The US-China Bilateral Investment Treaty (BIT)

Two beginnings and two approaches

After a false start, negotiations on a U.S.-China Bilateral Investment Treaty (BIT) have become a top priority in the economic relations between the world's two largest economies. BIT talks started in 2008 under the presidencies of George W. Bush and Hu Jintao, but were put on hold after President Obama took office. A decision to restart negotiations was reached at the U.S.-China Strategic and Economic Dialogue (S&ED) in July 2013, amid a confluence of favorable conditions. The Obama administration had released a new model BIT the previous year and the U.S. economy was starting to show signs of recovery from the Great Recession. Meanwhile, the new Chinese President Xi Jinping was calling for a new model of U.S.-Chinese relations and talked openly of revising China's economic growth strategy. China opened the way for renewed negotiations by agreeing to drop its request that the treaty exclude certain industries, many in the service sector[1].

This restart reflects the dynamic of the negotiations and, more generally, the two countries' approaches to BITs. The U.S. is standing firm on key standards established in its model BIT, while China is following a more reactive and protean approach[2], gradually accepting some of the new provisions in its partner's model BIT while resisting full liberalization. The U.S. approach has yielded relatively few agreements: the U.S. currently has BITs in place with 41 countries[3], only two of which were concluded in the past decade. China has signed BITs with 128 countries.

U.S.-China BIT negotiations have completed 19 rounds. The latest round took place 8-12 June 2015 in Beijing.

The highest-stakes BIT

The U.S.-China BIT has higher stakes than any other BIT either country has negotiated. The U.S. and China are the world's top two recipients of foreign direct

[1] The U.S. Chamber of Commerce's position was that these restrictions would have to be dropped as a pre-condition to BIT negotiations.
[2] Note that China has not issued a model BIT.
[3] Albania, Argentina, Armenia, Azerbaijan, Bahrain, Bangladesh, Bolivia, Bulgaria, Cameroon, Democratic Republic of Congo, Republic of Congo, Croatia, Czech Republic, Ecuador, Egypt, Estonia, Georgia, Grenada, Honduras, Jamaica, Jordan, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, Morocco, Mozambique, Panama, Poland, Romania, Rwanda, Senegal, Slovakia, Sri Lanka, Trinidad and Tobago, Tunisia, Turkey, Ukraine, and Uruguay.

investment (FDI)[4], but FDI flows between the two have been relatively small. Only around 1% of U.S. FDI flows to China, and 8% of Chinese FDI flows to the U.S. A BIT could help increase U.S. FDI flows to China by making the Chinese investment climate more attractive to US investors and opening more Chinese sectors to US investment. Meanwhile, a BIT could help lower the more political barriers that have hampered a number of Chinese investments in America. As Chinese FDI has diversified from natural resources to other sectors such as real estate, food, information and telecommunications technology (ICT), and financial services, interest in investing in the U.S. has rapidly grown. In the first half of 2015, Chinese companies concluded a first-semester record of 88 FDI transactions in the U.S. totaling $6.4 billion, including a record of 53 acquisitions.

The not-so-new U.S. BIT model

The U.S. has a publicly accessible model BIT that serves as a template for negotiations with potential BIT partners. This model is more detailed than that of other countries, and U.S. BITs have traditionally departed very little from it. Following a three-year review process, on 20 April 2012 the Obama administration unveiled a new model BIT to replace the 2004 version. The new version did not change any of the fundamental investment and arbitration provisions, which have served U.S. investors well in past BITs, considering the U.S. has never lost an ISDS case. Rather, the changes filled some gaps revealed by the financial crisis; U.S. companies' growing experience investing in state-led economies; and various public interest groups' focus on transparency, labor and environmental standards. The result disappointed many stakeholders who had recommended more significant changes during the consultation process, hoping to see a revision along the lines of the 2004 substantive overhaul of the 1994 model. The latter revision primarily strengthened the state's hand.

Below is an outline of the 2012 model BIT. Areas of difference from the 2004 model BIT are highlighted and explained.

Section A

Article 1: Definitions

[4] The U.S. has 20% of the global FDI stock, while China has 10%.

The new model specifies that "territory" means, with respect to the United States, "(i) the customs territory of the United States, which includes the 50 states, the District of Columbia, and Puerto Rico; (ii) the foreign trade zones located in the United States and Puerto Rico." Furthermore, "territory" means, "with respect to each Party, the territorial sea and any area beyond the territorial sea of the Party within which, in accordance with customary international law as reflected in the United Nations Convention on the Law of the Sea, the Party may exercise sovereign rights or jurisdiction." The latter addition to the definition of "territory" makes it clear that offshore oil and gas operations and fish farms fall under the scope of BITs.

Article 2: Scope and coverage

The new model specifies: "for greater certainty, government authority that has been delegated includes a legislative grant, and a government order, directive or other action transferring to the state enterprise or other person, or authorizing the exercise by the state enterprise or other person of, governmental authority".

Article 3: National treatment

Article 4: Most-Favored-Nation Treatment

Article 5: Minimum Standard of Treatment

Article 6: Expropriation and Compensation

Article 7: Transfers

Article 8: Performance Requirements

This article lists that "neither Party may, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor or a Party or of a non-Party in its territory, impose or enforce any requirement or enforce any commitment or undertaking" to meet (a) export, (b) domestic content, (c) domestic sourcing, or (d) foreign exchange inflow targets, (e) to restrict sales, (f) to transfer proprietary technology or knowledge, and (g) to exclusively supply a particular market; the new model adds (h) "(i) to purchase, use or accord a preference to, in its territory, technology or the Party or of persons of the Party; or (ii) that prevents the purchase or use of, or the according of a preference to, in its territory, particular technology, so as to afford protection on the basis of nationality to its own investors or investments or to technology or the

Party or of persons of the Party." The new model further specifies: "the term 'technology of the Party or of persons of the Party' includes technology that is owned by the Party or persons of the Party, and technology for which the Party holds, or persons of the Party hold, an exclusive license."

Article 9: Senior Management and Boards of Directors

Article 10: Publication of Laws and Decisions Respecting Investment

Article 11: Transparency

The new model removed the requirement that parties designate and identify contact points responsible for facilitating the parties' communications on any treaty issues. This requirement was replaced by a provision committing the parties to regularly consult on improving transparency practices.

Three other new transparency provisions were added:

1) Parties are to publish proposed central government regulations affecting issues covered in the BIT in an official journal at least 60 days before public comments are due, along with an explanation of their purpose. At the time of adoption of a final regulation, "significant, substantive comments received during the comment period" would have to be addressed, and "substantive revisions" explained in the aforementioned official journal or "in a prominent location on a government Internet site."
2) Parties are to publish adopted central government regulations affecting issues covered in the BIT in an official journal and explain their purpose.
3) A section on standards setting wherein "each Party shall allow persons of the other Party to participate in the development of standards and technical regulations" and of "conformity assessment procedures by its central government bodies, on terms no less favorable than those it accords to its own persons". A footnote explains that one way to satisfy this obligation would be to provide interested parties an opportunity to comment on proposed measures and to take these comments into account in the course of developing the measure. In addition, each party is to recommend that non-governmental standardizing bodies allow participation by persons of the other party in these areas. The Article notes that these standards setting provisions do not apply to sanitary and phytosanitary measures or "purchasing specifications prepared by a governmental body for its production or consumption requirements".

Article 12: Investment and Environment

The new model BIT includes five additional paragraphs in this section.

1) The first just recognizes the importance of domestic and multilateral environmental regulation in protecting the environment.
2) Additional emphasis is placed on Parties' discretion over regulation, compliance, investigations, and prosecution on matters regarding the allocation of resources and environmental priorities, provided the action or inaction is the result of a *bona fide* decision.
3) The term "environmental law" under this article is defined as

> "each Party's statues or regulations, or provisions thereof, the primary purpose of which is the protection of the environment, or the prevention of a danger to human, animal, or plant life or health, through the: (a) prevention, abatement, or control of the release, discharge, or emission of pollutants or environmental contaminants; (b) control of environmentally hazardous or toxic chemicals, substances, materials, and wastes, and the dissemination of information related thereto; or (c) protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas, in the Party's territory, but does not include any statute or regulation, or provision thereof, directly related to worker safety or health."

4) A party may now make written requests for consultations over any issue covered in Article 12 in order to try to reach a mutually acceptable solution; the other party has 30 days to respond to such a request.
5) Parties are free to enable public participation over any issue pertaining to this article.

Article 13: Investment and Labor

The 2012 model bolstered this article in similar ways as it did Article 12. A new first paragraph reaffirms the partners' commitments as International Labor Organization (ILO) members. Second, the definition of "labor laws" is expanded to include statutes or regulations related to "the elimination of discrimination in respect of employment and occupation". The same consultation and public participation provisions added to Article 12 were applied to Article 13.

Article 14: Non-Conforming Measures

Article 15: Special Formalities and Information Requirements

Article 16: Non-Derogation

Article 17: Denial of Benefits

Article 18: Essential Security

Article 19: Disclosure of Information

Article 20: Financial Services

In the event of arbitration under Investor-State Dispute Settlement (ISDS), the new model raises the bar of qualification for arbitrators to be appointed to the tribunal. Whereas expertise in financial services previously sufficed, expertise in the "particular sector of financial services in which the dispute arises" is now required. Other changes to ISDS with regard to financial services include a provision on non-disputing party submissions to the tribunal[5] and one on deciding unresolved issues[6]. With regard to transparency, the new model stipulates that in addition to publishing regulations relating to financial services in advance, parties shall specify the purpose of the regulation and "address in writing significant substantive comments received from interested parties with respect to the proposed regulations." Finally, the new model adds a provision stating that parties are authorized to implement prudential measures in the financial services[7].

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[5] "the non-disputing Party may make oral and written submissions to the tribunal regarding the issue of whether and to what extent paragraph 1 or 2 is a valid defense to the claim. Unless it makes such a statement, the non-disputing Party shall be presumed, for purposes of the arbitration, to take a position on paragraph 1 or 2 not inconsistent with that of the respondent."

[6] "On the request of the respondent made within 30 days after the expiration of the 120-day period for a joint determination referred to in subparagraph (c), or, if the tribunal has not been constituted as of the expiration of the 120-day period, within 30 days after the tribunal is constituted, the tribunal shall address and decide the issue or issues left unresolved by the competent financial authorities as referred to in subparagraph (c) prior to deciding the merits of the claim for which paragraph 1 or 2 has been invoked by the respondent as a defense. Failure of the respondent to make such a request is without prejudice to the right of the respondent to invoke paragraph 1 or 2 as a defense at any appropriate phase of the arbitration."

[7] "For greater certainty, nothing in this Treaty shall be construed to prevent the adoption or enforcement by a party of measures relating to investors of the other Party, or covered investments, in financial institutions that are necessary to secure compliance with laws or regulations that are not inconsistent with this Treaty, including those related to the prevention of deceptive and fraudulent practices or that deal with the effects of a default on financial services contracts, subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on investment in financial institutions."

Article 21: Taxation

Article 22: Entry into Force, Duration, and Termination

Section B

Article 23: Consultation and Negotiation

Article 24: Submission of a Claim to Arbitration

Article 25: Consent of Each Party to Arbitration

Article 26: Conditions and Limitations on Con sent of Each Party

Article 27: Selection of Arbitrators

Article 28: Conduct of the Arbitration

The last paragraph of this article was reworded and includes an additional provision that if an appellate mechanism for reviewing ISDS awards is developed, parties "shall strive to ensure that [it provide] for transparency of proceeding similar to the transparency provisions established in Article 29".

Article 29: Transparency of Arbitral Proceedings

Article 30: Governing Law

Article 31: Interpretation of Annexes

Article 32: Expert reports

Article 33: Consolidation

Article 34: Awards

Article 35: Annexes and Footnotes

Article 36: Service of Documents

Section C

Article 37: State-State Dispute Settlement

Annex A: Customary International Law
Annex B: Expropriation
Annex C: Service of Documents on a Party

The U.S.-China BIT at a crossroads

While negotiators have achieved several breakthroughs new challenges have emerged. Regarding breakthroughs, China agreed to offer non-discrimination treatment at all stages of investment for US companies. Next, a major milestone was reached when China agreed to a negative list approach for the first time in a BIT. Under this more liberal approach, foreign investment is allowed in all areas except those explicitly listed. The two parties exchanged lists during the latest round. Negotiators will address the length and quality of these lists over the next two rounds, with the goal of exchanging improved ones (i.e. shorter and more specific) in September, when Chinese President Xi Jinping is scheduled to make a state visit to the United States. The visit is expected to create momentum for an announcement on significant progress in the BIT negotiations.

However, the prospect of concluding a U.S.-China BIT during President Obama's term is dimmed by several recent developments. First, the pace and outcome of Trans-Pacific Partnership (TPP) negotiations will determine how much time and political capital are available to push through a U.S.-China BIT, not to mention the Transatlantic Trade and Investment Partnership (TTIP) between the U.S. and European Union. TPP negotiations are currently stalled after the limited progress made at the recent ministerial meeting in Maui.

Second, China has recently proposed and/or passed a number of laws the U.S. Treasury department fears will provide Chinese authorities with greater powers to restrict foreign investment and operations for reasons that go beyond the national security considerations allowed under the U.S. model BIT. These laws include China's recently passed "National Security Law" proposing an investment review process, draft "Foreign Investment Law", pilot provisions implemented in Foreign Trade Zones (FTZs), draft cyber-security legislation, and draft NGO legislation. It is still unclear how all these laws will be implemented and how they will interact with one another. U.S. negotiators will be closely watching how broadly China defines national security as it seeks to create its version of the Committee on Foreign Investment in the United States (CFIUS), which has rejected a number of Chinese investments on national security grounds. Progress will be set back if the U.S. believes new Chinese provisions undermine gains achieved in the BIT negotiations.

Third, the recent series of Chinese renminbi devaluations has brought the issue of currency manipulation to the fore, threatening to erode the political support that will be necessary to ratify a U.S.-China BIT.