

# TEARING DOWN THE GREAT WALL: THE NEW GENERATION INVESTMENT TREATIES OF THE PEOPLE'S REPUBLIC OF CHINA

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## ABSTRACT

The People's Republic of China (PRC or China) has emerged as the world's premier destination of foreign investment in the developing world and is continuously strengthening its position as a source of outward foreign investment, notably in Asia and Africa. In this context, the PRC has concluded over 110 bilateral investment treaties (BITs) that grant protection against expropriation and establish other standards of treatment for foreign investors in China and Chinese investors abroad. While the PRC was originally hesitant regarding international investment protection, the country started, beginning in the late 1990s, entering into new generation BITs that break with her long-standing reservations towards national treatment for foreign investments and comprehensive investor-State dispute settlement. Surprisingly, this change in treaty practice has so far only received little attention in international legal scholarship, although the conclusion of the new generation BITs constitutes a fundamental change in China's foreign economic policy. The paper gives an account of the PRC's investment treaty practice and shows how her new generation BITs provide novel mechanisms of protection for foreign investors. It is argued that these treaties help to transform China's domestic legal system significantly, support her transition to a market economy, and strengthen the country's integration into the global economy. Ultimately, China's new investment treaty practice is also 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 an increasingly global economy.

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## TABLE OF CONTENTS

I. INTRODUCTION .....	74	<b>R</b>
II. THE PRC'S CHANGING ATTITUDE TOWARDS INTERNATIONAL INVESTMENT PROTECTION .....	77	<b>R</b>
III. THE CONTENT OF THE PRC'S NEW GENERATION BITS .....	83	<b>R</b>
A. The Scope of Application of China's Investment Treaties .....	84	<b>R</b>
B. Dispute Settlement Mechanism under Chinese BITS .....	86	<b>R</b>
1. The Limited Scope of Investor-State Arbitration in the PRC's Old-Generation BITS .....	89	<b>R</b>
2. Investor-State Dispute Settlement in Recent Treaty Practice .....	91	<b>R</b>
C. Substantive Investors' Rights Conferred under BITS .....	94	<b>R</b>
1. National Treatment .....	94	<b>R</b>
a. Limited National Treatment in China's Old Generation BITS .....	94	<b>R</b>
b. National Treatment in China's New Generation BITS .....	97	<b>R</b>
2. Most-Favored-Nation Treatment .....	100	<b>R</b>
a. Extending the Substantive Protection of Old Generation BITS .....	100	<b>R</b>
b. Extending the Procedural Protection of Old Generation BITS? .....	101	<b>R</b>
3. Fair and Equitable Treatment .....	103	<b>R</b>
4. Full Protection and Security .....	106	<b>R</b>
5. Protection Against Expropriation .....	106	<b>R</b>
a. Direct and Indirect Expropriation .....	107	<b>R</b>
b. The Amount of Compensation .....	108	<b>R</b>
6. Umbrella Clause .....	109	<b>R</b>
7. Capital Transfer Provisions .....	111	<b>R</b>
8. Miscellaneous Provisions .....	113	<b>R</b>
IV. CONCLUSION .....	113	<b>R</b>

## I. INTRODUCTION

Although the People's Republic of China (PRC or China) has entered into well over 110 bilateral investment treaties (BITs),

ranking second only to Germany on a global scale,<sup>1</sup> her investment treaty practice has so far drawn only minor attention in international legal scholarship and the international business community. Extensive literature exists on the legal aspects of investing in the PRC.<sup>2</sup> However, accounts of the regime established by international investment treaties, granting protection to foreign investors under international law in China, are scarce.<sup>3</sup> This stands in sharp contrast to the analysis of the influence of China's accession to the World Trade Organization (WTO),<sup>4</sup> although the regime estab-

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<sup>1</sup> UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), *DEVELOPMENTS IN INTERNATIONAL INVESTMENT AGREEMENTS IN 2005*, 3 (2006), available at [http://www.unctad.org/en/docs/webiteiia20067\\_en.pdf](http://www.unctad.org/en/docs/webiteiia20067_en.pdf).

<sup>2</sup> 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 FOREIGN TRADE, INVESTMENT, AND THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA (Michael Moser ed., 1987); 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); WEI JIA, *CHINESE FOREIGN INVESTMENT LAWS AND POLICIES: EVOLUTION AND TRANSFORMATION* (1994); TRADE AND INVESTMENT IN CHINA: THE EUROPEAN EXPERIENCE (Robert Strange, Jim Slater, & Limin Wang eds., 1998); GUIGUO WANG, *CHINA'S INVESTMENT LAWS—NEW DIRECTIONS* (1988).

<sup>3</sup> For older accounts of BIT practice of the PRC, see Li Shishi, *Bilateral Investment Promotion and Protection Agreements: Practice of the People's Republic of China*, in INTERNATIONAL LAW AND DEVELOPMENT 163 (Paul de Waart, Paul Peters, & Erik Denters eds., 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); Hans-Martin Burkhardt, *Das Deutsch-Chinesische Investitionsschutzabkommen*, 30 RECHT DER INTERNATIONALEN WIRTSCHAFT 28 (1984); Qingjiang Kong, *Bilateral Investment Treaties: The Chinese Approach and Practice*, 8 ASIAN Y.B. INT'L L. 105 (1998–1999); John S. Mo, *Some Aspects of the Australia-China Investment Protection Treaty*, 25 J. WORLD TRADE L. 43 (1991).

For more recent accounts see Stephan Schill, *Der Schutz ausländischer Investitionen in den Investitionsschutzabkommen der VR China*, in CHINESISCHES WIRTSCHAFTSRECHT 75 (Michael-Florian Ranft & Christoph Schewe eds., 2006); WENHUA SHAN, *THE LEGAL FRAMEWORK OF EU-CHINA INVESTMENT RELATIONS—A CRITICAL APPRAISAL* (2005) (focusing on aspects of bilateral investment treaties between the PRC and EU-member States); Cai Congyan, *Outward Foreign Direct Investment Protection and the Effectiveness of Chinese BIT Practice*, 7 J. WORLD INVESTMENT & TRADE 621 (2006).

<sup>4</sup> See, e.g., CHINA AND THE CHALLENGE OF ECONOMIC GLOBALIZATION: THE IMPACT OF WTO MEMBERSHIP (Hung-Gay Fung, Changhong Pei, Kevin H. Zhang eds., 2006); CHINA'S PARTICIPATION IN THE WTO (Henry Gao & Donald Lewis eds., 2005); VAI LO & XIDOWEN TIAN, *LAW AND INVESTMENT IN CHINA: THE LEGAL AND BUSINESS ENVIRONMENT AFTER CHINA'S WTO ACCESSION* (2005); DAVID SMITH & ZHU GUOBIN, *CHINA AND THE WTO* (2002); Donald C. Clarke, *China's Legal System and the WTO: Prospects for Compliance*, 2 WASH. U. GLOBAL STUD. L. REV. 97 (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 Judi-*

lished by international investment treaties is bound to 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 to change 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 1990s 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.<sup>5</sup> This change is prominently marked by the conclusion of BITs with the Netherlands in 2001<sup>6</sup> and Germany in 2003<sup>7</sup> that conform, despite some remaining limitations, in all major aspects to what can be considered standard treaty practice in approximately 2,500 BITs worldwide.<sup>8</sup> China's change in BIT practice can, however, not only be observed in relation to traditional capital-exporting countries, but also emerges 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),

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*cial Review: Impact on Legal and Political Reform*, 52 AM. J. COMP. L. 77 (2004); Lindsay Wilson, *Investors Beware: The WTO Will Not Cure All Ills with China*, 2003 COLUM. BUS. L. REV. 1007 (2003); A. Yuan, *China's Entry into the WTO: Impact on China's Regulating Regime of Foreign Direct Investment*, 35 INT'L LAW. 195 (2001); T. L. Walmsley et al., *Assessing the Impact of China's WTO Accession on Investment* (GTAP Working Paper Series, 2003).

<sup>5</sup> For the specifics of the old generation, see Chinese investment treaties compared to international standards in Shishi, *supra* note 3, at 167.

<sup>6</sup> 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, Neth.-P.R.C., Nov. 26, 2001 [hereinafter Sino-Dutch BIT]. (Many of the investment treaties cited throughout this article are available in UNCTAD's online database of international investment instruments, located at <http://www.unctadxi.org/templates/DocSearch.aspx?id=779.aspx>.)

<sup>7</sup> Agreement Between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, F.R.G.-P.R.C., Dec. 1, 2003 [hereinafter Sino-German BIT].

<sup>8</sup> See UNCTAD, DEVELOPMENTS IN INTERNATIONAL INVESTMENT AGREEMENTS IN 2005, *supra* note 1, at 2 et seq.

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this article analyzes the PRC's new generation investment treaty practice (Part III). In describing the substantive investors' rights granted, this article 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 skepticism.<sup>9</sup> Similar to the Great Wall built in an attempt to protect various dynasties from raids by foreign powers between the third century BC and the beginning of the 17th century,<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup>

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<sup>9</sup> Kong, *supra* note 3, at 107 et seq. For the attitude of the PRC towards international law during this era, see JEROME A. COHEN, ET AL., *PEOPLE'S REPUBLIC OF CHINA AND INTERNATIONAL LAW* (1967), reprinted in *HARVARD LAW SCHOOL STUDIES IN CHINESE LAW* No. 7 (1974); *LAW IN CHINESE FOREIGN POLICY: COMMUNIST CHINA AND SELECTED PROBLEMS OF INTERNATIONAL LAW* (Shao-Chuan Leng & Hungdah Chui eds., 1972).

<sup>10</sup> For a history of the Great Wall, see ARTHUR WALDRON, *THE GREAT WALL OF CHINA: FROM HISTORY TO MYTH* (1990).

<sup>11</sup> On the development of the protection of foreign investment by international law, see RUDOLF DOLZER, *EIGENTUM, ENTEIGNUNG UND ENTSCHÄDIGUNG IM GELTENDEN VÖLKERRECHT* 13 et seq. (Springer 1985); ANDREAS F. LOWENFELD, *INTERNATIONAL ECONOMIC LAW* 391-415 (Oxford Univ. Press 2002).

<sup>12</sup> Pat K. Chew, *Political Risk and U.S. Investment in China: Chimera of Protection and Predictability?*, 34 VA. J. INT'L L. 615, 623 et seq. (1994) (describing the strategies of the

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.<sup>13</sup> Similar to principles put forward by Latin American States under the Calvo Doctrine,<sup>14</sup> 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.”<sup>15</sup> 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.<sup>16</sup>

Yet, after thirty 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

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Chinese government to terminate existing foreign investment in the 1950s by “retaliatory confiscation” and “hostage capitalism”).

<sup>13</sup> See Kong, *supra* note 3, at 109. 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* (MIT Press 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 *LIBER AMICORUM: PROFESSOR IGNAZ SEIDL-HOHENVELDERN 771* (Gerhard Hafner et al. eds., 1998).

<sup>14</sup> On the Calvo Doctrine and its ideological backdrop more generally, see DONALD R. SHEA, *THE CALVO CLAUSE—A PROBLEM OF INTER-AMERICAN AND INTERNATIONAL LAW AND DIPLOMACY* (1955); GUDRUN ZAGEL, *AUSLANDSINVESTITIONEN IN LATEINAMERIKA 69–77* (1999); K. Lipstein, *The Place of the Calvo Clause in International Law*, 22 *BRIT. Y.B. INT’L L.* 130 (1945).

<sup>15</sup> Kong, *supra* note 3, at 109.

<sup>16</sup> *Id.*

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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, and reference to international practice.”<sup>17</sup> 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.<sup>18</sup>

Attracting foreign investment to the PRC was a full success. Since 1979, the country has emerged as the world’s largest importer of foreign investment in the developing world.<sup>19</sup> Inflows of foreign direct investment in mainland China rose to over sixty billion dollars in the year 2004, totaling to an aggregate foreign direct investment stock of \$245 billion.<sup>20</sup> 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.<sup>21</sup> Tax incentives further add to attracting foreign investors.<sup>22</sup> In addition, China’s accession to the WTO in December 2001 resulted in lowering trade barriers and granted

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<sup>17</sup> *Id.* at 110.

<sup>18</sup> *Id.* at 111.

<sup>19</sup> On the history of foreign investment in China, see generally OWEN D. NEE, JR., *SHAREHOLDER AGREEMENTS AND JOINT VENTURES IN THE PRC* 3 (2005). On the development of foreign investment in China, see Yi Li, *Legal and Financial Framework of Promoting FDI in Capital-Importing and Capital-Exporting Countries—China*, in *LEGAL ASPECTS OF FOREIGN DIRECT INVESTMENT* 281, 282 et seq. (Daniel Bradlow & Alfred Escher eds., 1999); S. L. SHIRK, *HOW CHINA OPENED ITS DOOR: THE POLITICAL SUCCESS OF THE PRC’S FOREIGN TRADE AND INVESTMENT REFORMS* (1994).

<sup>20</sup> UNITED NATIONS CONFERENCE ON TRADE AND AGREEMENT (UNCTAD), *WORLD INVESTMENT REPORT 2005: TRANSNATIONAL CORPORATIONS AND THE INTERNATIONALIZATION OF R&D* 306 (July 2005) (prepared by Karl P. Sauvant et al.) (excluding Hong Kong and Macao), available at [http://www.unctad.org/en/docs/wir2005\\_en.pdf](http://www.unctad.org/en/docs/wir2005_en.pdf).

<sup>21</sup> See Chew, *supra* note 12, at 621; see also Yigang Pan, *The Inflow of Foreign Direct Investment to China: The Impact of Country-Specific Factors*, 56 *J. BUS. RES.* 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. UNCTAD, *WORLD INVESTMENT REPORT 2005*, *supra* note 20, at 34.

<sup>22</sup> Zhaodong Jiang, *China’s Tax Preferences to Foreign Investment*, 18 *NW. J. INT’L L. & BUS.* 549 (1998); Pierre Mauge, *Tax Incentives in the People’s Republic of China: Who Benefits*, 5 *TUL. J. INT’L & COMP. L.* 155 (1997); Samuel Tung & Stella Cho, *The Impact of*

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

At the same time, the PRC is emerging as an increasingly important exporter of foreign investment, notably to Asia and Africa.<sup>24</sup> Although her total outflow of foreign direct investment into other developing countries only amounted to an estimated aggregate of approximately thirty-nine billion dollars in 2004,<sup>25</sup> 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.<sup>26</sup> 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.<sup>27</sup> In

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*Tax Incentives on Foreign Direct Investment in China*, 9 J. INT’L ACCT. AUDITING & TAXATION 105 (2000).

<sup>23</sup> K.X. Li et al., *The Application of WTO Rules in China and the Implications for Foreign Direct Investment*, 4 J. WORLD INVESTMENT 343, 360 (2003). For the influence of the WTO accession on China’s foreign investment regime, see 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. INVESTMENT 859, 878 (2002).

<sup>24</sup> On the PRC emerging role as a capital exporter, see generally Kevin G. Cai, *Outward Foreign Investment: A Novel Dimension of China’s Integration into the Regional and Global Economy*, 160 CHINA QUARTERLY, 856, 880 (1999) (concluding that China’s outward foreign investment will “mak[e] the country even more completely and irreversibly integrated into the global community”). See also Congyan, *supra* note 3, at 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).

<sup>25</sup> UNCTAD, WORLD INVESTMENT REPORT 2005, *supra* note 20, app. at 310, tbl. B2. FDI toward flows in 2004 were approximately \$1.8 billion. *Id.* at 306, tbl. B1.

<sup>26</sup> Peter S. Goodman, *China Invests Heavily in Sudan’s Oil Industry*, WASH. POST, Dec. 23, 2004, available at <http://www.washingtonpost.com/wp-dyn/articles/A21143-2004Dec22.html>. For further information regarding outbound foreign investment, see Mitchell Silk & Richard Malish, *Are Chinese Companies Taking Over the World?*, 7 CHIC. J. INT’L L. 105 (2006).

<sup>27</sup> See generally Eric A. Posner & John Yoo, *International Law and the Rise of China*, 7 CHIC. J. INT’L L. 1 (2006) (analyzing how the future relationship of the United States and China will be affected by China’s rise to power). See also 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) (discussing the implications of China’s rise to a political and economic world power).

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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 regarding a Security Council resolution against Sudan.<sup>28</sup>

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 domestic laws,<sup>29</sup> but she has also started concluding bilateral investment treaties soon after initiating its open door policy for foreign investment. In 1982 the PRC signed its first BIT with Sweden.<sup>30</sup> Subsequently surging in number to well over 110,<sup>31</sup> BITs are now in existence with almost all capital-exporting countries, such as Germany, Japan, France, and 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 BIT with the United States after initial negotiations were terminated after the Tiananmen incident.<sup>32</sup> Although the PRC, unlike many developed countries, does not use a model

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<sup>28</sup> See Stéphanie Giry, *China's Africa Strategy—Out of Beijing*, THE NEW REPUBLIC, Nov. 15, 2005, available at <http://www.tnr.com/doc.mhtml?i=20041115&s=giry111504>.

<sup>29</sup> See Li, *supra* note 19, at 288 et seq. See also Qingjiang Kong, *Foreign Direct Investment Regime in China*, HEIDELBERG J. OF INT'L L. 872 (1997). R

<sup>30</sup> Agreement Between the Government of the Kingdom of Sweden and the Government of the People's Republic of China on the Mutual Protection of Investments, P.R.C.-Swed., Mar. 29, 1982.

<sup>31</sup> As of June 2006 the country has concluded a total of 117 BITs of which 87 have entered into force. A list of BITs by country is available at <http://www.unctad.org/Templates/Page.asp?intItemID=2344&lang=1> (search for "China").

<sup>32</sup> Chew, *supra* note 12, at 660–61. For more information on the proposed BIT between the United States and China, see also Roger W. Sullivan, *Do We Really Need a BIT?*, 15 CHINA BUS. REV. 6, 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); Timothy A. Steinert, Note, *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). Overseas Private Investment Corporation (OPIC) guarantees were, however, available to U.S. investors until Congress discontinued the program in 1990 after the Tiananmen incident. See Chew, *supra* note 21, at 668–69. For a discussion on the OPIC special program in China, see generally Henry R. Berghoef, *OPIC in China*, CHINA BUS. REV. 44 (Sept.–Oct. 1984). See also OVERSEAS PRIVATE INVESTMENT CORPORATION, 1987 ANNUAL REPORT 26; Anthony F. Marra, *OPIC Programs in China and Problems Faced by Investors*, 3 CHINA L. REP. 170 (1986); Marsha A. Cohan, *OPIC Programs in China: An Update*, E. ASIAN EXECUTIVE REP., Apr. 15, 1989, at 8. R

template for its BIT negotiations,<sup>33</sup> the high number of treaties already concluded and the efforts to negotiate further such agreements<sup>34</sup> merit the assertion that China has established a bilateral investment treaty program that is comparable to those of traditional capital-exporting countries.<sup>35</sup>

Initially, China's BIT practice was characterized by a certain hesitance with regards 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 United States 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 by the United

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<sup>33</sup> Kong, *supra* note 3, at 114.

<sup>34</sup> For examples on the PRC's negotiation with the Association of South-East Asian Nations (ASEAN) to establish the China-ASEAN Free Trade Area, see Chen Huiping, *China-ASEAN Investment Agreement Negotiations: The Substantive Issues*, 7 *J. WORLD INVESTMENT & TRADE* 143 (2006). On the negotiation between the PRC and Canada of an investment protection agreement, see Cliff Sosnow, *Canada-China Investment Protection Agreement—A Significant Stepping Stone to Deeper Economic Co-Operation*, Dec. 21, 2005, available at [http://www.bilaterals.org/article.php3?id\\_article=3342](http://www.bilaterals.org/article.php3?id_article=3342). China and Australia are also negotiating a Free Trade Agreement that is intended to contain provision on the protection of investment. Damon Vis-Dunbar, *Investment Treaty News (ITN)*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, July 4, 2006, available at [http://www.iisd.org/pdf/2006/itn\\_july4\\_2006.pdf](http://www.iisd.org/pdf/2006/itn_july4_2006.pdf). See also *China to Advance Bilateral and Regional Free Trade Negotiation*, PEOPLE'S DAILY, Sept. 16, 2006, available at [http://english.peopledaily.com.cn/200609/16/eng20060916\\_303325.html](http://english.peopledaily.com.cn/200609/16/eng20060916_303325.html) (reporting China's announcement that it will negotiate further bilateral and regional free trade agreements).

<sup>35</sup> Cf. Congyan, *supra* note 3, at 634 et seq. (emphasizing the use of BITs as an instrument to promote and protect outward foreign direct investment from the PRC).

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States.<sup>36</sup> Today, by contrast, both standards of investment protection are featured in the PRC's new generation treaty practice.

### 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.<sup>37</sup> Unlike investment insurances or the mere maintenance of good relations with the host government,<sup>38</sup> 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.<sup>39</sup> 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.

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<sup>36</sup> See Chew, *supra* note 12, at 661–63; Steinert, *supra* note 32, at 432, 452 et seq.

<sup>37</sup> 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* 1 et seq. (2005). For a general account of BITs, see RUDOLF DOLZER & MARGARETE STEVENS, *BILATERAL INVESTMENT TREATIES* (1995); LOWENFELD, *supra* note 11, at 474–488; MUTHUCUMARASWAMY SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 315 (2d ed. 2004); Giorgio Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 *RECUEIL DES COURS* 251 (1997).

<sup>38</sup> Investment or political risk insurance is available on the private insurance market from government-sponsored entities, such as the Overseas Private Investment Corporation (OPIC) in the United States, 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 *V.A. 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 *ECON. GEOGRAPHY* 261 (2005).

<sup>39</sup> Christoph Schreuer, *Paradigmenwechsel im Internationalen Investitionsrecht*, in *PARADIGMENWECHSEL IM VÖLKERRECHT ZUR JAHRTAUSENDWENDE* 237 (Waldemar Hummer ed., 2002) (describing the advent of investor-State arbitration as a “change in paradigm in international investment law”).

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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”;<sup>40</sup> 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 productive use of resources.”<sup>41</sup> 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.<sup>42</sup>

A. *The Scope of Application of China's Investment Treaties*

BITs apply 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.<sup>43</sup> It regularly encompasses

every kind of asset invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party 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 permit-

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<sup>40</sup> Sino-German BIT, *supra* note 7, art. 2.

<sup>41</sup> 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, Den.-P.R.C., Apr. 29, 1985.

<sup>42</sup> For a discussion of MFN clauses, *see infra* Part III.C.2.

<sup>43</sup> For an in-depth account of the notion of investment under international investment agreements, *see generally* Noah Rubins, *The Notion of "Investment" in International Investment Arbitration*, in *ARBITRATING FOREIGN INVESTMENT DISPUTES* 283 (Norbert Horn & Stefan Kröll eds., Kluwer Law Int'l 2004).

ted by law, including concessions to search for, cultivate, extract or exploit natural resources.<sup>44</sup>

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

Frequently, the treaties also accord protection to investors whose investments are 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.<sup>46</sup> Similarly, the BIT between China and Argentina stipulates

[i]f 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.<sup>47</sup>

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<sup>44</sup> Agreement Between the Government of the Republic of Trinidad & Tobago and the People's Republic of China on the Reciprocal Promotion and Protection of Investments, P.R.C.-Trin. & Tobag., art. 1(1), July 22, 2002 [hereinafter Trin. & Tobago-Sino BIT].

<sup>45</sup> See, e.g., Sino-German BIT, *supra* note 7, art. 1(2).

<sup>46</sup> *Id.* art. 1(1).

<sup>47</sup> 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, Arg.-P.R.C., art. 1(2), Nov. 5, 1992. The Treaty, however, requires that the home State of the subsidiary renounces its right under general international law to exercise diplomatic protection on behalf of the subsidiary. This has to be viewed against the backdrop of the *Barcelona Traction* decision of the I.C.J. 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. *Barcelona Traction, Light and Power Company, Limited (Belg. v. Spain)*, 1970 I.C.J. 3, 34 (Feb. 5). 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 *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, para. 137 (Aug. 3, 2004) (concerning the standing of indirect shareholders absent an explicit treaty provision to this effect); *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, par. 48 (June 17, 2003) (concerning standing of a minority shareholder). See also Stanimir A. Alexandrov, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals—*

The protection of indirect investments enables the structuring 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.

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 United States,<sup>48</sup> State measures restricting the establishment of an investment in China are not subject to the rights conferred under a BIT.<sup>49</sup> Instead, the admission of foreign investment is in the discretionary power of the PRC.<sup>50</sup> Therefore, investment treaties 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

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*Shareholders as "Investors" under Investment Treaties*, 6 J. WORLD INVESTMENT & TRADE 387, 387 (2005).

<sup>48</sup> See Kenneth J. Vandeveld, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT'L L. 621 (1993); Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L. & POL'Y 157 (2005).

<sup>49</sup> 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 Article 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." Agreement Between the Government of the People's Republic of China and the Government of the Original Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investments, P.R.C.-Uru., art. 2, Dec. 2, 1993. Similarly, according to the Sino-Britain BIT, investment shall be admitted "subject to its right to exercise power conferred by its laws." See Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China and Concerning the Promotion and Reciprocal Protection of Investments, P.R.C.-U.K., art. 2(1), May 15, 1986 [hereinafter Sino-British BIT].

<sup>50</sup> SHAN, *supra* note 3, at 119.

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,<sup>51</sup> this empowerment of private investors has accurately been described as a "change in paradigm in international investment law."<sup>52</sup> Instead of depending on the discretion of its home State to grant diplomatic protection,<sup>53</sup> 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.<sup>54</sup>

In standard international practice, investor-State arbitration is most often conducted under the rules of the International Centre

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<sup>51</sup> 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* (Banks Law Publ'g Co. 1916). Classical international law thus mediated the investor through an inter-State prism. See also L. OPPENHEIM, *INTERNATIONAL LAW* § 20, at 25 (2d ed. 1912). For the classical expression of this view, see *The Mavrommatis Palestine Concessions* (Greece v. Gr. Brit.), Judgment No. 2, 1924 P.C.I.J. (ser. A) No. 2, at 12 (Aug. 30).

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. [I]t 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 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.

*Id.*

<sup>52</sup> Schreuer, *supra* note 39.

<sup>53</sup> Generally, no internal obligation of a State exists to pursue claims against a foreign State on an international level. See, e.g., RAINER HOFMANN, *GRUNDRECHTE UND GRENZÜBERSCHREITENDE SACHVERHALTE* 107 (1994) (on the legal situation in Germany). On the situation in the United Kingdom, see *Abbasi v. Secretary of State for the Home Department* [2002] EWCA (Civ) 1598 (Eng.). Ultimately, this discretion is the expression of the difference in the legal relation between the investor and the host State, and the relationship between the two States.

<sup>54</sup> On the specificities of the consent to arbitration under modern investment treaties, see Barton Legum, *Emerging Fora for International Litigation (Part 1): The Innovation of Investor-State Arbitration Under NAFTA*, 43 HARV. INT'L L.J. 531 (2002).

for Settlement of Investment Disputes (ICSID).<sup>55</sup> 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,<sup>56</sup> 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.<sup>57</sup> Instead, member States have to "recognize an award . . . as binding and enforce [it] within its territory as if it were a final judgment of a court in that State."<sup>58</sup> 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.<sup>59</sup>

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<sup>55</sup> The Centre was established in 1966 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 575 U.N.T.S. 159 (Oct. 14, 1966) [hereinafter ICSID Convention]. China signed the ICSID Convention on February 9, 1990. It entered into force on February 6, 1993. As of Dec. 15, 2006, the ICSID Convention has been ratified by 143 of the 155 signatory States, including China, allowing most foreign investors to avail themselves of the investor-State dispute settlement mechanism if they feel that the PRC violated provisions of the relevant bilateral investment treaty. For a list of contracting States, see <http://www.worldbank.org/icsid/constate/c-states-en.htm>.

<sup>56</sup> See ICSID Convention, *supra* note 55, art. 52.

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<sup>57</sup> CHRISTOPH SCHREUER, ICSID CONVENTION: A COMMENTARY, Article 54, ¶ 71 (2001). This differs from international commercial arbitration enforced pursuant to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards where Article V allows the enforcement state to invoke its *ordre public* in order to deny enforcement of an arbitral award. See United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), art. V, June 10, 1958, 330 U.N.T.S. 38.

<sup>58</sup> ICSID Convention, *supra* note 55, art. 54(1). The only loophole enabling States to refuse recognition and enforcement of an ICSID award is State immunity. See *id.* art. 55. On state immunity as a bar to enforcement of ICSID awards comprehensively, see SCHREUER, *supra* note 57, Article 55.

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<sup>59</sup> This does not, however, exclude that the domestic legal system actually offers possibilities for foreign investors to challenge conduct by the host state. On possibilities for foreign investors to challenge the acts of administrative agencies in the PRC, see David L. Weller, *The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action*, 98 COLUM. L. REV. 1238 (1998).

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.<sup>60</sup> The first BIT with Sweden did not contain investor-State dispute provisions at all. According to an accompanying letter by the Swedish Government, this was due to the fact that China had not become a party to the ICSID Convention. The Contracting Parties had, however, agreed that upon the PRC's accession 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 International Centre for Settlement of Investment Disputes."<sup>61</sup> Yet, even before the PRC signed the ICSID Convention on February 9, 1990,<sup>62</sup> 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 dis-

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<sup>60</sup> 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, e.g., JEROME A. COHEN ET AL., *ARBITRATION IN CHINA: A PRACTICAL GUIDE* (2004); JINGZHOU TAO, *ARBITRATION LAW AND PRACTICE IN CHINA* (Kluwer Law Int'l 2004); Charles Kenworthy Harer, *Arbitration Fails to Reduce Foreign Investors' Risk in China*, 8 PAC. RIM L. & POL'Y J. 393 (1999); Marie Kidwell & James Brown, *China: A Perspective on International Arbitration in China, Recent Developments and CIETAC Arbitration*, 20 CONST. L.J. 253 (2004); Ge Liu, *International Commercial Arbitration in China: History, New Developments, and Current Practice*, 28 J. MARSHALL L. REV. 539 (1995); 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); 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 *NEW HORIZONS IN INTERNATIONAL COMMERCIAL ARBITRATION AND BEYOND* (Albert Jan van den Berg ed., 2005) (containing various contributions on arbitration in China in connection with the proceedings of the 17th ICCA Conference, May 16–18, 2004); William 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 n.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).

<sup>61</sup> See Letter from Sten Sundeldt, Swedish Ambassador, to Wei Yuming, PRC Vice Minister of Economic Affairs (Mar. 29, 1982), available at [http://www.unctad.org/sections/dite/ia/docs/bits/china\\_sweden.pdf](http://www.unctad.org/sections/dite/ia/docs/bits/china_sweden.pdf).

<sup>62</sup> See ICSID Convention, *supra* note 55.

putes concerning the amount of compensation due in case of expropriation.<sup>63</sup>

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.”<sup>64</sup>

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.”<sup>65</sup>

Given that expropriations increasingly constituted a negligible political risk and that other forms of host State misconduct, such as violations of judicial and administrative due process, negatively affected foreign investors across the globe,<sup>66</sup> China’s limited consent

<sup>63</sup> SHAN, *supra* note 3, at 200. In addition, the covered investments did not benefit from the considerable advantages of the ICSID Convention. See *supra* notes 55–59 and accompanying text.

<sup>64</sup> 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, P.R.C.-Sing., art 13(3), Nov. 21, 1985.

<sup>65</sup> See FRESHFIELDS BRUCKHAUS DERINGER, RESOLVING DISPUTES IN CHINA THROUGH ARBITRATION 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 Articles 19 to 23 of the Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331. Instead, it constitutes a notification under Article 25(4) of the 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).

*Id.* See REPORT OF THE EXECUTIVE DIRECTORS ON THE CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES, ICSID CONVENTION, REGULATIONS AND RULES 18–19 (2006), available at [http://www.worldbank.org/icsid/basicdoc/CRR\\_English-final.pdf](http://www.worldbank.org/icsid/basicdoc/CRR_English-final.pdf).

<sup>66</sup> Michael S. Minor, *The Demise of Expropriation as an Instrument of LDC Policy, 1980–1992*, 25 J. INT’L BUS. STUD. 177, 180 (1994).

to investor-State arbitration vitiated the effectiveness of the dispute settlement mechanism. In addition, the limited access to IC-SID 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 courts<sup>67</sup> 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.<sup>68</sup>

## 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 1990s, 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.<sup>69</sup> This

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<sup>67</sup> This option is explicitly mentioned by most old generation BITs. See, e.g., Agreement Between the Government of the Kingdom of Bahrain and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investment, Bahr.-P.R.C., art. 9(2), June 17, 1999 (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").

<sup>68</sup> On the problem of corruption in the Chinese judiciary see, for example, THOMAS P. BERNSTEIN & XIAOBO LU, TAXATION WITHOUT REPRESENTATION IN RURAL CHINA 109 et seq. (2003); see also HRIC, *The Wuhan Court Bribery Case*, 1 CHINA RTS. FORUM 30 (2005) (describing several bribing techniques in China). More generally on the problem of corruption in the judiciary, see Edgardo Buscaglia & Maria Dakolias, *An Analysis of the Causes Of Corruption in the Judiciary*, 30 LAW & POL'Y INT'L BUS. 95 (1999); Maria Dakolias & Kim 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).

<sup>69</sup> Agreement Between the Government of the Republic of Botswana and the Government of the People's Republic of China on the Promotion and Protection of Investments, Bots.-P.R.C., art. 9, June 12, 2000. The first comprehensive dispute settlement mechanism

broad clause allowed investors not only to resolve disputes concerning the amount of compensation in expropriation cases, but also to invoke all substantive rights granted in the applicable BIT.<sup>70</sup>

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 not, however, involve court proceedings and is thus different from the exhaustion of local remedies.<sup>71</sup>

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.<sup>72</sup> The compulsory recourse to this local remedy may thus be less motivated by suspicion vis-à-vis international arbitration, but rather driven by the desire to build domestic institu-

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was included in Article 9 of the 1998 Sino-Barbados BIT. Agreement Between the Government of the People's Republic of China and Barbados Concerning the Encouragement and Reciprocal Protection Investments, Barb.-P.R.C., art. 9, July 1998.

<sup>70</sup> 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 investors to bring treaty claims and contract claims. Cf. Jörn Griebel, *Jurisdiction Over "Contract Claims" in Treaty-Based Investment Arbitration on the Basis of Wide Dispute Settlement Clauses in Investment Agreements*, *TRANSNAT'L DISP. MGMT.* (Feb. 2007), available at <http://www.transnational-dispute-management.com>.

<sup>71</sup> See Administrative Reconsideration Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 29, 1999, effective Oct. 1, 1999). On the Administrative Review Procedure, see ALBERT HUNG-YEE CHEN, *AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA* 228 et seq. (2004).

<sup>72</sup> 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](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).

tions 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 capital-exporting country. Rather, it was introduced in a number of South-South BITs with other developing countries.<sup>73</sup> This could suggest that in relation to these countries the PRC behaves like a traditional capital-exporting country that attempts to secure its investment abroad without much probability of being involved as a respondent in any investor-State dispute.<sup>74</sup> 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 Article 9 "that any dispute concerning investments . . . shall, at the request of the investor of the other Contracting State, be submitted for arbitration."<sup>75</sup> 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."<sup>76</sup> Providing therefore for effective enforcement of investor's rights, China's new generation BITs "mark another significant step forward"<sup>77</sup> in the country's integration into the international economy

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<sup>73</sup> See the following BITs: Benin-P.R.C., Feb. 18, 2004; Bots.-P.R.C., June 12, 2000; Bosn. & Herz.-P.R.C., June 12, 2000, June 26, 2002; Brunei-P.R.C., Nov. 17, 2000; Cyprus-P.R.C., Aug. 31, 2006; Cote d'Ivoire-P.R.C., Sept. 23, 2002; P.R.C.-Djib., Aug. 18, 2003; Guy.-P.R.C., Mar. 27, 2003; Jordan-P.R.C., Nov. 5, 2001; Lat.-P.R.C., Apr. 15, 2004; Mozam.-P.R.C., July 10, 2001; Kenya-P.R.C.; July 16, 2001; P.R.C.-Sierra Leone, May 16, 2001; P.R.C.-Trin. & Tobago, July 22, 2002; P.R.C.-Tunis., June 21, 2001; P.R.C.-Uganda, May 27, 2004.

<sup>74</sup> An Chen, *Should the Four Great Safeguards in Sino-Foreign BITs Be Hastily Dismantled?*, 7 J. WORLD INVESTMENT & TRADE 899 (2006) (critically analyzing this change in China's BIT practice); Congyan, *supra* note 3, at 646. R

<sup>75</sup> Sino-German BIT, *supra* note 7, art. 9. The Sino-Dutch BIT parallels this language in Article 10. Sino-Dutch BIT, *supra* note 6, art. 10.

<sup>76</sup> Protocol to the Sino-German BIT, Ad. art 9.

<sup>77</sup> SHAN, *supra* note 3, at 215. R

and significantly enhance the protection of foreign investors in the PRC.

### 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 provide one of the standard guarantees in international investment protection, the guarantee of national treatment, its new generation BITs increasingly conform to international standards in this respect. By contrast, the other investors' 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 remained largely unchanged. Yet, due to the introduction of comprehensive investor-state dispute settlement, they are now readily enforceable by foreign investors and do not remain in the realm of interstate relations.

#### 1. *National Treatment*

National treatment is one of the core guarantees regularly endorsed in international BIT practice.<sup>78</sup> 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."<sup>79</sup>

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<sup>78</sup> DOLZER & STEVENS, *supra* note 37, at 63 et seq.

<sup>79</sup> Sino-British BIT, *supra* note 49, art. 3(3) (emphasis added). Similar clauses are contained in several Chinese BITs. *See, e.g.*, 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, Ice.-P.R.C., art. 3(2), Mar. 31, 1994; Agreement Between the Government of the People's Republic of China and the

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.<sup>80</sup>

Only a few older Chinese BITs contained national treatment provisions that went beyond the language of the Sino-British Treaty. Article 3(2) of the BIT with Japan, signed in 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.”<sup>81</sup>

While some commentators considered this clause as a “milestone” in China’s investment treaty practice,<sup>82</sup> the Sino-Japanese national treatment provision was, however, significantly limited by the treaty’s Additional Protocol.<sup>83</sup> Article 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

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Government of the Republic of Slovenia Concerning the Encouragement and Reciprocal Protection of Investments, P.R.C.-Slovn., art. 3(2), Sept. 13, 1993.

<sup>80</sup> SHAN, *supra* note 3, at 153; Kong, *supra* note 3, at 124; Wenhua Shan, *National Treatment for Foreign Investment Enterprises and the Conditions for Its Implementation*, 5 SOC. SCI. IN CHINA 128, 132 (1998).

<sup>81</sup> Agreement Between Japan and the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, Japan-P.R.C., art. 3(2), Aug. 27, 1988. The scope of Article 3(2) is further specified in Article 3(3), defining business activity as including *inter alia* the maintenance of branches and other establishments necessary for the business activity, the control and management of companies, the employment and discharge of personnel, and the making and performance of contracts. *Id.* art. 3(3). 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. *Id.*

<sup>82</sup> In this sense, see Robert T. Greig & Claudia Annacker, *How Bilateral Investment Treaties Can Protect Japanese Investors*, 32 JAPANESE INST. OF INT’L BUS. L. 1607, (2004), available at [http://www.cgsh.com/files/tbl\\_s47Details/FileUpload265/443/CGSH\\_HBilateral\\_Investment\\_Treaties\\_English.pdf](http://www.cgsh.com/files/tbl_s47Details/FileUpload265/443/CGSH_HBilateral_Investment_Treaties_English.pdf).

<sup>83</sup> For a critique as to whether this is a substantial concession on behalf of the PRC, see SHAN, *supra* note 3, at 154 et seq.; Kong, *supra* note 3, at 124.

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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.<sup>84</sup>

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 was aimed at upholding public order or at furthering economic development. This is particularly true with respect 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.<sup>85</sup>

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.<sup>86</sup> 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.<sup>87</sup> At the

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<sup>84</sup> A similar framing of national treatment is reportedly also contained in the BIT between China and the Czech and Slovak Republic. Jian Zhou, *National Treatment in Foreign Investment Law: A Comparative Study from a Chinese Perspective*, 10 *TOURO INT’L L. REV.* 39, 122 (2000).

<sup>85</sup> 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 v. Argentina*, ICSID Case No. ARB/01/8, Award, para. 366–373 (May 12, 2005) (considering the exceptions from BIT obligations under U.S.-Arg. BIT, art. XI as not self-judging). Article 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.” Agreement Between the Government of the People’s Republic of China and the Government of the Argentine Republic on the Protection and Reciprocal Protection of Investments, Arg.-P.R.C., Nov. 5, 1992.

<sup>86</sup> SHAN, *supra* note 3, at 163 et seq.; see also Yasheng Huang, *One Country, Two Systems: Foreign-invested Enterprises and Domestic Firms in China*, 14 *CHINA ECON. REV.* 404, 404–405 (2003). R

<sup>87</sup> See Zhou, *supra* note 84, at 48, 114 et seq. (mentioning “subsidies and special preferential treatment” for state-owned enterprises). R

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.<sup>88</sup> Still, regulatory disadvantages persist compared to state-owned enterprises.<sup>89</sup> In addition, foreign investors *de facto* often receive less favourable treatment in domestic courts and administrative proceedings.<sup>90</sup> 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 broader basis. Starting in late 2001 with the BIT with the Netherlands, the PRC increasingly often includes general national treatment in its BITs.<sup>91</sup> 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.”<sup>92</sup>

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;

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<sup>88</sup> See SHAN, *supra* note 3, at 164 et seq.; Huang, *supra* note 86, at 416.

<sup>89</sup> Huang, *supra* note 86, at 409.

<sup>90</sup> Zhou, *supra* note 84, at 118.

<sup>91</sup> Yet, at least one earlier BIT contained a national treatment provision for Chinese investors in Peru but not vice versa. See 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, Peru-P.R.C., Ad arts. 3, 5, June 9, 1994 [hereinafter Sino-Peruvian BIT].

<sup>92</sup> Sino-German BIT, *supra* note 7, art. 3(2).

(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.<sup>93</sup>

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-called "rollback").<sup>94</sup> 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.<sup>95</sup> 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

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<sup>93</sup> *Id.* Ad. Arts. 2, 3. Similar provisions on national treatment, including the "grandfather clause," are also contained in other new generation BITs. See Sino-Dutch BIT, *supra* note 6, art. 3(3); Agreement on the Promotion and Protection of Investments Bosn. & Herz-P.R.C., art. 3(1), Ad art. 3, June 26, 2002. 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 Article 3(1). See Additional Protocol for the Promotion and Reciprocal Protection of Investments, P.R.C.-Slovk., art 3(1) (national treatment is, however, subject to a "grandfather clause" in Article 3(4) of the Treaty).

<sup>94</sup> 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 10 (2003), available at [http://www.oecd.org/data\\_oecd/14/13/1935919.pdf](http://www.oecd.org/data_oecd/14/13/1935919.pdf).

<sup>95</sup> Compare *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, paras. 108–120 (Aug. 3, 2004) (allowing the parallel case of "cherry-picking" under the most-favored-nation clause).

direction,<sup>96</sup> while others handle national treatment more restrictively and only allow for a sector-specific comparison between foreign and domestic investors.<sup>97</sup> 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 led to including national treatment as a general principle into its new generation investment treaties.<sup>98</sup> In this context, the PRC's dual 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,<sup>99</sup> itself constituting a regime that relies on non-discrimination and national treatment as one of its core principles.<sup>100</sup> Finally, the development towards comprehensive national treatment is also closely connected with China's econ-

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<sup>96</sup> See *LG&E Energy Corp. v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, paras. 140–148 (Oct. 3, 2006); *Occidental Exploration and Prod. Co. v. Ecuador*, LCIA Case No. UN3467, Final Award, paras. 167 et seq. (July 1, 2004).

<sup>97</sup> *Methanex Corporation v. United States of America*, UNCITRAL, Final Award, Part IV-Chapter C para. 25 (Aug. 3, 2005); *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, paras. 285–295 (May 12, 2005).

<sup>98</sup> This becomes particularly clear with respect to the asymmetric national treatment provision in the Protocol to the Sino-Peruvian BIT, *supra* note 91, Ad arts. 3, 5. *But see* Congyan, *supra* note 3, at 641 (suggesting that the inclusion of national treatment is mainly a function of negotiating pressure from developed countries).

<sup>99</sup> Wenhua Shan, *Towards a Level Playing Field of Foreign Investment in China*, 3 J. WORLD INVESTMENT 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 INVESTMENT 343, 347 et seq. (2003); Kong, *supra* note 23, at 878.

<sup>100</sup> See General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 art. III; General Agreement on Trade in Service, Apr. 15, 1994, 1869 U.N.T.S. 183 art. XVII:l. The international trade regime even requires its Members to integrate non-discrimination between foreign and national products into the domestic legal order. Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S. 143, art. XVI:4.

omy 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."<sup>101</sup>

## 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."<sup>102</sup>

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

### 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.<sup>104</sup> 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

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<sup>101</sup> The provision was originally introduced in Article 15 of the Constitution of the People's Republic of China. Meanwhile it can now be found in Article 7.

<sup>102</sup> Agreement Between the Government of Australia and the Government of the People's Republic of China on the Reciprocal Encouragement and Protection of Investments, Austl.-P.R.C., art. 3(c), July 11, 1988.

<sup>103</sup> For MFN treatment standard in investment law, see UNCTAD, *MOST-FAVOURLED-NATION TREATMENT, SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS* (1999); Marie France Houde & Fabrizio Pagani, *Most-Favoured-Nation Treatment in International Investment Law*, 2 (OECD Working Papers on International Investment 2004/2), available at <http://www.oecd.org/dataoecd/21/37/33773085.pdf>.

<sup>104</sup> See *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Decision on the Respondent's Request for Continued Stay of Execution, paras. 100 et seq., 197 et seq. (May 25, 2004); see also *Pope & Talbot Inc. v. Canada*, UNCITRAL (NAFTA), Award, paras. 105 et seq. (Apr. 10, 2001) (for examples of the extension of substantive investor's rights by means of MFN treatment).

clause contained in the Sino-British BIT,<sup>105</sup> 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.<sup>106</sup> 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."<sup>107</sup>

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,<sup>108</sup> it is contentious whether it can also broaden the 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

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<sup>105</sup> See Sino-British BIT, *supra* note 49, art. 3(1).

<sup>106</sup> Emilio Augustín Maffezini v. Spain, ICSID Case No. ARB/97/7, Decision on Objections to Jurisdiction, para. 38 (Jan. 25, 2000).

<sup>107</sup> *Id.* at para. 54.

<sup>108</sup> See *Suez, Sociedad General de Aguas de Barcelona S.A. (AGBAR) and Vivendi Universal S.A. v. Argentina & AWD Group Ltd. v. Argentina* (joint decision), ICSID Case No. ARB/03/19, Decision on Jurisdiction, paras. 52 et seq. (Aug. 3, 2006); *Suez, Sociedad General de Aguas de Barcelona, S.A. (AGBAR) and Interaguas Servicios Integrales del Agua, S.A. v. Argentina*, ICSID Case No. ARB/03/17, Decision on Jurisdiction paras. 52 et seq. (May 16, 2006); *Gas Natural SDG, S.A. v. Argentina*, ICSID Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction, para. 24 (June 17, 2005); *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction para. 32 (Aug. 3, 2004) (all cases allowing the foreign investor to circumvent waiting periods by invoking more favourable provisions in another host State BIT).

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.<sup>109</sup> 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.”<sup>110</sup> 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.<sup>111</sup>

Although the decision has been approved by subsequent tribunals,<sup>112</sup> 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 under an international investment treaty for substantive rights that fall short of any legal effect without enforcement mechanism.<sup>113</sup> It would, thus, appear to be surprising if States that agree to most-favored-nation treatment would

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<sup>109</sup> See *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, paras. 183 et seq. (Feb. 8, 2005).

<sup>110</sup> *Id.* para. 200; see also *id.* para. 218.

<sup>111</sup> See TIBOR VARADY ET AL., INTERNATIONAL COMMERCIAL ARBITRATION 188 (2006).

<sup>112</sup> *Telenor Mobile Comm. A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, paras 81 et seq. (Sept. 13, 2006). 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](http://www.iisd.org/pdf/2006/itn_aug23_2006.pdf).

<sup>113</sup> Cf. *Gas Natural v. Argentina*, ICSID Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction, para. 49. 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

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.<sup>114</sup>

### 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.<sup>115</sup> In the practice of arbi-

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disputes that may arise, most-favoured nation provisions in BITs should be understood to be applicable to dispute settlement.

*Id.*

<sup>114</sup> 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, see Rudolf Dolzer & Terry Myers, *After Tecmed: Most-Favoured-Nation Clauses in International Investment Protection Agreements*, 19 ICSID REV-FOREIGN INVESTMENT L.J. 49 (2004); 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. WORLD INVESTMENT & TRADE 25 (2006); Dan H. Freyer & David Herlihy, *Most-Favoured Nation Treatment and Dispute Settlement in Investment Arbitration: Just How “Favoured” is “Most-Favoured”?*, 20 ICSID REV-FOREIGN INVESTMENT L.J. 58 (2005); Jürgen Kurtz, *The MFN Standard and Foreign Investment: An Uneasy Fit?*, 5 J. WORLD INVESTMENT & TRADE 861 (2004); Ruth Teitelbaum, *Who's Afraid of Maffezini? Recent Developments in the Interpretation of Most Favored Nation Clauses*, 22 J. INT'L ARB. 225 (2005).

<sup>115</sup> To understand fair and equitable treatment as an independent standard, see *Saluka Investments (The Netherlands) v. Czech Republic*, UNITRAL, Partial Award, para. 294 (Mar. 17, 2006); *Pope & Talbot v. Canada*, UNCITRAL (NAFTA), Award on the Merits of Phase 2, para. 111 (Apr. 10, 2001); *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, para. 155 (May 29, 2003); DOLZER & STEVENS, *supra* note 37, at 60; JEAN-PIERRE LALIVE, PROTECTION ET PROMOTION DES INVESTISSEMENTS: ETUDE DE DROIT INTERNATIONAL ECONOMIQUE 94 (1985); PETER MUCHLINSKI, MULTINATIONAL ENTERPRISES AND THE LAW 626 (1995); United Na-

tral tribunals, the standard is regularly specified on a case-by-case basis.<sup>116</sup>

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.<sup>117</sup>

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 govern-

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tions Conference on Trade and Development (UNCTAD), *FAIR AND EQUITABLE TREATMENT* 39 et seq. (United Nations 1999); F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 BRIT. Y.B. INT'L L. 241, 244 (1981); Stephan Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, 70 BRIT. Y.B. INT'L L. 99, 144 (1999). On the understanding fair and equitable treatment as an expression of the international minimum standard, see *CMS Gas Transmission v. Argentina*, ICSID Case No. ARB/01/8, Award, para. 284 (May 12, 2005); *Occidental Exploration and Prod. Co. v. Ecuador*, LCIA Case No. UN3467, Final Award, paras. 188 et seq. (July 1, 2004); OECD, *Draft Convention on the Protection of Foreign Property 1967*, 7 I.L.M. 117, 120 (1968).

<sup>116</sup> See Barnali Choudhury, *Evolution or Devolution?—Defining Fair and Equitable Treatment in International Investment Law*, 6 J. WORLD INVESTMENT & TRADE 297 (2005); Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. WORLD INVESTMENT & TRADE 357 (2005); Catharine Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law* (OECD Working Papers on International Investment, No. 2004/3), available at <http://www.oecd.org/dataoecd/22/53/33776498.pdf>. See also 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>.

<sup>117</sup> *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, para. 98 (Apr. 30, 2004).

ment.<sup>118</sup> 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 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.<sup>119</sup>

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.<sup>120</sup> Similarly, denial of justice by domestic courts is considered to constitute a violation of fair and equitable treatment.<sup>121</sup> 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.<sup>122</sup> 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 on the activity of the national leg-

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<sup>118</sup> Schill, *supra* note 116.

<sup>119</sup> *Id.* at 11 et seq.

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

<sup>121</sup> *See Compañía de Aguas del Aconquija v. Argentina*, ICSID Case No. ARB/97/3, Award, para. 80 (Nov. 21, 2000); *Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3, Final Award, para. 132 (June 26, 2003); *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, para. 132. *See also* JAN PAULSSON, *DENIAL OF JUSTICE IN INTERNATIONAL LAW* (Cambridge Univ. Press 2005) (comprehensively on the closely related concept of denial of justice in international law).

<sup>122</sup> *See LG&E Energy Corp. v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, paras. 100 et seq. (Oct. 3, 2006); *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, par. 279 (June 17, 2003).

islator. It grants, *inter alia*, procedural rights in administrative proceedings such as the right to be heard, or the requirement to give reasons for administrative decision-making. Furthermore, it provides 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.<sup>123</sup> Investment arbitration under China's BITs and the fair and equitable treatment standard may thus also be a way to cope with the massive center-periphery problem in the PRC stemming deficiencies in law enforcement by local administrative agents.<sup>124</sup>

#### 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.<sup>125</sup> The concept was held to be violated, for instance, in a case of the destruction of foreign-owned commercial property by the host State's armed forces.<sup>126</sup>

#### 5. Protection Against Expropriation

Given China's history of expropriations of foreign investors after the communist take-over,<sup>127</sup> 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

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<sup>123</sup> See RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 394 et seq. (2002).

<sup>124</sup> See KEVIN J. O'BRIEN & LIANJIANG LI, *Suing the Local State: Administrative Litigation in Rural China*, in ENGAGING THE LAW IN CHINA—STATE, SOCIETY, AND POSSIBILITIES FOR JUSTICE 31 et seq. (Neil J. Diamant et al. eds., 2005).

<sup>125</sup> 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).

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

<sup>127</sup> See Chew, *supra* note 12, at 623 et seq.; 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).

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).”<sup>128</sup>

#### 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 is broader and also covers so-called indirect, creeping, or *de facto* expropriations, involving state measures that do not interfere with the owner’s title as such, but negatively affect the property’s substance or void the owner’s control of it.<sup>129</sup> In light of receding numbers of direct expropriations,<sup>130</sup> 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.”<sup>131</sup> While it is not settled how to draw a distinction between compensable indirect expropriation and non-

<sup>128</sup> Sino-German BIT, *supra* note 7, art. 4(2).

<sup>129</sup> On the concept of indirect expropriation, see Charles Leben, *La liberté normative de l’Etat et la question de l’expropriation indirecte*, in *LE CONTENTIEUX ARBITRAL TRANSNATIONAL RELATIF A L’INVESTISSEMENT INTERNATIONAL: NOUVEAUX DÉVELOPPEMENTS* 163 (Charles Leben ed., 2006); Jan Paulsson & Zachary Douglas, *Indirect Expropriation in Investment Treaty Arbitrations*, in *ARBITRATING FOREIGN INVESTMENT DISPUTES* 145 (Norbert Horn & Stefan Kröll eds., Kluwer Law Int’l 2004); George C. Christie, *What Constitutes a Taking of Property Under International Law?*, 38 *BRIT. Y.B. INT’L L.* 307 (1962); Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 *ICSID REV. – FOREIGN INVESTMENT L.J.* 41 (1986); 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 REV. – FOREIGN INVESTMENT L.J.* 293 (2004); Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 *RECUEIL DES COURS* 259, 322 et seq. (1982); BJØRN KUNOY, *Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration*, 6 *J. WORLD INVESTMENT & TRADE* 467 (2005); Andrew Newcombe, *The Boundaries of Regulatory Expropriation*, 20 *ICSID REV. – FOREIGN INVESTMENT L.J.* 1 (2005); Thomas Waelde & Abba Kolo, *Environmental Regulation, Investment Protection and “Regulatory Taking” in International Law*, 50 *INT’L & COMP. L.Q.* 811 (2001); 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); Catherine Yannaca-Small, “Indirect Expropriation” and the “Right to Regulate” in International Investment Law (OECD Working Paper on International Investment, No. 2004/4, 2004).

<sup>130</sup> See Minor, *supra* note 66, at 177.

<sup>131</sup> The concept of indirect expropriation in international law often runs parallel to the concept of “regulatory takings” under the Fifth Amendment to the U.S. Constitution.

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compensable regulation,<sup>132</sup> 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.<sup>133</sup>

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 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.<sup>134</sup> Finally and most importantly, both direct and indirect expropriations require compensation.<sup>135</sup>

#### 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.<sup>136</sup> Instead, most of the PRC's BITs simply refer to "compensation," or further classify the standard with notions like "reasonable" or "appropriate."<sup>137</sup>

China's new generation investment treaties, by contrast, address the standard of compensation more clearly. The recent Sino-

<sup>132</sup> See DOLZER, *supra* note 11, at 186 et seq.; see generally Rudolf Dolzer, *Indirect Expropriation: New Developments?*, 11 N.Y.U. ENVTL. L.J. 64 (2002–2003). R

<sup>133</sup> See *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, paras. 95–151 (May 29, 2003); *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, paras. 102–112 (Aug. 30, 2000).

<sup>134</sup> Concerning domestic due process, see for example, *Acuerdo para la protección y fomento recíprocos de inversiones entre el Reino de España y la República Popular de China*, P.R.C.-Spain, art. 4(1), Feb. 6, 1992; concerning review in national Chinese courts see for example the Sino-German BIT, *supra* note 7, art. 4(2). R

<sup>135</sup> For a discussion of the level of compensation for indirect expropriation, see Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENVTL. L.J. 110 (2002–2003); W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and its Valuation in the BIT Generation*, 74 BRIT. Y.B. INT'L L. 115 (2003).

<sup>136</sup> On the development of the standard of compensation under international law, see LOWENFELD, *supra* note 11, at 397–403. R

<sup>137</sup> SHAN, *supra* note 3, at 200. The amount of compensation was also a contentious point of debate in the U.S.-China BIT negotiations. The P.R.C. considered the Hull standard as "extortionate." Chew, *supra* note 21, at 66; Steinert, *supra* note 32, at 444. R

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.”<sup>138</sup> 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 to the standard of compensation included in general BIT practice, i.e. compensation based on fair market value according to the Hull formula.<sup>139</sup>

### 6. *Umbrella Clause*

Violations of national treatment, fair and equitable treatment, and direct and indirect expropriation primarily protect against interferences by governmental power.<sup>140</sup> 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 of 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.<sup>141</sup>

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<sup>138</sup> See Sino-German BIT, *supra* note 7, art. 4(2).

<sup>139</sup> See SHAN, *supra* note 3, at 137.

<sup>140</sup> See, e.g., Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Pakistan, ICSID Case No. ARB/03/29, Decision on Jurisdiction, paras. 180–182 (Nov. 14, 2005); Impregilo S.p.A. v. Pakistan, ICSID Case No. ARB/02/17, Decision on Jurisdiction, para. 281 (Apr. 26, 2005); Consortium RFCC v. Royaume du Maroc, ICSID Case No. ARB/00/6, paras. 51, 65 (Dec. 22, 2003).

<sup>141</sup> For a discussion on the limited protection of investor-State contracts by customary international law, see Böckstiegel, *Der Staat als Vertragspartner ausländischer Privatunternehmen* (1971); Robert Jennings, *State Contracts in International Law*, 37 BRIT. Y.B.

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.”<sup>142</sup> 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.<sup>143</sup>

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.<sup>144</sup>

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INT'L L. 156 (1961); Pierre Lalive, *Contrats entre etats 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 209 (2004); F.A. Mann, *State Contracts and State Responsibility*, 54 AM. J. INT'L L. 572 (1960); Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, 128 RECUEIL DES COURS 95 (1969).

<sup>142</sup> Sino-German BIT, *supra* note 7, art. 10(2). R

<sup>143</sup> 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. These clauses 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.” Sino-Peruvian BIT, *supra* note 91, art. 10. 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, 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, Jordan-P.R.C., art. 9(2), Nov. 5, 2001; Trin. & Tobago-Sino BIT, *supra* note 44, art. 13(2). R

<sup>144</sup> See DOLZER & STEVENS, *supra* note 37, at 81; Weil, *supra* note 141, at 130. 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. For the recent debate, see Bjørn Kunoy, *Singing in the Rain—Developments in the Interpretation of Umbrella Clauses*, 7 J. WORLD INVESTMENT & TRADE 275 (2006). See also Stanimir A. Alexandrov, *Breaches of Contract and Breaches of Treaty*, 5 J. WORLD INVESTMENT & TRADE 555 (2004); Christoph Schreuer, *Travelling the BIT Route—Of Waiting Period, Umbrella Clauses and Forks in the Road*, 5 J. WORLD INVESTMENT & TRADE 231 (2004); Thomas W. Waelde, *The Umbrella (or Sanctity of Contracts/Pacta sunt servanda) Clause in Investment Arbitration: A Com-* R

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,<sup>145</sup> 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.<sup>146</sup> 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 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,<sup>147</sup> instead of having to deal with the challenges of conducting commercial arbitration in the PRC.<sup>148</sup>

### 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 her 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

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*ment on Original Intentions and Recent Cases*, 6 J. WORLD INVESTMENT & TRADE 183 (2005).

<sup>145</sup> Until the mid-1990s 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. *NEE, supra* note 19.

<sup>146</sup> *See* Report of the International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, General Assembly, Sess. 56, A/56/10 (Supp.). *See also* JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY* (2002).

<sup>147</sup> *See supra* Part III.B.2.

<sup>148</sup> *See generally* NEW HORIZONS IN INTERNATIONAL COMMERCIAL ARBITRATION AND BEYOND, *supra* note 60.

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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 . . . .”<sup>149</sup> 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.”<sup>150</sup>

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 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.<sup>151</sup>

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.<sup>152</sup> 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,<sup>153</sup> which,

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<sup>149</sup> See Agreement Between the Government of the Republic of Finland and the Government of the People’s Republic of China for the Protection of Investments, Fin.-P.R.C., art. 6, Sept. 4, 1984.

<sup>150</sup> See Sino-British BIT, *supra* note 49, art. 6(4).

<sup>151</sup> Sino-German BIT, *supra* note 7, art. 6(1).

<sup>152</sup> *Id.* Ad. art. 6(a) (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”).

<sup>153</sup> *Id.* art. 6(3), Ad. art 6(b).

compared to the six-month period in the older Sino-German BIT, is a considerable improvement.<sup>154</sup> Again, investors from other home countries are able to rely on these more favorable investment provisions because of 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."<sup>155</sup> 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"<sup>156</sup> 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."<sup>157</sup>

### 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 also most importantly contain advance consent to investor-State arbitration

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<sup>154</sup> SHAN, *supra* note 3, at 173.

<sup>155</sup> Sino-German BIT, *supra* note 7, art. 2(3).

<sup>156</sup> *Id.* art. 2(4).

<sup>157</sup> *Id.* art. 5.

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.<sup>158</sup> 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 constitutes the product of arms-length negotiation that resulted in China's deliberate choice to include broader rights

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<sup>158</sup> See B.S. Chimni, *International Institutions Today: An Imperial Global State in the Making*, 15 *EUR. J. INT'L L.* 1 (2004); B.S. Chimni, *Marxism and International Law—A Contemporary Analysis*, *ECON. & POL. WKLY.*, Feb. 6 1999, 337–349 (1999).

for foreign investors.<sup>159</sup> 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.<sup>160</sup> China's change in BIT practice and her acceptance of international standards of investment protection rather suggest that the restrictions of her 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 an interest in protecting its own investors abroad. The change in treaty practice may therefore 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. Moreover, 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 interests in both inward and outward foreign investments. This dual role of a capital-importing and capital-exporting country would arguably lead to a particularly balanced outcome in the negotiation of international investment agreements. This is 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 in-

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<sup>159</sup> 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.

<sup>160</sup> See, e.g., Joel C. Beauvais, *Regulatory Expropriations under NAFTA: Emerging Principles & Lingering Doubts*, 10 N.Y.U. ENVTL. L.J. 245 (2001–2002); Andrew Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998); Lawrence L. Herman, *Settlement of International Trade Disputes—Challenges to Sovereignty—A Canadian Perspective*, 24 CAN.-U.S. L.J. 121 (1998); J. M. Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999); Julia 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 ENVTL. L. & POL'Y 499 (2000); Samrat 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).

vestors 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 China's interests as a capital-exporting and capital importing country that will not favor either interest.<sup>161</sup> The fact that China's new generation BITs are not more advantageous to Chinese investors abroad as compared to the standard of protection for investors 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 also 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 functioning of market

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<sup>161</sup> Cf. Clayton P. Gillette and Robert E. Scott, *The Political Economy of International Sales Law*, 25 *INT'L REV. L. & ECON.* 446 (2005) (describing 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 reason 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. *Id.*

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.<sup>162</sup> This is especially true with respect to the conduct of administrative agencies and the deployment of judicial proceedings, as 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 procedures<sup>163</sup> as well as procedures applied by domestic courts.<sup>164</sup> Ultimately, even the national legislator may be restricted in implementing its policies by the regime set up by international investment treaties.<sup>165</sup>

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 will 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

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<sup>162</sup> 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 modernize the domestic legal system").

<sup>163</sup> *Id.*; Schill, *supra* note 116, at 24 et seq.

<sup>164</sup> *See* Schill, *supra* note 116, at 26 et seq.

<sup>165</sup> *Id.* at 27 et seq.

economy and its integration into the global economy. Conforming to the framework set up by international investment agreements is thus another step to improve the investment climate in the PRC.<sup>166</sup>

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<sup>166</sup> 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).