Proceedings of the 3rd International Conference on Business and Policy Studies
DOI: 10.54254/2754-1169/81/20241537

The US-China BIT: Enhancing Dispute Settlement Mechanism

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Abstract: This article critically examines the inadequacies of the International Centre for Settlement of Investment Disputes (ICSID) and the intricacies surrounding the divergent strategies employed by the United States and China in managing investor-state disputes. Given the lack of an explicit dispute resolution mechanism in the envisioned US-China Bilateral Investment Treaty (BIT), the paper advocates for a comprehensive strategy for shaping future agreements. It proposes integrating UNCITRAL Arbitration Rules as an alternative to ICSID; the inclusion of ad hoc Arbitration Panels is recommended for tailored resolutions; and the incorporation of alternative dispute resolution (ADR) mechanisms as pre-arbitration procedures is emphasized. This multifaceted strategy aims to address the deficiencies of a singular arbitration mechanism and foster a more adaptable and effective dispute resolution framework tailored to the specific needs of China and the United States, providing a balanced means of addressing the complexities inherent in investor-state disputes.

Keywords: International Investment, Dispute Settlement, ICSID, Bilateral Investment Treaty (BIT).

1. Introduction

This article first provides the background to the lack of a clearly defined investment dispute settlement mechanism in the China-US Bilateral Investment Treaty (BIT). It provides a brief overview of the International Center for Settlement of Investment Disputes (ICSID) mechanism and its adoption in the United States and China. Subsequently, the article analyzes why the ICSID mechanism should not be applied separately in the dispute clauses of the US-China BIT. These reasons include internal flaws in the ICSID investment arbitration mechanism, public interest protection measures, and lack of transparency and redress mechanisms. In addition, this article also provides an in-depth exploration of the differences and evolution of attitudes towards ICSID arbitration between China and the United States.

Based on this analysis, the article proposes an optimization strategy: introducing multiple dispute settlement mechanisms into the US-China bilateral investment agreement. This requires the incorporation of the UNCITRAL Arbitration Rules, the establishment of specialized arbitral tribunals and the exploration of alternative dispute resolution (ADR) methods. Finally, this article emphasizes the necessity of including a diversified dispute settlement mechanism in future bilateral investment agreements between China and the United States and how it can resolve the shortcomings of a single arbitration mechanism.

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2. Background

Currently, there is no clear investment dispute settlement mechanism between China and the U.S. provided by a bilateral investment treaty. As the negotiation of a US-China BIT encounters dilemmas, a probe into the establishment of a dispute settlement mechanism manifests the necessities.

ICSID is the world's leading institution devoted to international investment dispute settlement. States have agreed on ICSID as a forum for investor-State dispute settlement in most international investment treaties and in numerous investment laws and contracts. The U.S. ratified the convention in 1966 when ICSID was founded, while China ratified it in 1993. By the end of 2022, ICSID has registered a total of 910 cases under the ICSID Convention and the Additional Facility Rules[1].

3. ICSID arbitration in the context of US-China investment disputes

3.1. Internal problems of ICSID that undermine its legitimacy and effectiveness

Although the ICSID Convention has been ratified by nearly 160 states, its arbitration mechanism is encountering discussions of a crisis of legitimacy in the following aspects. Some developing countries have gradually realized the risks that may arise from fully accepting the ICSID mechanism, and therefore have begun to reform the relevant provisions of ICSID jurisdiction in BITs in order to retain more sovereignty and autonomy in investment disputes. Some Latin American countries, such as Bolivia and Ecuador, even announced their withdrawal from the ICSID Convention. The discussion of the shortcomings of the ICSID arbitration mechanism includes but is not limited to the following aspects.

Firstly, it showed inadequate protection of public interests. Some scholars have argued that the ICSID system is "biased towards investors…[and] provides greater protection to investors than to host states"[2]. Many bilateral investment treaties do not set substantial restrictions on investors when submitting disputes to international arbitration. Especially when the host country has explicitly accepted the compulsory arbitration system, investors may initiate international arbitration against sovereign states without restrictions. In addition, most arbitral tribunals place too much emphasis on the protection of investors when interpreting the provisions of bilateral investment treaties, and sometimes override the protection of investors' rights and interests beyond a reasonable level by expanding the interpretation of the provisions. In fact, in order to safeguard its interests as a host country, the United States has taken measures to circumvent this mandatory investment arbitration process. In the trade agreement signed with Australia, the United States eliminated the provision that foreign investors can directly submit disputes to international arbitration institutions for adjudication[3]. This adjustment reflects a prudent re-evaluation of the investment dispute settlement mechanism to balance the relationship between the protection of investor rights and interests and the sovereignty of the host country.

Secondly, its arbitration process lacks sufficient transparency. Investment arbitration emphasizes the independent will of the parties and the confidentiality of the procedures. Therefore, the arbitration process and award results are usually not disclosed to the public, which brings many obstacles to the international community's understanding and supervision of investment dispute settlement. ICSID investment arbitration practice in recent years has stipulated and improved the existing transparency rules. Compared with the previous fragmented transparency provisions, the 2022 Arbitration Rules have a dedicated transparency chapter, further highlighting the emphasis on ICSID transparency issues[4]. However, although the international community generally supports research on improving transparency, the ICSID arbitration rules are still not detailed enough[5], which is reflected in the disclosure of court proceedings, the disclosure of arbitration documents, and the participation of third

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parties in arbitration[6]. Moreover, the new rules have not yet been applied in examples, so there is not enough evidence to show their effectiveness and rationality.

Thirdly, the ICSID Convention lacks a remedy mechanism for arbitration awards. Article 52 of the Convention provides for the annulment of ICSID arbitrary awards, but this provision has not been effectively applied by both Contracting States in practice[7]. On the one hand, regarding the ICSID arbitration annulment system, the academic community has not been able to reach an agreement on the scope of review. The main point of dispute is whether substantive issues should be reviewed in addition to procedural issues. This has led to confusion in practice between the ICSID arbitration annulment system and the appellate relief system. Some scholars advocate a clear distinction between the two systems and emphasize that when interpreting the provisions of Article 52, the relief function of the arbitration annulment procedure should be limited to avoid over-interpretation. On the other hand, regarding the ICSID appeal mechanism, academic circles generally call for the establishment and improvement of this mechanism. This is because the appeal mechanism can not only meet the parties' needs for a comprehensive review of the award but also effectively respond to the imbalance between ICSID fairness and efficiency. However, the establishment of an appeal mechanism still needs to be further advanced and requires countries to explicitly accept ICSID appeal provisions in their BITs. This needs to be verified through long-term practice. Therefore, to ensure that the dispute settlement provisions in the BIT between China and the United States have a reasonable remedy mechanism, a more efficient solution may be to skip the ICSID amendment process and directly stipulate the relevant provisions in the BIT. This helps ensure that the relief mechanism is more closely aligned with the actual needs of both parties.

3.2. Different approaches to ICSID between China and the US

Since the establishment of the ICSID mechanism, Chinese and U.S. acceptance of ICSID arbitration rules have evolved in different ways. Initially after signing the ICSID Convention, China took a prudent attitude towards ICSID's arbitration jurisdiction and was reluctant to submit investment disputes to international arbitration[8] . But after entering the 21st century, with the rise of China's outbound foreign investment, China began to accept ICSID jurisdiction in BITs. One of the characteristics of a typical BIT in 21st-century China is "a relatively quick, but still cautious approximation to modern international standards and to international arbitration"[9] .

In contrast, the United States is becoming more cautious in its attitude towards ICSID arbitration. In the past, the U.S. had fully accepted the investment arbitration mechanism under ICSID, which is reflected in the BITs between the United States and developing countries. However, in recent years, the U.S. has begun to discuss the shortcomings of the ICSID dispute settlement mechanism, and has tried to reform the international investment arbitration system, such as by advocating that investor-host investment disputes should be resolved on the domestic level[10].

Alongside the expansion of acceptance of ICSID jurisdiction, China no longer limits the scope of arbitrable matters submitted to ICSID in recent BITs to only expropriation and nationalization. When China ratified the Convention, it submitted a declaration according to Article 25(4) purporting that it would only submit "disputes over compensation resulting from expropriation and nationalization" to the ICSID center. Such a practice is not anymore present in the more recent BITs between China and foreign states. For instance, Article 7(b) of the China-Turkey BIT (1990) stated that "a dispute involving the amount of compensation resulting from an expropriation or nationalization referred to in Article 3" can be submitted to an ad-hoc arbitral tribunal[11]. In comparison, Article 9 of a newer China-Turkey BIT (2015) declares that any disputes which "has breached an obligation under Article 2 through 8" can be submitted to ICSID[12].

The U.S. regulations on the scope of arbitrable matters are broader than those in China. The 2012 U.S. Model Bilateral Investment Treaty stipulates that disputes that violate (A) an obligation under

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Articles 3 through 10, (B) an investment authorization, or (C) an investment agreement can be submitted to arbitration[13]. “It refers to the BIT's substantive standards but adds investment agreements and investment authorizations as possible bases for a claim”[14]. In fact, while the broad definition of arbitrable matters in the 2012 U.S. Model BIT is expected to ensure that more disputes are resolved through arbitration, there are many voices in China that believe this definition is too broad. For example, some people believe that matters in item (C) (an investment agreement can be submitted to arbitration) should be resolved through ordinary commercial arbitration and should not fall under the special category of investment arbitration. Therefore, when constructing a BIT between China and the United States, driving the parties to agree on the scope of arbitrable matters remains a challenging task.

4. Multiple Arbitration Mechanisms in a US-China BIT

4.1. Alternative Mechanisms to ICSID

Given the internal problems of ICSID as a dispute arbitration system, three alternative mechanisms can be provided to address investment disputes between investors and host governments.

First, UNCITRAL arbitration rules, which provide full-scale procedural rules whereby the parties may accept the arbitral proceedings, can be added to the BIT as an option for investors and host countries. “The UNCITRAL Rules are intended to be acceptable in countries with different legal, social, and economic systems and are widely used in both ad hoc arbitrations and administered arbitrations”[15]. Article 22.1(c) of China-Canada BIT set “the UNCITRAL Arbitration Rules, as supplemented or modified by the rules set out in this Agreement or adopted by the Contracting Parties”[16]. Although both China and the United States are parties to ICSID, it may still be stipulated in the future BIT that UNCITRAL rules may be applied to make up for the lack of exhaustiveness of ICSID rules. Currently, UNCITRAL is promoting ISDS reform on a broader scale. UNCITRAL Working Group III is expected to complete the negotiation and drafting of all rules by 2027, laying a good foundation for promoting the completion of the latter on time. China submitted written opinions on ICSID Working Paper No. 4 in December 2018, and then proposed an intermediate plan to UNCITRAL Working Group III in July 2019, aiming to retain investment arbitration and establish a permanent appeals mechanism[17]. It can be seen that the ICSDI mechanism and the UNCITRAL mechanism are showing an optimization trend of common development and mutual complementation, which is expected to provide the option of a more complete dispute settlement mechanism between investors and host countries in the future.

Second, ad hoc arbitration panels should remain a viable means of resolving investment disputes. The advantages of ad hoc arbitration are its flexibility, efficiency and cost-effectiveness over institutional arbitration. Although China resists ad hoc arbitration under domestic law, China broadly accepts ad hoc arbitration in many of its bilateral investment treaties with other countries. Since the 2012 US Model BIT recognizes that arbitration can be conducted in any institution or by any arbitration rules upon mutual agreement of the investor and the host country, in the US-China BIT negotiations, parties can discuss setting up specialized ad hoc arbitration panels to complement arbitration by ICSID.

Third, alternative dispute resolution (ADR), which refers to the different ways that people can resolve disputes without going to trial, shall be included in the terms of BIT. The ADR mechanism helps the host country and investors reach an agreement through a full consultation, which avoids the cost of formally submitting to ICSID and the current problems of ICSID’s ineffective protection of the host country’s public interest[18]. China and the United States could consider adding more language to international investment agreements that encourage amicable settlement or promote conciliation and mediation methods. At the same time, the ADR mechanism can be explicitly

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included in international investment agreements or become part of subsequent specific implementation measures as relevant provisions of investment dispute prevention policies. This approach helps reduce and prevent investment dispute cases between China and the United States and provides an effective way to promote a more amicable settlement between the two parties. In a future US-China BIT, ADR can be included as an applicable dispute settlement mechanism and can be used as a pre-procedure for investors to initiate international investment arbitration.

4.2. Pathways through which alternative mechanisms solve abovementioned problems

First, the UNCITRAL arbitration rules can be an alternative rule to address the crisis of confidence in ICSID. It can be voluntarily chosen by both parties, which avoids the problem of applying different definitions of arbitrable matters. The UNCITRAL Arbitration Rules have been widely used in international investment cases in recent years. For example, in the Montenegro v. China case in 2021, its applicability was clearly demonstrated. The China-Switzerland BIT (2009) stipulates that investors have the right to choose to submit to arbitration in accordance with ICSID rules or to submit ad hoc arbitration in accordance with UNCITRAL rules[19]. In this case, the investor chose to submit to ad hoc arbitration to resolve the dispute based on the 1976 UNCITRAL Rules in effect when the China-Switzerland BIT (2009) was signed, which provided useful reference experience for the formulation of BITs between China and the United States.

Second, the ad hoc arbitration panels, which can exempt disputes from submission to ICSID bodies, have more flexibility since the parties can choose ready-made mechanisms like UNCITRAL arbitration rules and establish specific rules according to particular cases. Considering the significant differences between China and the United States in their treatment of ICSID institutional arbitration, it is of great significance to establish an investment arbitration institution specifically for China and the United States. This will not only help promote the tailor-made investment dispute settlement mechanism in the US-China BIT, but will also help to combine the different national conditions of the two countries. While bridging the differences in investment environment and policies between China and the United States, such an institution can meet the needs of both countries for investment dispute settlement to the greatest extent.

Thirdly, alternative dispute resolution (ADR) containing mediation and conciliation can be a circumvention of arbitration proceedings as a pre-procedure which resolves the disputes before the arbitration stage. The ADR method provides significant flexibility both in the dispute resolution process and in the substantive content of the solution. In the ADR procedure, both legal obligations and specific dispute facts can be handled flexibly. The solution does not have to strictly rely on the interpretation of treaty provisions, nor does it need to deliberately identify the facts of breach of contract and damage, but more emphasis is placed on reaching a consensus acceptable to both parties. The ADR method goes beyond the rights and obligations of both parties in specific legal documents and provides a broad space for promoting the establishment of long-term and sustainable relationships between the two parties. ADR methods not only provide faster and cheaper resolutions, especially when disputes are resolved at an early stage but also help avoid escalation. In addition, the ADR method can also accommodate other issues besides financial compensation, providing a more comprehensive solution for all parties. During the previous US-China BIT construction negotiations, discrepancies arose on terms such as the "negative list," "labor standards," "environmental protection," and the "safety review system." These differences underscored the contrasting national conditions and diverse economic environments of the two countries. The complexity of these disputes is deeply rooted in these disparities. Adopting a fixed international investment institution arbitration system (e.g. ICSID system) might prove challenging in effectively resolving these intricate and dynamically evolving investment disputes. Hence, it is evidently crucial to explicitly establish the ADR method as an arbitration prevention procedure within the BIT framework. This proactive

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measure aims to address investment disputes that may emerge across varied countries, industries, and backgrounds, providing both parties with a more adaptable and pragmatic solution. Including ADR clauses in BITs can pave the way for a more responsive and equitable investment dispute settlement mechanism tailored to the specific needs of China and the United States, thus mitigating the complexity arising from divergent national conditions and the multifaceted nature of economic environments.

5. Conclusion

Within the framework of exploring future dispute settlement provisions under the US-China BIT, there are many problems with the ICSID mechanism, including the inadequate protection of public interests, lack of arbitration transparency, and lack of remedy mechanisms. The United States and China have different attitudes towards ICSID arbitration, including the degree of acceptance of jurisdiction and different regulations on the scope of arbitrable matters. ICSID is no longer a perfect stand-alone mechanism for resolving investment disputes between China and the United States. Therefore, multiple investment dispute resolution mechanisms should be made available in the future US-China BIT, including UNCITRAL arbitration rules, ad hoc arbitration panels, and alternative dispute resolution (ADR).

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