

# BITs, MFN Treatment and the PRC: The Impact of China's Ever-Evolving Bilateral Investment Treaty Practice

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## Abstract

*The People's Republic of China departed from past practice when it amended its bilateral investment treaties (BITs) with Germany and the Netherlands to include the protections of national treatment for foreign investors and comprehensive investor-state dispute resolution procedures. Virtually all of China's other BITs contain a most-favored-nation (MFN) clause. MFN treatment raises the level of substantive protection guaranteed by each of China's BITs to the level guaranteed by its most protective, investor-friendly BIT. International arbitral tribunals, however, have reached conflicting results as to whether MFN treatment also applies to procedural protections. This article suggests that it would be consistent with international investment policy and practice to also allow procedural protections to receive MFN treatment. Such an approach is significant because it would extend the reach of the more favorable provisions found in China's recently amended BITs to all investors whose states have entered into a BIT with China.*

## I. Introduction

The People's Republic of China (the PRC or China) has been called "a land and people of contrasts."<sup>1</sup> China is something of a dichotomy as it "seeks to entice foreign trade and investment with its sweet siren songs of economic benefits, while at the same time somewhat petulantly seeking to regulate the contact and the degree of influence. It is a country where some of the banks' employees will work with an abacus while others will work with a computer."<sup>2</sup> Indeed, many of the terms the Chinese use to describe their country and its evolving economic, social, and political structures are seemingly oxymoronic or paradoxical.

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1. Ronald C. Brown, *The Role of the Legal Environment in doing Business in the People's Republic of China*, in INT'L BUS. IN CHINA, 63, 63 (Lane Kelley & Oded Shenkar eds., 1993).

2. *Id.*

cal.<sup>3</sup> An amendment to the Chinese Constitution in 1993 declared the new economic system to be a “socialist market economy.”<sup>4</sup> The government has been labeled with such uncertain terms as a “socialist democracy” or “socialism with Chinese characteristics.”<sup>5</sup> Its history, size, population, and government combine to make China truly unique. Nobody disagrees that China has been and continues to be “very much in transition,”<sup>6</sup> but any fears that foreign companies may have had about investing in China have always been quickly allayed by the “entrepreneurial dreams and . . . alluring mysticism of doing business” in China.<sup>7</sup>

As a “big player in the world’s economy and a leading magnet for foreign direct investment,”<sup>8</sup> China began entering into what one commentator calls “new generation” bilateral investment treaties (BITs) in the late 1990s.<sup>9</sup> These treaties mark a departure from China’s long-standing reservations toward two provisions often included in BITs: 1) national treatment for foreign investors, i.e., foreign investors are treated no less favorably than national investors, and 2) comprehensive investor-state dispute resolution procedures.<sup>10</sup> China amended its BITs with Germany in 2003 and the Netherlands in 2001<sup>11</sup>—two developed countries whose investors are likely to hale China into an arbitral tribunal in the event of a dispute. The once onerous “procedural requirements imposed by the treaties on anyone actually wanting to assert a claim against the Chinese state” have been significantly relaxed.<sup>12</sup> Indeed, the Sino-German and Sino-Dutch BITs represent a significant “breakthrough,”<sup>13</sup> usher in “major innovations,”<sup>14</sup> and “constitute a fundamental change in the country’s foreign economic policy.”<sup>15</sup>

The focus of this article is China’s acceptance of comprehensive investor-state dispute settlement as it relates to “the principle of most-favored-nation (MFN) treatment contained in all Chinese BITs.”<sup>16</sup> “As the term indicates, the most-favored-nation standard seeks to assure investors of one country treatment that is not less favorable than that which the host State accords to nationals and companies of any other country.”<sup>17</sup> Dutch and German investors now have the right to fully arbitrate substantive investor-state claims against the PRC. This article addresses whether this right also extends to foreign investors from other countries. For instance, there is a BIT between China and Kuwait

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3. Pat K. Chew, *Political Risks and U.S. Investments in China: Chimera of Protection and Predictability?*, 34 VA. J. INT’L L. 615, 634 (1994).

4. Jian Zhou, *National Treatment in Foreign Investment Law: A Comparative Study from a Chinese Perspective*, 10 TOURO INT’L L. REV. 39, 60 (2000).

5. Chew, *supra* note 3.

6. *Id.* at 630.

7. *Id.* at 623.

8. Michael J. Moser, *Treaty Claims in China: Do China’s BITs Have Teeth?*, in *DOING BUSINESS IN CHINA: RESOLVING THE CHALLENGES IN TODAY’S ENVIRONMENT*, 283, 283.

9. Stephan W. Schill, *Tearing Down the Great Wall: The New Generation Investment Treaties of the People’s Republic of China*, 15 CARDOZO J. INT’L & COMP. L. 73, 76 (2007).

10. *Id.*

11. Moser, *supra* note 8, at 285-86; Schill, *supra* note 9, at 76.

12. Moser, *supra* note 8, at 285-86.

13. WENHUA SHAN, *THE LEGAL FRAMEWORK OF EU-CHINA INVESTMENT RELATIONS: A CRITICAL APPRAISAL* 217 (2005).

14. Schill, *supra* note 9, at 77.

15. *Id.* at 76.

16. *Id.* at 100.

17. RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 65 (1995).

that contains an MFN clause. Does a Kuwaiti investor, by virtue of an MFN clause contained in the Sino-Kuwaiti BIT, now have the same procedural rights as its German and Dutch counterparts to arbitrate substantive investor-state claims against the PRC?<sup>18</sup> This article addresses that question as it applies all investors whose states have entered into a BIT with China.

Treatment of foreign investments and dispute settlement are two of the four different substantive areas covered by BITs.<sup>19</sup> Perhaps due to the use of the common term “treatment,” there does not seem to be much controversy surrounding the idea of a foreign investor being entitled to more favorable *substantive* protections extended to a third state by virtue of an MFN clause, because “[t]he question of whether the beneficiary of an MFN clause may invoke the more favorable substantive rights of a third-party treaty raises little difficulty.”<sup>20</sup> In discussing the development of China’s BIT practice, one commentator stated rather matter-of-factly that “by means of the MFN clause contained in the Sino-British BIT, a U.K. investor can benefit from the more comprehensive national treatment obligations contained in the 2003 Sino-German BIT.”<sup>21</sup> But whether those same U.K. investors can benefit from the more comprehensive *procedural* protections contained in the new Sino-German BIT is much less certain.

Whether an MFN clause entitles a foreign investor to invoke the dispute settlement provisions of a third party’s BIT with the host state has been of central importance in at least five arbitrations conducted under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID);<sup>22</sup> the tribunals have “reached sharply divergent results.”<sup>23</sup> For purposes of this article, the two most important cases are *Maffezini v. Spain* and *Plama Consortium v. Bulgaria*. *Maffezini* is the first decision “to address directly the question of whether an MFN clause entitles a claimant to invoke dispute settlement provisions from third-party treaties[,]” and the tribunal answered in the affirmative.<sup>24</sup> The tribunal in *Plama*, on the other hand, “argu[ed] in favor of a presumptively narrow interpretation of MFN clauses.”<sup>25</sup>

18. Moser, *supra* note 8, at 286-87.

19. DOLZER & STEVENS, *supra* note 17, at xii.

20. Emmanuel Gaillard, *Establishing Jurisdiction Through a Most-Favored-Nations Clause*, 233 N.Y. L.J. 105 (2005).

21. Schill, *supra* note 9, at 100-01.

22. For an in-depth discussion of each case see Scott Vesel, *Clearing a Path Through a Tangled Jurisprudence: Most-Favored-Nation Clauses and Dispute Settlement Provisions in Bilateral Investment Treaties*, 32 YALE J. INT’L L. 125 (2007). The five decisions are: *Maffezini v. Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, 5 ICSID (W. Bank) 396 (2000), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC565\\_En&caseId=C163](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC565_En&caseId=C163); *Siemens A.G. v. Arg.*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (2004), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowDoc&docId=DC508\\_En&caseId=C7](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowDoc&docId=DC508_En&caseId=C7); *Salini Costruttori S.p.A. v. Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, 44 I.L.M. 573 (2004), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC635\\_En&caseId=C218](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC635_En&caseId=C218); *Plama Consortium v. Bulg.*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 44 I.L.M.721 (2005), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC521\\_En&caseId=C24](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC521_En&caseId=C24); *Gas Natural SDG v. Arg.*, ICSID Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction (2005), <http://www.asil.org/pdfs/GasNat.v.Argentina.pdf>.

23. Vesel, *supra* note 22, at 126.

24. *Id.* at 156.

25. *Id.* at 173.

Recognizing that each investment dispute must be resolved on a case-by-case basis,<sup>26</sup> one may argue that the *Maffezini* rule should prevail, allowing foreign investors from other countries that have concluded BITs with China to have access to the same dispute settlement procedures China has granted Dutch and German investors for the following reasons: 1) BITs and MFN treatment are based upon and designed to encourage competition in a global market economy; 2) substantive rights and procedural remedies are mutually dependent—each essentially becomes meaningless without the other; 3) because China is inching ever-closer to a market economy, and assuming a dual role as both host state (seeking additional foreign direct investment) and investor state (seeking to increase protection for its national investors abroad), it has made a conscious decision to change its BIT practice; and 4) the indirect investment provision of the Sino-German BIT is further evidence of China's shift in policy to grant more favorable protections to more investors. Principles of sovereignty and consent are therefore not violated, and the more favorable treatment of China's new BITs should inure to the benefit of *all* investors whose countries have concluded Chinese BITs containing MFN clauses.

## II. Bilateral Investment Treaties and Most-Favored-Nation Treatment

Modern BITs are the descendants of early bilateral commercial treaties.<sup>27</sup> The United States began concluding bilateral treaties of friendship, commerce and navigation (FCNs) as early as the eighteenth century.<sup>28</sup> These FCNs “were primarily concerned with facilitating trade as opposed to regulating foreign investment.”<sup>29</sup> It was not until 1959, still in the wake of World War II, that Germany and Pakistan concluded the first modern BIT.<sup>30</sup> Unlike the previous commercial agreements that dealt primarily with trade, this treaty was the first to deal exclusively with foreign investment.<sup>31</sup>

Just as modern BITs descended from bilateral agreements of trade and other commercial relationships, modern MFN clauses are the progeny of age-old international economic agreements—MFN clauses have been traced back to the eleventh century.<sup>32</sup> MFN treatment has been called the “cornerstone of international commercial transactions[.]”<sup>33</sup> and is included in most BITs.<sup>34</sup>

When states enter a treaty containing an MFN clause, they “agree to accord each other the same treatment they grant to any other nation”<sup>35</sup> such that “any favorable provision provided for in a BIT will be available to every other country with which the host country

26. *Id.* at 127.

27. Jeswald W. Salcuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investments in Developing Countries*, 24 INT'L LAW. 655, 657 (1990).

28. Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L & POL'Y 157, 158 (2005).

29. DOLZER & STEVENS, *supra* note 17, at 10.

30. Salcuse, *supra* note 27, at 657.

31. *Id.*

32. Vesel, *supra* note 22, at 128-29; Gabriel Egli, Comment, *Don't Get Bit: Addressing ICSID's Inconsistent Application of Most-Favored-Nation Clauses to Dispute Resolution Provisions*, 34 PEPP. L. REV. 1045, 1065 (2007).

33. SHAN, *supra* note 13, at 150; Vesel, *supra* note 22, at 126.

34. SHAN, *supra* note 13, at 150; Vesel, *supra* note 22, at 126; DOLZER & STEVENS, *supra* note 17, at 65; Egli, *supra* note 32.

35. Vesel, *supra* note 22, at 126.

has a BIT containing an MFN clause.”<sup>36</sup> The end result is that the “host state will not discriminate among foreign investments owned or controlled by investors of different nationalities,”<sup>37</sup> and the level of protection guaranteed by each BIT concluded by the host state rises to the level guaranteed by that state’s most protective BIT.<sup>38</sup> MFN treatment has the economic effect of leveling the playing field to allow foreign investors to compete more fairly against one another in a given host country.<sup>39</sup> Without MFN treatment, states would be allowed to play favorites and grant better protection to investors from State A than to their competitors from State B. The host government would be able to create a monopoly by essentially forcing State B’s investors out of the market.

The kinds of competitive structures that MFN treatment ensures are at the core of market economics.<sup>40</sup> Fostering competition is a part of the “market liberalization” model,<sup>41</sup> and market liberalization is one of the goals of the BIT movement.<sup>42</sup> BITs are viewed as “instruments of liberalization.”<sup>43</sup> Therefore, MFN clauses specifically, and the BIT movement generally, represent the “victory of market ideology”<sup>44</sup> and international investment law’s choice to endorse and embrace capitalism and competition instead of communism and government control of markets.

### III. The People’s Republic of China

In the thick of the Cold War, just over a month after the Soviet Union acquired its own atomic bomb, Mao Zedong emerged victorious from the nearly quarter-century-long civil war between Chinese nationalists and Chinese communists, and formed the People’s Republic of China on October 1, 1949.<sup>45</sup> “The new Chinese leader was a dedicated Marxist-Leninist who was more than ready to defer to Stalin as the head of the international communist movement.”<sup>46</sup>

The dynamic between the Soviet Union and China, as well as China’s stance toward capitalism, changed significantly by the 1970s. Whereas “the Soviet Union and most Eastern European countries refused to recognize” the European Community (EC) after it

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36. Egli, *supra* note 32.

37. Kenneth J. Vandeveld, *Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties*, 36 COLUM. J. TRANSNAT’L L. 501, 511 (1998).

38. Egli, *supra* note 32.

39. GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 43 n.163 (“A dynamic of inter-state competition is written into investment treaties themselves through the standard of most favoured nation treatment, which requires states to make their commitments under one investment treaty available under others.”).

40. Schill, *supra* note 9, at 98.

41. Susan D. Franck, *Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law*, 19 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 337, n. 118 (2007).

42. Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT’L L.J. 67, 76 (2005). “The ideal of economic liberalism holds that the market, not governmental laws and regulations, should determine economic decisions.” *Id.* at 90.

43. Vandeveld, *supra* note 37, at 504. “The basic premise of liberal economic theory is that free markets will yield the most efficient use of resources and thus the greatest productivity.” *Id.*

44. Vandeveld, *supra* note 28, at 177.

45. JOHN LEWIS GADDIS, THE COLD WAR: A NEW HISTORY 35-37 (2005).

46. *Id.* at 37.

was established in January 1958, China did not follow suit.<sup>47</sup> Instead, it “developed positively close ties with the EC . . . viewing [it] as a useful economic partner, a factor for stability, and an irritant for the Soviet Union.”<sup>48</sup> Since at least 1979, when “China’s attitude towards foreign direct investment radically changed” with the announcement of its “open-door policy,”<sup>49</sup> the PRC, “in the middle of its transition from a planned socialist economy to an unprecedented socialist market economy,”<sup>50</sup> has had a delicate relationship with international law.

On the one hand, Chinese concepts of international law were heavily influenced by Marxism. “Thus, some Chinese interpreted the role and effect of international law through class analysis transported from the domestic arena: Bourgeois international law . . . is mainly a weapon used by civilized states to control and oppress what they consider to be uncivilized states.”<sup>51</sup> Western countries’ international goals are considered ideologically hegemonic and/or “under the control of multinational corporations who search for super profits.”<sup>52</sup> On the other hand, “Deng Xiaoping, the diminutive . . . but relentlessly pragmatic successor to Mao Zedong, . . . brushed aside communism’s prohibitions on free enterprise while encouraging the Chinese people to get rich.”<sup>53</sup> Thanks to Deng’s pragmatic approach of experimenting with capitalism and rejuvenating China’s study of and participation in international law,<sup>54</sup> China’s per capita income tripled, gross domestic product quadrupled, and exports increased by a factor of ten between 1978 and 1994.<sup>55</sup>

That China walks a tightrope of sorts between communism and capitalism is also evident in its unique relationship with the United States. The United States and China began BIT negotiations in mid-1983<sup>56</sup> but never came to an agreement owing in part to the “Tiananmen incident” in 1989, after which initial negotiations were terminated.<sup>57</sup> The United States, however, is one of the largest investors in China even though there is no BIT.<sup>58</sup> The existence of a BIT is merely one of many variables that go into potential investors’ decisions. Many other factors such as China’s size, location (“proximity to economically growing East and Southeast Asian areas”), potential for low-cost quality labor, abundant natural resources, and land space, make the PRC very appealing to investors.<sup>59</sup>

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47. Zeng Huaqun, *Promoting a New Bilateral Legal Framework for China-EU Economic Relations*, 3 CHINESE J. INT’L L. 189, 191 (2004).

48. *Id.*

49. Schill, *supra* note 9, at 78-79.

50. Zhou, *supra* note 4, at 45.

51. 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. CHINESE L. 405, 430 (1988) (internal quotations omitted).

52. *Id.* at 431 (internal quotations omitted).

53. Gaddis, *supra* note 45, at 197 (internal quotations omitted).

54. Steinert, *supra* note 51, at 431; Chew, *supra* note 3, at 633 (“Deng and other so-called pragmatists generally favor economic modernization, reduction in and the restructuring of the national bureaucracy, and increased internationalization including the encouragement of increased foreign investments.”) (internal quotes omitted).

55. GADDIS, *supra* note 45, at 215.

56. Steinert, *supra* note 51, at 432.

57. Schill, *supra* note 9, at 81.

58. Moser, *supra* note 8, at 287.

59. Chew, *supra* note 3, at 621.

Entering into BITs carries with it a certain signaling function.<sup>60</sup> A country signals that it is trying to: 1) “promote foreign investment and . . . increase the amount of capital and associated technology flowing to [its] territor[y];”<sup>61</sup> 2) “strengthen [its] relationship with [developed] countries so as to obtain other benefits and favors, such as those in the domain of trade or foreign aid, which such a strengthened relationship may yield;”<sup>62</sup> 3) “liberalize [its] econom[y] and thereby promote economic growth;”<sup>63</sup> 4) “encourage[ ] domestic entrepreneurs, who might be skeptical of their government’s intentions toward private capital, to undertake productive investments;”<sup>64</sup> and 5) “remedy the deficiencies in [its] own governance institutions and in [its] own enforcement of the rule of law.”<sup>65</sup>

While there may not be a U.S.-China BIT, China *is* sending these signals:

In 1982 the PRC signed its first BIT with Sweden. Subsequently surging in number to well over 110, 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.<sup>66</sup>

Furthermore, the PRC signed the ICSID Convention on February 9, 1990.<sup>67</sup>

China is sending all the right signals, and the United States and other western states are getting the message. They view China’s efforts to modernize its domestic and international policies and legal structures as positive, progressive, and “proof that China is developing its market system.”<sup>68</sup> Nevertheless, several Chinese commentators urge Westerners to be cautious not to jump to conclusions about China.<sup>69</sup> Zhou warns that “corruption and a lack of transparency hinder the establishment of an independent and impartial legal system” and that sometimes businesspersons must “tender benefits to local government officials in order to achieve a business goal.”<sup>70</sup> Chew hints at the same corruption and lack of transparency when she says, “In China, who one knows is as important as what one knows, and what one knows may not be easily discernible.”<sup>71</sup> Li does not mince words in labeling, and almost dismissing, “the typical statement by the Chinese government” that “[t]he whole purpose of China’s economic reform is to transform the so-called planned economy to a market economy” as “bureaucratic propaganda.”<sup>72</sup> According to Li, “Chinese economy, in its nature, is a power-oriented economy. Both the planned economy and the market economy are only disguises to cover the power-oriented economy.”<sup>73</sup>

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60. Jeswald W. Salacuse, *The Treatification of International Investment Law*, 13 L. & BUS. REV. AM. 155, 158 (2007).

61. *Id.*

62. *Id.* at 159.

63. *Id.* at 160.

64. *Id.* at 161.

65. *Id.*

66. Schill *supra* note 9, at 81.

67. *Id.* at 89.

68. Chew, *supra* note 3, at 635-36.

69. *Id.* at 636.

70. Zhou, *supra* note 4, at 46.

71. Chew, *supra* note 3, at 623.

72. SHOU SHUANG LI, *THE LEGAL ENVIRONMENT AND RISKS FOR FOREIGN INVESTMENT IN CHINA*, 313 (2007).

73. *Id.*

From its Cold War origins in Marxism-Leninism to the current controversies of its hybrid economy, the PRC occupies a unique position in the global era of international investment.

#### IV. BITs, MFN Treatment and the PRC

Set against the background of the forces behind the BIT movement, the function of MFN treatment within that movement, and China's ever-evolving role in the global economy, the issue of whether "pursuant to the most favored nation treatment, . . . foreign investors from other countries that have entered into similar investment with China should also enjoy the same [procedural dispute settlement] benefits provided by China to Dutch and German investors"<sup>74</sup> no longer appears quite so controversial. If the *Maffezini v. Spain* and *Plama v. Bulgaria* awards stand for the two possible outcomes (*Maffezini*—a presumptively broad reading of MFN clauses and *Plama*—a presumptively narrow reading of MFN clauses), a tribunal should adopt the broader, *Maffezini*-like standard, as pertaining to the China's recent BITs, for at least four reasons: 1) BITs and MFN treatment are based upon and designed to encourage competition in a global free market economy; 2) substantive rights and procedural remedies are mutually dependent—each essentially becomes meaningless without the other; 3) because China is a) inching ever-closer to a market economy and always seeking additional foreign direct investment and b) assuming a dual role as both host state and investor state and seeking to increase protection for its national investors abroad, it has made a conscientious decision to change its BIT practice; and 4) the indirect investment provision of the Sino-German BIT is further evidence of China's policy shift toward making more favorable protections available to a greater number of potential investors.

China's acceptance of comprehensive investor-state dispute settlement procedures and inclusion of national treatment in its BITs with Germany and the Netherlands "constitute [such] a fundamental change in the country's foreign economic policy,"<sup>75</sup> that to deny non-German, non-Dutch investors the more favorable provisions of China's most recent BITs, a tribunal would have to ignore the underlying policies of the regime of international investment law altogether. The PRC's BITs have slowly evolved since its first in 1982.<sup>76</sup> The Sino-German and Sino-Dutch treaties finally "conform in all major aspects to international standards," suggesting that "the PRC has come to terms with the widely accepted standards in this field of international law,"<sup>77</sup> which is to say that the PRC has come to terms with capitalism and competition-driven markets, at least with respect to international investment.

This change is especially evident in light of the fact that the new Chinese BITs grant national treatment protection in addition to comprehensive dispute settlement procedures.<sup>78</sup> National treatment "is based on the presumption that there is a unified national

74. Moser, *supra* note 8, at 287.

75. Schill, *supra* note 9, at 76.

76. *Id.* at 113.

77. *Id.* at 113-14.

78. Axel Berger, German Development Institute, China's New Bilateral Investment Treaty Programme: Substance, Rational and Implications for International Investment Law Making 12 (2008), available at <http://www.asil.org/files/ielconferencepapers/berger.pdf>.



market where nationals and foreign investors can compete and cooperate"<sup>79</sup>—a notion that, until the new BITs, was viewed as incompatible with China's planned economy.<sup>80</sup>

As the *Maffezini* tribunal pointed out, "dispute settlement arrangements are inextricably related to the protection of foreign investors."<sup>81</sup> "From the point of view of foreign investors, the lack of fair dispute settlement mechanisms would render the discussion of [substantive protections] almost meaningless."<sup>82</sup> Investors' "rights exist only to the extent that they can be enforced through binding international arbitration"<sup>83</sup> and MFN treatment should apply not only to the substantive rights granted in BITs, but also to the procedural remedies.

China's new BITs should not be separated from the fact that China is no longer only an importer of foreign capital, but now is an "emerging capital-exporter."<sup>84</sup> As host states of foreign direct investment gradually take on dual roles and also become home states of outward-flowing capital, their motives change because their "desire to protect their own investors gives [them] . . . an additional incentive to sign BITs."<sup>85</sup> Because "restrictive interpretations of MFN clauses will tend to benefit importers of capital, whereas expansive interpretations will benefit exporters of capital . . . a state's complex interests do not necessarily map onto those of its investors."<sup>86</sup> Thus China has to find a trade-off between her motives as a capital-exporting country interested in a wide range of investment protection for her investors' abroad, and her motives as a capital-importing country interested in upholding state sovereignty and regulatory leeway as far as possible.<sup>87</sup> China's new BITs with the Netherlands and Germany represent "China's deliberate choice to include broader rights for foreign investors."<sup>88</sup>

Furthermore, an innovation in the 2003 Sino-German BIT covers "indirect" investments. Even if a tribunal were to find that it lacked jurisdiction over the investor-state arbitration of a substantive claim between a non-German, non-Dutch investor and the PRC, the indirect investment provision protects "holding constructions where the investment is not directly held by the mother company but effectuated via one or several subsidiaries."<sup>89</sup> This allows "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."<sup>90</sup> U.S. investors, for instance, who do not enjoy the benefits of a Sino-American BIT, may run an investment through a subsidiary incorporated in Germany and enjoy the very favorable protections of the Sino-German BIT.<sup>91</sup>

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79. SHAN, *supra* note 13, at 163.

80. *Id.*

81. Vesel, *supra* note 22, at 158.

82. Steinert, *supra* note 51, at 452.

83. Vesel, *supra* note 22, at 158.

84. Schill, *supra* note 9, at 99.

85. Ryan Suda, The Effect of Bilateral Investment Treaties on Human Rights Enforcement and Realization, in *TRANSNATIONAL CORPORATIONS AND HUMAN RIGHTS*, at 80-81 (ed. Olivier De Schutter) (2006).

86. Vesel, *supra* note 22, at 132-33.

87. Schill, *supra* note 9, at 115-16.

88. *Id.* at 114-15.

89. *Id.* at 85.

90. *Id.* at 86.

91. *Id.*

By its explicit consent to this indirect investment provision which allows investors to benefit from BIT protection without having a BIT or an MFN clause at all, China implicitly consents to a broad interpretation of its MFN clauses with respect to dispute settlement procedures. It would be paradoxical to apply the restrictive *Plama*-like reading of MFN protection and preclude those investors of third-party states, who have at least entered into an “old generation” BIT with China, from benefiting from the “new generation” BITs while simultaneously permitting investors from states with no legal investment relationship with China whatsoever to suddenly acquire substantive rights and procedural remedies vis-à-vis China simply by engaging in relatively straightforward corporate restructuring.

## V. Conclusion

China’s new BITs mark a substantial departure from its past BIT practice. The new provisions—national treatment, comprehensive investor-state arbitration, and indirect investment protection—level the playing field and are evidence of a huge step in the direction of the economic system at the heart of international investment law: capitalism. While China may feel weakened and more vulnerable to arbitration by consenting to comprehensive dispute resolution procedures, it is a classic example of a state yielding a portion of its sovereignty in order to “promot[e] aggregate gain to the public good through the type of broad cross-border investment fostered by arbitration.”<sup>92</sup>

China knows that MFN clauses function like a “one-way ratchet” such that “[r]ather than renegotiating a large number of BITs to incorporate [a] change, a host state can simply agree to a single BIT with the more favorable provision *with the knowledge* that by operation of the MFN clauses, the new treatment will apply to investors from *any* country with a BIT.”<sup>93</sup> By renegotiating its BITs with the Netherlands and Germany, China has done precisely that. It agreed to more favorable provisions knowing that Dutch and German investors would not have a monopoly on the benefits of these investor-friendly changes. Rather, investors from any other country with which China has a BIT should also benefit.

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92. Guillermo Aguilar Alvarez, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT’L L. 365, 399 (2003).

93. Vesel, *supra* note 22, at 142-43 (emphasis added).

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Chandler, Aaron. "BITs, MFN Treatment and the PRC: The Impact of China's Ever-Evolving Bilateral Investment Treaty Practice." *The International Lawyer*, Fall 2009, Vol. 43, No. 3: 1301-1310.

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