (2005); LOCKNIE HSU, *MFN and Dispute Settlement – When the Twain Meet*, 7 J.W.I.T. 25 (2006).

¹¹⁵ Understanding fair and equitable treatment as an independent standard: MANN, *British Treaties for the Promotion and Protection of Investments*, 52 Brit. Yb. Int'l L 241, 244 (1981); UNCTAD, *Fair and Equitable Treatment*, p. 39 *et seq.* (1999); DOLZER/STEVENS, *Bilateral Investment Treaties*, 1995, p. 60; PETER MUCHLINSKI, *Multinational Enterprises and the Law*, p. 626 (1995); PIERRE LALIVE, *Protection et Promotion des Investissements: Etude de Droit International*

The arbitral tribunal in *Waste Management v. Mexico*, for example, summarized the existing arbitral jurisprudence on fair and equitable treatment as

“suggest[ing] that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”¹¹⁷

In arbitral jurisprudence the standard is regularly applied in a broad manner, using it as a reference for the conduct of the national legislator, domestic administration and domestic courts. From a more conceptual perspective, fair and equitable treatment can be understood as an embodiment of the rule of law that serves as an overarching principle for all branches of domestic government.¹¹⁸ The jurisprudence of investment tribunals interpreting fair and equitable treatment regularly has recourse to certain sub-elements that run parallel to the concept of the rule of law in domestic legal systems that endorse legal and political traditions of liberal democracies. In this context, fair and equitable treatment includes the requirement of stability and predictability of the legal framework and

Economique, p. 94 (1985); STEPHAN VASCIANNIE, 70 Brit. Yb. Of Int'l Law 99, 144 (1999); *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of Aug. 30, 2000, par. 74 et seq., *Pope & Talbot v. Canada*, UNCITRAL (NAFTA), Award on the Merits of Phase 2 of Apr. 10, 2001, par. 111; *Tecmed v. Mexico*, par. 155; *Saluka v. Czech Republic*, par. 294. Understanding fair and equitable treatment as an expression of the international minimum standard: OECD, *Draft Convention on the Protection of Foreign Property 1967*, 7 I.L.M. 117, 120 (1968); *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award of July 1, 2004, par. 188 et seq., *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award of May 12, 2005, par. 284.

¹¹⁶ See CATHARINE YANNACA-SMALL, *Fair and Equitable Treatment Standard in International Investment Law*, OECD Working Papers on International Investment, Number 2004/3, available at <http://www.oecd.org/dataoecd/22/53/33776498.pdf>; CHRISTOPH SCHREUER, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. World Inv. & Trade 357 (2005); BARNALI CHOUDHURY, *Evolution or Devolution? – Defining Fair and Equitable Treatment in International Investment Law*, 6 J. World Inv. & Trade 297 (2005). RUDOLF DOLZER, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 Int'l Law. 87 (2005); STEPHAN SCHILL, *Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law*, IILJ Working Paper 2006/6 (Global Administrative Law Series), available at <http://www.iilj.org/20066SchillGAL.htm>.

¹¹⁷ *Waste Management, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of Apr. 30, 2004, par. 98.

¹¹⁸ SCHILL (*supra* footnote 116), IILJ Working Paper 2006/6.

consistency in the host State's decision-making, the principle of legality, the protection of investor confidence or legitimate expectations, procedural due process and denial of justice, protection against discrimination and arbitrariness, the requirement of transparency and the concept of reasonableness and proportionality.¹¹⁹

Based on a violation of fair and equitable treatment, arbitral tribunals have, for instance, ordered host States to pay damages to foreign investors for the refusal to grant or to prolong an operating license for a waste landfill.¹²⁰ Similarly, denial of justice by domestic courts is considered to constitute a violation of fair and equitable treatment.¹²¹ In two cases involving Argentina's 2001 emergency legislation, even the national legislator has been found to have violated the fair and equitable treatment standard by fundamentally changing the regulatory regime for investments in the country's energy sector and thereby contravening the legitimate expectations of affected investors.¹²² Overall, fair and equitable treatment is one of the most influential investor's guarantees, having the potential to shape domestic administrative law, influence the deployment of judicial proceedings and serve as a quasi-constitutional standard that sets limits to the activity of the national legislator. It grants, *inter alia*, procedural rights in administrative proceedings such as the right to be heard, the requirement to give reasons for administrative decision-making and provide for protection against retroactive legislation. It may be particularly useful for foreign investors to tackle the rampant problems of China's "unruly bureaucracy" that is characterized by a lack of control by courts, wide discretion and arbitrariness of administrative agencies and corruption.¹²³ Investment arbitration under China's BITs and the fair and equitable treatment standard may thus

¹¹⁹ See SCHILL (*supra* footnote 116), IILJ Working Paper 2006/6, p. 11 *et seq.*

¹²⁰ *Técnicas Medioambientales Tecmed S. A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003, par. 152 *et seq.* (concerning the non-prolongation of an operating license for a waste landfill) and *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of Aug. 30, 2000, par. 74 *et seq.* (concerning the refusal to grant a construction permit for a waste landfill).

¹²¹ See *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux (Vivendi) v. Argentina*, ICSID Case No. ARB/97/3, Award of Nov. 21, 2000, par. 80; *Loewen Group, Inc. and Raymond L. Loewen v. United States*, ICSID Case No. ARB(AF)/98/3, Final Award of June 26, 2003, par. 132; *Waste Management v. Mexico* (*supra* note 117), par. 132. See comprehensively on the closely related concept of denial of justice in international law JAN PAULSSON, *Denial of Justice in International Law* (2005).

¹²² See *CMS v. Argentina*, par. 279; *LG&E v. Argentina*, par. 100 *et seq.*

¹²³ See RANDALL PEERENBOOM, *China's Long March Toward Rule of Law*, p. 394 *et seq.* (2002).

also be a way to cope with the massive center-periphery problem in the PRC stemming deficiencies in law enforcement by local administrative agents.¹²⁴

4. Full Protection and Security

Closely connected to the fair and equitable treatment standard is the guarantee of full protection and security that is included in virtually all Chinese BITs. Its main content is the obligation of the host State to protect investments by conferring police protection against physical interferences by private actors, such as demonstrating or rioting individuals.¹²⁵ The concept was held to be violated, for instance, in a case of destruction of foreign-owned commercial property by the host State's armed forces.¹²⁶

5. Protection Against Expropriation

Given China's history of expropriations of foreign investors after the communist take-over,¹²⁷ another important investor's right is the protection against expropriation contained in all Chinese BITs. The Sino-German BIT, for instance, provides that

“[i]nvestments by investors of either Contracting Party shall not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting Party (hereinafter referred to as expropriation)”.¹²⁸

a) Direct and Indirect Expropriation

Expropriation does not only comprise direct expropriations or nationalizations that involve the transfer of title from the foreign investor to the State or a third-party. Its scope

¹²⁴ See KEVIN J. O'BRIEN/LIANJIANG LI, *Suing the Local State: Administrative Litigation in Rural China*, in: NEIL J. DIAMANT/STANLEY B. LUBMAN/KEVIN J. O'BRIEN (eds.), *Engaging the Law in China – State, Society, and Possibilities for Justice*, p. 31 *et seq.*

¹²⁵ See HELGE ELISABETH ZEITLER, *The Guarantee of “Full Protection and Security” in Investment Treaties Regarding Harm Caused by Private Actors*, *Stockholm Int'l Arb. Rev.* 1 (2005) (with references to and discussion of the case law on full protection and security).

¹²⁶ *American Manufacturing & Trading, Inc. (AMT) v. Republic of Zaire*, ICSID Case No. ARB/93/1, Award of Feb. 21, 1997, par. 6.04 *et seq.*; *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award of June 27, 1990, par. 45 *et seq.*

¹²⁷ See CHEW (*supra* footnote 12), 34 *Virg. J. Int'l L.* 615, 623 *et seq.* (1994); see also LAURIE A. PINARD, *United States Policy regarding Nationalization of American Investments: The People's Republic of China's Nationalization Decree of 1950*, 14 *Cal. W. Int'l L. J.* 148 (1984).

¹²⁸ Art. 4(2) of the Sino-German BIT.

is broader and also covers so-called indirect, creeping or *de facto* expropriations, involving state measures that do interfere with the owner's title but negatively affect the property's substance or void the owner's control of it.¹²⁹ In light of receding numbers of direct expropriations,¹³⁰ this pattern of host State conduct is an important instrument for the protection of foreign investors and enables foreign investors to challenge measures taken in the context of the modern regulatory State, such as strangulating taxation or other "regulatory takings".¹³¹ While it is not settled how to draw a distinction between compensable indirect expropriation and non-compensable regulation,¹³² the emerging arbitral jurisprudence tends to view unreasonable destruction of the value of foreign investment, interferences with the management of a company or the repudiation of an investor-State contract as compensable indirect expropriation. Similarly, the cancellation and the non-prolongation of operating licenses have been classified as indirect expropriations by investment tribunals.¹³³

Both direct and indirect expropriations are only lawful under China's BITs if they fulfil a public purpose, are implemented in a non-discriminatory manner and observe due

¹²⁹ See on the concept of indirect expropriation GEORGE C. CHRISTIE, *What Constitutes a Taking of Property Under International Law?*, 38 Brit. Yb. Int'l L. 307 (1962); BURNS H. WESTON, "Constructive Takings" under International Law: A Modest Foray into the Problem of „Creeping Expropriation“, 16 Va. J. Int'l. L. 103 (1975); ROSALYN HIGGINS, *The Taking of Property by the State: Recent Developments in International Law*, 176 Recueil des Cours 259, 322 et seq. (1982); RUDOLF DOLZER, *Indirect Expropriation of Alien Property*, 1 ICSID Review – Foreign Inv. L. J. 41 (1986); THOMAS W. WÄLDE/ABBA KOLO, *Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law*, 50 Int'l & Comp. L. Q. 811 (2001); CATHERINE YANNACA-SMALL, *'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law*, Working Paper on International Investment, No. 2004/4. OECD (2004); JAN PAULSSON/ZACHARY DOUGLAS, *Indirect Expropriation in Investment Treaty Arbitrations*, in: Horn (ed.), *Arbitrating Foreign Investment Disputes*, p. 145 – 158 (2004); L. YVES FORTIER/STEPHEN L. DRYMER, *Indirect Expropriation in the Law of International Investment : I know it when I see it, or Caveat Investor*, 19 ICSID Review— Foreign Inv. L. J. 293 (2004); ANDREW NEWCOMBE, *The Boundaries of Regulatory Expropriation*, 20 ICSID Review— Foreign Inv. L. J. 1 (2005); BJØRN KUNOY, *Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration*. 6 J. W. I. T. 467 (2005); CHARLES LEBEN, *La liberté normative de l'état et la question de l'expropriation indirecte*, in: CHARLES LEBEN (ed.), *Le contentieux arbitral transnational relatif a l'investissement international: nouveaux développements*, p. 163 (2006).

¹³⁰ See MINOR (*supra* footnote 66), 25 J. Int'l. Bus. Stud. 177 (1994).

¹³¹ The concept of indirect expropriation in international law often runs parallel to the concept of "regulatory takings" under the Fifth Amendment to the United States Constitution.

¹³² See RUDOLF DOLZER, *Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht*, p. 186 et seq. (1985); RUDOLF DOLZER, *Indirect Expropriation: New Developments?*, 11 N.Y.U. Env't'l L. J. 64 (2002-2003) with further references.

¹³³ See *Tecnicas Medioambientales Tecmed S. A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003, par. 95 et seq.; *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of Aug. 30, 2000, par. 102 et seq.

process of law. Some of China's BITs expressly state that this includes the possibility of judicial review in national courts concerning the legality of an expropriatory measure.¹³⁴ Finally and most importantly, both direct and indirect expropriations require compensation.¹³⁵

b) The Amount of Compensation

With regard to the amount of compensation, China's BITs regularly often do not endorse an express standard. Above all, they do not incorporate the Hull formula of "prompt, adequate and effective compensation" which is traditionally demanded as the standard of compensation under international law by developed countries.¹³⁶ Instead, most of the PRC's BITs simply refer to "compensation" or further classify the standard with notions like "reasonable" or "appropriate".¹³⁷

China's new generation investment treaties, by contrast, address the standard of compensation more clearly. The recent Sino-German BIT, for example, requires that the "compensation shall be equivalent to the value of the investment immediately before the expropriation is taken or the threatening expropriation has become publicly known"; it also stipulates that "[t]he compensation shall be paid without delay and shall carry interest at the prevailing commercial rate until the time of payment; it shall be effectively realizable and freely transferable".¹³⁸ Whether this wording refers to full market value is, however, still debatable. In practice, calculating the amount of compensation on the basis of market value may also constitute difficulties, because the Chinese economy has not yet developed full-fledged market mechanisms. Yet, the PRC seems to be willing to conform

¹³⁴ Concerning domestic due process see for example Art. 4(1) of Acuerdo para la promoción y fomento recíprocos de inversiones entre el Reino de España y la República Popular de China, signed Feb. 6, 1992; concerning review in national Chinese courts see for example Art. 4(2) of the Sino-German BIT.

¹³⁵ For the question of whether the level of compensation differs for indirect expropriation see YVES NOUVEL, *L'indemnisation d'une expropriation indirecte*, 5 Int'l L. FORUM du droit int. 198 (2003); THOMAS W. MERRILL, *Incomplete Compensation for Takings*, 11 N.Y.U. Env't'l L. J. 110 (2002-2003).

¹³⁶ See on the development of the standard of compensation under international law ANDREAS F. LOWENFELD, *International Economic Law*, pp. 397 et seq. (2002).

¹³⁷ See SHAN, *Legal Framework*, p. 200. The amount of compensation was also a contentious point of debate in the U.S.-China BIT negotiations. The PRC considered the Hull standard as "extortionate", see CHEW (*supra* footnote 21), 34 Virg. J. Int'l L. 615, 661 (1994); STEINERT (*supra* footnote 32), 2 J. Chin. L. 359, 444.

¹³⁸ See Art. 4(2) of the Sino-German BIT.

to the standard of compensation included in general BIT practice, i. e. compensation based on fair market value according to the Hull formula.¹³⁹

6. *Umbrella Clause*

Violations of national treatment, fair and equitable treatment and direct and indirect expropriation primarily protect against interferences by governmental power.¹⁴⁰ Yet, many foreign investment projects, in particular large-scale infrastructure projects, such as the construction and operation of a power plant or a highway, are conducted on the basis of investor-State contracts with the central or regional government or with specific state agencies or state enterprises. In such cases, the investor may not only be concerned with interferences by the government as a regulator, but face the unwillingness of his contracting partner to live up to its contractual obligations. The conduct of the host State in such cases is often neither expropriatory nor a violation of fair and equitable treatment, but may simply consist in not paying the contractually due price. These “simple” violations of contract usually do not amount to expropriation or a violation of fair and equitable treatment, because the element of exercising public authority is missing.¹⁴¹

Protection against purely commercial breaches may be accorded by so-called umbrella clauses that stipulate that “[e]ach Contracting Party shall observe any other obligation it has entered into with regard to investments in its territory by investors of the other Contracting Party.”¹⁴² While the PRC has initially been reluctant to incorporate such clauses into her investment treaties, they are increasingly often included in the new generation treaties.¹⁴³

¹³⁹ See SHAN, *Legal Framework*, p. 200.

¹⁴⁰ See, for example, *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/02/17, Decision on Jurisdiction of April 26, 2005, par. 281; *Consortium RFCC v. Royaume du Maroc*, ICSID Case No. ARB/00/6, Award of Dec. 22, 2003, par. 51 and 65; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction of Nov. 14, 2005, par. 180 *et seq.*

¹⁴¹ See on the limited protection of investor-State contracts by customary international law MANN, *State Contracts and State Responsibility*, 54 AJIL 572 (1960); ROBERT JENNINGS, *State Contracts in International Law*, 37 Brit. Yb Int'l. L. 156 (1961); Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, 128 Recueil des Cours 95 (1969); BÖCKSTIEGEL, *Der Staat als Vertragspartner ausländischer Privatunternehmen* (1971); PIERRE LALIVE, *Contrats entre états ou entreprises étatiques et personnes privées*, 181 Recueil des Cours 9 (1983); CHARLES LEBEN, *La théorie du contrat d'Etat et l'évolution du droit international des investissements*, 302 Recueil des Cours 197 (2004).

¹⁴² Art. 10(2) of the Sino-German BIT, signed Dec. 1, 2003.

¹⁴³ Earlier BITs only contain so-called “preservation of rights”-clauses that clarify that the guarantees in a BIT were not intended to override more favorable protection in an investor-State contract or domestic laws and regulations.

Provided that the contract qualifies as an investment within the meaning of the applicable BIT, these clauses have the effect that the breach of an investor-State contract also constitutes a violation of the applicable BIT. This allows the foreign investor to avail itself of the dispute settlement mechanism under the investment treaty for breaches of investor-State contracts.¹⁴⁴

An interesting question is whether the umbrella clause would allow a foreign investor to sue its Chinese partner in a Joint Venture Agreement, often a State-owned enterprise,¹⁴⁵ under a bilateral investment treaty, instead of initiating arbitration under the contractual arbitration clause. The main argument for such an application of the umbrella clause is that the State is responsible under international law for the conduct of its sub-entities, including State-owned enterprises if they are exercising public authority.¹⁴⁶ In view of the lack of a clear-cut distinction between private economic activity and State economy, one could argue that the breaches of contracts by State enterprises always

These clauses, such as Art. 10 of the Sino-Peruvian BIT, stipulate: “If the treatment to be accorded by one Contracting Party in accordance with its laws and regulations to investment or activities associated with such investments of investors of the other Contracting Party is more favorable than the treatment provided for in this Agreement, the more favorable treatment shall be applicable” (see Art. 10 of the Agreement between the Government of the Republic of Peru and the Government of the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, signed June 9). Such clauses merely clarify that the BIT protection is only a minimum standard that does not prevent the host State from granting broader protection in its domestic legislation or in an investor-State contract. For umbrella clauses in modern Chinese BITs see, for example, Art. 9(2) of the Agreement between the Government of the Hashemite Kingdom of Jordan and the Government of The People’s Republic of China on the Reciprocal Promotion and Protection of Investments, signed on Nov. 5, 2001, Art. 13(2) of the Sino-Trinidad and Tobago BIT, Art. 3(4) of the Sino-Dutch BIT.

¹⁴⁴ See DOLZER/STEVENS, *Bilateral Investment Treaties*, p. 81 et seq. (1995); PROSPER WEIL, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, 128 Recueil des Cours 95, 130 (1969). As the interpretation and application of umbrella clauses by arbitral tribunals has created much academic debate and clearly inconsistent decisions, one will have to closely monitor the developments in arbitral jurisprudence and scholarship that are likely to clarify the operation and function of umbrella clauses as well as its limits. See for the recent debate BJØRN KUNOY, *Singing in the Rain – Developments in the Interpretation of Umbrella Clauses*, 7 J. World Inv. & Trade 275 (2006); see also THOMAS W WAELDE, *The Umbrella (or Sanctity of Contracts/Pacta sunt servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases*, 6 J. World Inv. & Trade 183 (2005); STANIMIR A ALEXANDROV, *Breaches of Contract and Breaches of Treaty*, 5 J. World Inv. & Trade 555 (2004); CHRISTOPH SCHREUER, *Travelling the BIT Route – Of Waiting Period, Umbrella Clauses and Forks in the Road*, 5 J. World Inv. & Trade 231 (2004).

¹⁴⁵ Until the mid-1990’s all Chinese partners in Joint Venture Agreements were State-owned enterprises. Only thereafter did it become possible for Chinese private entrepreneurs to become a party to a foreign investment joint venture. See NEE (*supra* footnote 19), p. ___ (2005).

¹⁴⁶ See Art. 4, 5 and 8 of the International Law Commission’s Draft Articles on Responsibility of States for Internationally Wrongful Acts, Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 10 (A/56/10) (2001). See also JAMES CRAWFORD, *The International Law Commission’s Articles on State Responsibility* (2002).

constitute the exercise of public authority and are thus attributable to the PRC under international law. For the investor, it would carry significant benefits to rely on international investment arbitration with its enhanced enforcement mechanism,¹⁴⁷ instead of having to deal with the challenges of conducting commercial arbitration in the PRC.¹⁴⁸

7. *Capital Transfer Provisions*

Capital transfer provisions complement the protection of foreign investment by ensuring that the host State does not restrict an investor in repatriating his profits. Free capital transfer collides, however, with the PRC's traditionally strict foreign exchange and currency control policies that aim at shielding her State-planned economy and its currency against uncontrolled foreign exchange flows. Such a system would not have been compatible with the free transfer provisions that are usually included in international investment treaties. In consequence, capital transfer provisions in China's old generation BITs have always been limited in order to uphold foreign exchange control. This was done either by clauses subjecting capital transfer to domestic laws and regulations such as the 1984 Sino-Finnish BIT that provides that "[e]ach Contracting Party shall, *subject to its laws and regulations*, allow without undue delay [...] to transfer freely in a convertible currency [...] profits, capital gains, dividends [etc.]"¹⁴⁹ or by inserting a clause in the BIT or its protocol that explicitly ensured China's right to implement its foreign exchange control. This second approach was chosen, for instance, in the Sino-British BIT that provides: "In respect of the People's Republic of China, transfers of convertible currency by a national [...] of the United Kingdom [...] shall be made from the foreign exchange account of the national [...] transferring the currency".¹⁵⁰

New grounds concerning transfer and repatriation of capital are broken again by China's new generation BITs, such as the 2003 Sino-German BIT. Achieving a further liberalization of China's currency transfer policy, the treaty itself now contains unlimited capital transfer provisions in a freely convertible currency for

“(a) the principal and additional amounts to maintain or increase the investment; (b) returns; (c) proceeds obtained from the total or partial sale or liquidation of investments or amounts obtained from the reduction of

¹⁴⁷ See *supra* III.B.2.

¹⁴⁸ See *supra* footnote 60.

¹⁴⁹ See Art. 6 of the Agreement between the Government of the Republic of Finland and the Government of the People's Republic of China for the Protection of Investments, signed Sept. 4, 1984.

¹⁵⁰ See Art. 6(4) of the Sino-Britain BIT.

investment capital; (d) payments pursuant to a loan agreement in connection with investments; (e) payments in connection with contracting projects; (f) earnings of nationals of the other Contracting Party who work in connection with an investment in its territory”.¹⁵¹

The free capital transfer under the Sino-German BIT is only restricted by provisions in the Supplemental Protocol. Similar to the “grandfather-clause” on national treatment, the protocol allows China to keep its current foreign exchange system in place, but also envisages an abandonment of existing restrictions.¹⁵² Likewise, the introduction of new measures restricting capital transfers is not permissible. The Sino-German BIT also obliges China’s foreign exchange administration to handle requests for capital transfers within a maximum period of two months,¹⁵³ which, compared to the six-month period in the older Sino-German BIT, is a considerable improvement.¹⁵⁴ Again, investors from other home countries are able to rely on these more favorable investment provisions owing to MFN treatment.

8. *Miscellaneous Provisions*

Apart from these core investors’ rights, Chinese BITs often include a number of additional miscellaneous provisions that relate to ancillary aspects of foreign investment projects. By way of example, the 2003 Sino-German BIT contains a specific provisions prohibiting “arbitrary or discriminatory measures against the management, maintenance, use, enjoyment and disposal of the investments”.¹⁵⁵ Furthermore, it requires “sympathetic consideration to applications for obtaining visas and working permits to nationals of the other Contracting Party engaging in activities associated with investments”¹⁵⁶ and contains specific provisions for national and MFN treatment for the compensation of measures “owing to war or other armed conflict, revolution, a State of national emergency”.¹⁵⁷

¹⁵¹ Art. 6(1) of the Sino-German BIT.

¹⁵² See Ad. Art. 6(a) of the Protocol to the Sino-German BIT (providing that “[t]o the extent that the formalities mentioned above are no longer required according to the relevant provisions of Chinese law, Article 6 shall apply without restrictions.”).

¹⁵³ See Art. 6(3) and Ad. Art 6(b) of the Sino-German BIT.

¹⁵⁴ WENSHUA SHAN, *Legal Framework*, p. 173.

¹⁵⁵ Art. 2(3) of the Sino-German BIT.

¹⁵⁶ Art. 2(4) of the Sino-German BIT.

¹⁵⁷ Art. 5 of the Sino-German BIT.

IV. Conclusion

The preceding survey showed that the PRC's bilateral investment treaties have slowly evolved since the country signed its first BIT with Sweden in 1982. Initially reluctant to include national treatment and comprehensive investor-State dispute settlement, over time China changed its attitude with respect to the protection of foreign investment by international law and adapted its BIT program to the level of investment protection that prevails in international practice. This development culminated in the conclusion of new generation investment treaties with traditional capital-exporting countries, like Germany and the Netherlands, and with various developing countries. These treaties conform in all major aspects to international standards.

China's new generation investment treaties do not only endorse a broader standard of national treatment, but most importantly contain advance consent to investor-State arbitration under ICSID rules that allow foreign investors to bring claims for the alleged violation of all investor's rights granted in Chinese BITs, such as direct and indirect expropriation, fair and equitable treatment, full protection and security, free capital transfer and the observance of commitments under umbrella clauses. This fundamental change in the PRC's investment treaty practice should, therefore, further strengthen the confidence of foreign investors' in China's general policy to create a safe and reliable investment climate that is based on notions of stability, reliability and predictability and protects foreign investors against undue government interferences. This change in China's BIT practice reflects a fundamental change in the country's attitude towards the protection of foreign investment by international law. It suggests that the PRC has come to terms with the widely accepted standards in this field of international law and actively seeks integration into the international community.

More generally, China's new generation BITs can also be viewed as an important indicator for the evaluation of the standard protections contained in international investment treaties by a developing country. The fact that the PRC deliberately gave up earlier reservations vis-à-vis some standards of international investment protection supports the conclusion that the recently accepted BITs reflect an overall beneficial trade-off between attracting foreign investment and the competing interest of upholding state sovereignty and regulatory leeway to the greatest possible extent. The content of China's new generation BITs should thus serve as a strong counterargument against criticism of international investment law as the outcome of hegemonic domination of capital-

exporting countries over capital-importing countries.¹⁵⁸ This is particularly true, since China disposes of sufficient negotiating power, even vis-à-vis capital-exporting countries, in order to decline the acceptance of certain standards, as has been done in the past above all in respect of investor-State dispute settlement provisions. Instead, the content of her new generation BITs with traditional capital-exporting countries like Germany or the Netherlands constitute the product of arms-length negotiation that resulted in China's deliberate choice to include broader rights for foreign investors.¹⁵⁹ In view of this deliberate choice, it is thus not convincing to argue that the content of international standards on investment protection generally overemphasizes the interests of foreign investors over the interests and concerns of host States.¹⁶⁰ China's change in BIT practice and its acceptance of international standards of investment protection rather suggest that the restrictions of its sovereignty over foreign investment represent a beneficial bargain in view of attracting further foreign investment.

In view of China's increasing importance as a capital-exporter, one might argue that her new BIT practice may primarily be prompted by its interests in protecting its own investors abroad. The change in treaty practice might thus be the result of hegemonic behavior of China vis-à-vis other developing countries. Yet, China's overall stakes as a capital-exporting country are still relatively small compared to its inward foreign investment. In addition, even if China is pressing for more comprehensive investment protection in its new generation BITs in view of its rising stakes in future outward foreign investment, the country is an even better example for a State that is in a position to have significant interest in both inward and outward foreign investments. This dual role of a

¹⁵⁸ Distinctively in this sense CHIMNI, *International Institutions Today: An Imperial Global State in the Making*, 15 Eur. J. Int'l L. 1 (2004); CHIMNI, *Marxism and International Law – A Contemporary Analysis*, Economic and Political Weekly, February 6, p. 337-349 (1999).

¹⁵⁹ This conclusion is supported by information provided to the author by members of the German Ministry of Economic Affairs which is in charge of negotiating BITs on behalf of the Federal Republic of Germany. According to German government officials, it was China's own desire to include, *inter alia*, comprehensive dispute settlement provisions in the new Sino-German BIT, because this constituted the international standard of investment protection. China therefore deliberately and consciously sought the conclusion of its new generation BITs with its considerable improvements in terms of investment protection.

¹⁶⁰ See, for example, GUZMAN, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 Va. J. Int'l L. 639 (1998); BEAUVAIS, *Regulatory Expropriations under NAFTA: Emerging Principles & Lingering Doubts*, 10 N.Y.U. Env't'l L. J. 245 (2001–2002); HERMAN, *Settlement of International Trade Disputes—Challenges to Sovereignty—A Canadian Perspective*, 24 Can.-U.S. L. J. 121 (1998); WAGNER, *International Investment, Expropriation and Environmental Protection*, 29 Golden Gate U. L. Rev. 465 (1999); FERGUSON, *Note and Comment: California's MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretative Note on Article 1110 of NAFTA*, 11 Colo. J. Int'l Env't'l L. & Pol'y 499 (2000); GANGULY, *Note: The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 Colum. J. Transnat'l L. 113 (1999).

capital-importing as well as a capital-exporting country would arguably lead to a particularly balanced outcome in the negotiation of international investment agreements because China has to find a trade-off between her interests as a capital-exporting country that is interested in a broad range of investment protection for her investors abroad while, in view of inward foreign investment, she is interested in upholding state sovereignty and regulatory leeway as far as possible. This role will prompt a position that results in a balance between her interests as a capital-exporting country, on the one hand, and as a capital-importing, on the other, and will thus not favor either interest.¹⁶¹ The fact that China's new generation BITs are not more advantageous to Chinese investors abroad compared to the standard of protection for investor from States like Germany or the Netherlands thus indicates that the PRC also considers the international standard of investment protection as an appropriate level for the protection of its own investments abroad. The growing convergence of investment treaty practice towards accepting international standards in BIT protection therefore has to be taken as an indicator that BITs strike an appropriate balance between the protection of foreign investment and state sovereignty more generally.

Finally, the regime set up by the new generation BITs does not only benefit foreign investors in the PRC but should affect China's domestic institutions and the procedures they apply in broader terms because BITs exercise significant influences on the development of the domestic legal and economic structures in the host State. The specific guarantees contained in the treaties aim at implementing structures that are essential for the functioning of a market economy. National and most-favored-nation treatment aim at ensuring a level playing field for the economic activity of foreign and domestic economic actors and are a prerequisite for competition. The protection against expropriation guarantees the respect for property rights as an essential institution for market transactions; capital transfer guarantees ensure the free flow of capital and contribute to the efficient allocation of resources in a global market. The umbrella clause backs up private ordering between foreign investors and the home State. Fair and equitable treatment and full protection and security ensure basic due process rights for foreign investors and require adequate police protection, features that are equally essential for the

¹⁶¹ Cf. GILLETTE/SCOTT, *The Political Economy of International Sales Law*, 25 Int'l Rev. L. & Econ 446 (2005) for a parallel situation with respect to the negotiation of the United Nations Convention on the International Sale of Goods, 1489 U.N.T.S. 3. The authors suggest that no special interests of sellers or buyers have influenced the negotiating behavior of States in this respect because the interests of buyers and sellers have to be reconciled in a way that does not unilaterally favor either interest group. The reasons for this is that it is not foreseeable that a single country has higher stakes in being a buyer or a seller in international sales relations.

functioning of market economies. Finally, the possibility to have recourse to international arbitration represents a mechanism that allows foreign investors to enforce China's compliance with her BIT obligations.

The content of investment treaties should thus support legal reform developments in the PRC by establishing good governance standards as a reference for legislative, administrative and judicial conduct.¹⁶² Especially, concerning the conduct of administrative agencies and the deployment of judicial proceedings, investment treaties support the establishment of procedures, practices and rules that conform to rule of law standards and are conducive for sustainable development and economic growth. Above all, the fair and equitable treatment standard is predestined to influence the law on domestic administrative procedures¹⁶³ as well as procedures applied by domestic courts.¹⁶⁴ Ultimately, even the national legislator may be restricted in implementing its policies by the regime set up by international investment treaties.¹⁶⁵

Even though the scope of BITs is restricted to foreign investors, the substantive rights and guarantees they contain are likely to have spill-over effects on the domestic legal system. BITs will thus not only influence the situation of foreign investors in China and the treatment they can expect, but also create an incentive for the PRC to promote liberal values on a broader basis by letting domestic economic actors benefit from the overall changes in the economic and legal system. Although nationals cannot rely on the substantive provisions contained in BITs, it is probable, for example, that the forms and procedures of government conduct required vis-à-vis foreign investors will increasingly be applied with respect to domestic actors. The main reason for this is that the implementation of parallel systems for local and foreign investors will be more costly than a uniform system. Similar to obligations incurred under WTO law, bilateral investment treaties should therefore continuously lead to giving up the distinction between foreign and national economic actors in Chinese law and help to support the transgression of the Chinese economy into a full-fledged market economy and its integration into the global

¹⁶² RUDOLF DOLZER, *The Impact of International Investment Treaties on Domestic Administrative Law*, 37 N.Y.U. J. Int'l L & Pol 953, 971 (2005) (concluding that BITs and their application by arbitral tribunals should "provide a powerful incentive to review and to modernise the [domestic] legal system").

¹⁶³ DOLZER (*supra* footnote 162); SCHILL (*supra* footnote 116), IILJ Working Paper 2006/6, p. 24 *et seq.*

¹⁶⁴ See SCHILL (*supra* footnote 116), IILJ Working Paper 2006/6, p. 26 *et seq.*

¹⁶⁵ See SCHILL (*supra* footnote 116), IILJ Working Paper 2006/6, p. 27 *et seq.*

economy. Conforming to the framework set up by international investment agreements is thus another step to improve the investment climate in the PRC.¹⁶⁶

¹⁶⁶ For further recommendations, such as reducing approval procedures for foreign investment, establishing training systems for employees, improving the general infrastructure and reducing access barriers for foreign investment see SHENGLIANG DENG/YUAN LI/JINXIAN CHEN, *Evaluating Foreign Investment Environment in China: A Systematic Approach*, 100 Eur. J. Operational Res. 16 (1997).