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# **Discriminatory Application of Competition Law and International Investment Agreements**

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## **Discriminatory Application of Competition Law and International Investment Agreements<sup>1</sup>**

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### Abstract

The relationship between competition law and investment law has been a topic of recent discussion. The former aims to establish fair competition conditions in the markets. The latter seeks to protect foreign investments in the State. The broader the regulation of international investment agreements (IIAs), the more visible is the tension between the two laws. For example, the monopoly of a sector by the host State's domestic companies can be regarded as a barrier for foreign investors' entry into the market. If a host State interprets and applies its domestic laws in favor of its domestic companies, then consequently, to the foreign investors' disadvantage, there is discrimination based on nationality. This should be regarded as a breach of national treatment as stipulated in the IIAs. The relationship between the two laws should be analyzed and discussed in greater detail in the future.

*Keywords:* International investment law, Investor-State dispute settlement, Competition law, Chinese anti-monopoly law, National treatment, Discrimination, Nationality

*JEL classification:* K33, K41, K42

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## **Introduction**

A thorough discussion regarding the relationship between competition law and investment law is lacking. The aim of the former is to realize fair competition in a market, whereas the latter aims at protecting foreign investments established by foreign investors in a State's territory. The broader the regulation by international investment agreements (IIAs), the greater is the tension that exists between the two laws. For example, the monopoly of a sector by domestic companies in the host State's market can be regarded as an obstacle for foreign investors' entry into this market. Similarly, if a host State interprets and applies its domestic laws in favor of its domestic companies, then consequently, and to the detriment of foreign investors, discrimination occurs based on nationality. Arguably, this constitutes a breach of the national treatment clause in IIAs. Despite the scarce cases relating to investment arbitration that discuss the relationship between the two laws, this topic warrants further examination in the future.

### **1. The Relationship between Competition Law and Investment Law**

The relationship between competition law and investment law has not yet attracted much academic interest. In fact, the recent Free Trade Agreements (FTAs) contain different chapters on "competition" and "investment," but they fail to explain the link between these two chapters, although, as we see below, the two laws overlap in several aspects of the industry.

#### **1.1. Negotiation**

This unclear situation can also be observed in the Trans-Pacific Partnership (TPP), which will contain two different chapters: investment and competition policy. The former chapter is expected to provide the investment protection (and/or promotion) corresponding to many other FTA/Economic Partnership Agreements (EPAs). The latter chapter will touch upon the harmonization of competition policy among contracting parties of the TPP.<sup>2</sup> The main aim of this part appears to be to regulate the state-owned enterprises (SOEs), which are widely admitted in developing countries. It is unclear, however, whether the TPP contains a clause that clarifies the relationship between the two chapters. On this point, the *Nikkei* observed that the investor-state dispute settlement (ISDS) will not be applicable to the SOE issue; only the State-to-State dispute settlement (SSDS) will apply. The ISDS is inapplicable because the U.S. government accepts the fear of developing countries to be sued by American companies before the ISDS.<sup>3</sup>

#### **1.2. The Japan–Australia EPA**

The Japan–Australia EPA,<sup>4</sup> concluded in 2014, is one example that stipulates the investment chapter and the competition policy chapter. Chapter 15 reflects the specific position of

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<sup>2</sup> Regarding the "Competition", the Leaders of the nine Trans-Pacific Partnership countries announced the "Outlines" of the TPP (on 12 November 2012), which stated the following: "The competition text will promote a competitive business environment, protect consumers, and ensure a level playing field for TPP companies. Negotiators have made significant progress on the text, which includes commitments on the establishment and maintenance of competition laws and authorities, procedural fairness in competition law enforcement, transparency, consumer protection, private rights of action and technical cooperation." "Enhancing Trade and Investment, Supporting Jobs, Economic Growth and Development: Outlines of the Trans-Pacific Partnership Agreement," available at [<http://www.ustr.gov/about-us/press-office/fact-sheets/2011/november/outlines-trans-pacific-partnership-agreement>].

<sup>3</sup> *Nikkei*, 21 August 2013 (Electronic version). However, after this article, we cannot find any follow-up on this topic. It is thus not clear whether this position is maintained in the present TPP negotiation.

<sup>4</sup> Agreement between Japan and Australia for an Economic Partnership, signed in 2014. Available at [[http://www.mofa.go.jp/ecm/ep/page22e\\_000430.html](http://www.mofa.go.jp/ecm/ep/page22e_000430.html)].

Australia (i.e., emphasizing the importance of competition policy in its territory). Exceptionally, this EPA contains an article on the SOEs, specifically Article 15.4 (State-Owned Enterprises), which states the following:

“In addition to Article 15.3, bearing in mind the relationship between the promotion of competition and other policy objectives, the Parties recognise that seeking to ensure that governments do not provide competitive advantages to state-owned enterprises simply because they are state owned can contribute to the promotion of competition.”

This article can be seen as a new trend of regulating SOEs from the perspective of competition law and, at the same time, must be the result of Australia’s negative attitude toward the SOEs and its consequential domestic regulations. However, there are some flaws in this chapter. First, a definition of SOE is lacking although a precise definition of SOE has been provided in Australian domestic law.<sup>5</sup> Second, the Japan–Australia EPA denies the applicability of dispute settlement procedure to the chapter on competition policy.<sup>6</sup> Thus, there can be no means to solve any dispute arising from the competition policy of the host State. Third, with regard to the relationship between competition policy and ISDS, the Japan–Australia EPA contains a huge loophole (i.e., it provides no article on the ISDS at all). Accepting Australia’s persistent position against the ISDS is the result of this negotiation. Even though a “review” for inserting an ISDS clause is built into the investment chapter,<sup>7</sup> there is currently no means for investors to resort to the ISDS. Fourth, there is no mention of the relationship between “competition” and “investment.” Thus, it is clear that the recent EPA, concluded by Japan, attempted to address the issue of SOE but only partially realized this goal.

### 1.3. The Position of the U.S.

Exceptionally, in the U.S., an insightful discussion has been held on the relationship among competition, SOE, and the bilateral investment treaty (BIT). During the process of revising the 2004 U.S. Model BIT,<sup>8</sup> one Report was submitted to the Advisory Committee of International Economic Policy Regarding the Model Bilateral Investment Treaty (ACIEP) in 2009,<sup>9</sup> which resulted in the new U.S. Model BIT in 2012. In this Report, the Committee

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<sup>5</sup> Fujio Kawashima, “Competitive Neutrality Principles in Australia: Lessons for the TPP negotiation on disciplines over state-owned enterprises,” RIETI Discussion Paper Series 15-J-026 (in Japanese), available at [<http://www.rieti.go.jp/en/publications/summary/15060001.html>]. This can be explained by the fact that the TPP negotiation, which touches upon and provokes the issue about the definition of SOE, was and now still is in the process and that the two contracting parties decided not to make any influence, by their EPA, on the sensitive negotiation of TPP. On this point, the MOFA had observed that any insufficiency in the Japan–Australia EPA concerning the competition policy will be covered by TPP. MOFA, November 2011, available at [[http://www.mofa.go.jp/mofaj/gaiko/tpp/pdfs/tpp02\\_02.pdf](http://www.mofa.go.jp/mofaj/gaiko/tpp/pdfs/tpp02_02.pdf)].

<sup>6</sup> Art 15.9 (Non-Application of Chapter 19 (Dispute Settlement)) states that “[t]he dispute settlement procedures provided for in Chapter 19 (Dispute Settlement) shall not apply to this Chapter.”

<sup>7</sup> Art 14.19 (“Review”) states that “1. Unless the Parties otherwise agree, the Parties shall conduct a review of this Chapter with a view to the possible improvement of the investment environment through, for example, the establishment of a mechanism for the settlement of an investment dispute between a Party and an investor of the other Party. Such review shall commence in the fifth year following the date of entry into force of this Agreement or a year on which the Parties otherwise agree, whichever comes first.” It is said, in this context, that as China–Australia FTA will contain an ISDS clause, this must be a trigger for starting the review procedure stipulated in Art 14.19.

<sup>8</sup> U.S. Model BIT 2004, ‘Treaty between the Government of the United States of America and the Government of [Country] concerning the Encouragement and Reciprocal Protection of Investment’. Available at [<http://www.state.gov/documents/organization/117601.pdf>].

<sup>9</sup> ‘Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty’ (30 September 2009). Available at [<http://www.state.gov/e/eb/rls/othr/2009/131098.htm>]. On that day, the Advisory Committee on International

members touched upon the pivotal problems concerning competition law and SOEs. The most important paragraphs are as follows:

“20. We recommend that the Administration consider whether the Model BIT should include a provision requiring that Parties ensure that their respective state enterprises, in the provision of their goods and/or services, accord National Treatment, in accordance with Article 3, and Most Favored Nation Treatment, in accordance with Article 4, to covered investments.

Given the significant state-owned sectors of several potential BIT partners, it could be useful to clarify certain aspects of the national treatment (NT) and most-favored nation (MFN) provisions of the current Model BIT to ensure that these obligations extend to certain non-regulatory actions by state enterprises. We recommend the Administration consider whether the Model BIT needs to be amended to ensure that states are not able to evade their NT/MFN obligations by delegating authority to and then taking certain impermissible actions through their state-owned enterprises.

21. Some Subcommittee members recommend that the Administration consider whether the Model BIT should clarify that the fact of being owned by a government does not defeat the quality of an enterprise’s being “in like circumstances” with another enterprise for purposes of the National Treatment or Most Favored Nation Treatment obligations.

The Model BIT requires a Party to provide investors and investments of the other Party with no less favorable treatment than it provides to domestic or other foreign investors and investments that are “in like circumstances.” Some Subcommittee members believed that clarification might be made that a Party cannot evade its NT/MFN obligations by claiming that an investor or investment of that Party is a state enterprise and, solely for that reason, not “in like circumstances” with a privately-owned investor or investment. Other Subcommittee members believed that this interpretation was already clear from the text of the existing Model BIT.”

First, it clarified that some members had an expectation that the NT clause and the MFN clause should be applied, “in like circumstances,” to SOEs owned by other countries. Second, it should be pointed out that the issue of SOE, within the U.S. BIT policy, had not been discussed at the previous review process in 2004.<sup>10</sup> This means that the issue of SOE, especially that of China, appeared after 2004. In addition to the above expectation, the Report focuses on the other side of the SOE issue, as follows:

“22. The Subcommittee held discussions on ways to address access of SOEs to financing at below-market interest rates and other such anticompetitive subsidization. The Subcommittee discussed concerns raised by preferential and non-market based financing of inbound investments into the United States by foreign SOEs. Some members were of the view that a new Model BIT should strike a balance that ensures that foreign SOEs operating in the United States do not import anti-competitive industrial policies regarding their purchase and operations in the United States (e.g., subsidization) that likely would result in the undermining of domestic investors’ competitiveness, productive capacity, innovation and job creation in the United States. These members believed that a BIT should not offer protection to foreign SOEs that operate by receiving financing and inputs at below-market rates or access to other

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Economic Policy submitted the Report on Review of U.S. Model Bilateral Investment Treaty to the Department of State and the Office of the United States Trade Representative (USTR).

<sup>10</sup> “Report of the Subcommittee on Investment Regarding the Draft Model Bilateral Investment Treaty Presented To: The Advisory Committee on International Economic Policy” (January 30, 2004). This report had a purpose of revising the 1994 U.S. Model BIT. Available at [http://www.ciel.org/Publications/BIT\\_Subcmte\\_Jan3004.pdf](http://www.ciel.org/Publications/BIT_Subcmte_Jan3004.pdf).

anti-competitive subsidization from the foreign government, but rather believed that a BIT should provide meaningful disciplines to ensure open and fair competition in the United States free from such foreign government intervention.”

First, contrary to this discussion, there was an opposite view of members. This put doubt on the treatment of competition issue in the framework of BIT.<sup>11</sup> Second, the discussion regarding SOE was limited to Chinese companies operating in the U.S., which receive financial support from the Chinese government. However, the recent issue of SOE in debate has an opposite aspect (i.e., the U.S. companies, operating in China, suffer unequal treatment between Chinese companies and foreign companies). In this case, some regulations must be applied, not to the U.S., but to China.

In the Annex, attached to the ACIEP Report,<sup>12</sup> some members of the Subcommittee discussed and opined more actively on the issue of SOEs, in particular on the issue of “Creating a Level Playing Field Between State-Owned and Private Enterprises.” First, it repeats the need to regulate the financing of state enterprises, operating in the U.S., at below-market interest rates. On this point, some elements are taken into consideration (e.g., the domestic competitiveness or an unfair competitive advantage for Chinese SOEs and a “strategic industrial policy” of making “dominance” in some industrial sectors, taken by the Chinese government). Second, the Annex states that the anti-competitive policies of China “have created disadvantages for U.S. companies investing in China.” Finally, the Annex reiterates the Organization for Economic Co-operation and Development (OECD) Declaration on Sovereign Wealth Funds (SWF),<sup>13</sup> in the sense that there should not be discrimination between foreign investors and domestic investors “in like circumstances.”<sup>14</sup>

Lastly, based on the above discussion on the BIT reform, the U.S. has long considered that the relevant provisions of BIT, such as the NT and the MFN, should be applied to the issue of SOEs, which are favorably financed by their home States. This expectation was not clearly stipulated in the 2012 Model BIT,<sup>15</sup> but there have been some amendments. For example, the 2012 Model BIT clarifies that the BIT obligations apply to state-owned enterprises by the following articles:

Article 1 stipulates that:

“‘enterprise’ means any entity constituted or organized under applicable law, whether or not for profit, and *whether privately or governmentally owned or controlled*,

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<sup>11</sup> According to those members, the issue of SOE is “far beyond the scope of a negotiable BIT and raise complex questions for which a single response is not likely to be found. [...] it would be most appropriate to address the aforementioned concerns through national or international rules concerning competition policy.” *Ibid.*

<sup>12</sup> Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty: Annex B: Particular Viewpoints of Subcommittee Members. Available at [<http://www.state.gov/e/eb/rls/othr/2009/131118.htm#b>].

<sup>13</sup> OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies (Adopted by Ministers of OECD countries at the Council at Ministerial level, on 5 June 2008), C/MIN(2008)8/FINAL. Available at [[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=C/MIN\(2008\)8/FINAL](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=C/MIN(2008)8/FINAL)]. The relevant part of the Declaration states as follows:

“Recipient countries [receiving SWF] should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.”

<sup>14</sup> It is stated that “[i]nvestors that have access to unlimited sovereign government largess, and those who do not, are not ‘in like circumstances’.”

<sup>15</sup> 2012 U.S. Model Bilateral Investment Treaty, “Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment.” Available at [<http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>].

including a corporation, trust, partnership, sole proprietorship, joint venture, association, or similar organization; and a branch of an enterprise (emphasis added). Article 2 (2) states the following:

“A Party’s obligations under Section A shall apply: (a) to a state enterprise or other person when it exercises any regulatory, administrative, or other governmental authority delegated to it by that Party.”

The note, attached to Article 2 (2), states as follows:

“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.”

Here, the U.S. 2012 Model BIT made it clear that the SOEs often gain special privileges, such as access to preferential financing from their governments or certain immunities that may not be available to foreign investors.<sup>16</sup> This means that the U.S. approves certain instances of differential treatment between foreign investors and domestic investors.

#### **1.4. China’s AML**

The most controversial topic concerning the conflict between competition law and investment law can be found in the application (and/or interpretation) of the anti-monopoly law (AML) in China.<sup>17</sup> The concrete issue is that the Chinese competition authority tends to apply the AML discriminatorily in favor of its domestic companies and, moreover, does so without expressing any reason. Several articles of China’s AML have been in question, such as the following:

“Article 7

With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security or the industries implementing exclusive operation and sales according to law, the state protects the lawful business operations conducted by the business operators therein. The state also lawfully regulates and controls their business operations and the prices of their commodities and services so as to safeguard the interests of consumers and promote technical progresses.

The business operators as mentioned above shall lawfully operate, be honest and faithful, be strictly self-disciplined, accept social supervision, shall not damage the interests of consumers by virtue of their dominant or exclusive positions.”

This article admits some exceptions of legal controls by the anti-monopoly authority, in accordance to Chinese laws. This exemption, basically in conflict with some international obligations, must correspond to the exemptions in IIAs.

One of the most controversial clauses in China’s AML is found in Art. 27(5), which states the following:

“Article 27

In the case of the examination on the concentration of business operators, it shall consider the relevant elements as follows:

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<sup>16</sup> Shayerah Ilias Akhtar and Martin A. Weiss, “U.S. International Investment Agreements: Issues for Congress,” *Congressional Research Service*, 2013, available at [<https://www.fas.org/sgp/crs/row/R43052.pdf>], p.10.

<sup>17</sup> China’s anti-monopoly law is available at [[http://www.china.org.cn/government/laws/2009-02/10/content\\_17254169.htm](http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm)]. As to the analysis of the application of AML of China, Fujio Kawashima, “Enforcement Trend in the Chinese Antimonopoly Law: Selectively targeting foreign companies and being used as a tool of industrial policies?,” RIETI Discussion Paper Series 15-J-042 (July 2015), available at [<http://www.rieti.go.jp/en/publications/summary/15070017.html>]. In this paper, Professor Kawashima puts doubt toward the argument that China’s application is selective and discriminatory.

- (1) the market share of the business operators involved in the relevant market and the controlling power thereof over that market,
- (2) the degree of market concentration in the relevant market,
- (3) the influence of the concentration of business operators on the market access and technological progress,
- (4) the influence of the concentration of business operators on the consumers and other business operators,
- (5) the influence of the concentration of business operators on the national economic development, and
- (6) other elements that may have an effect on the market competition and shall be taken into account as regarded by the Anti-monopoly Authority under the State Council.”

Under Art 27(5), the Anti-monopoly Authority under the State Council can take into account “the influence of the concentration of business operators on *the national economic development*.” For example, if a concentration or monopoly can be regarded as a contribution to China’s “national economic development,” then there will be a moderate examination in favor of domestic investors, more advantageous than to foreign investors. Whether or not there is a breach of national treatment in IIAs is disputable.

### **1.5. Applicability of the ISDS**

Many experts, including governmental authorities, believe that the application of the national treatment clause contained in IIAs is possible. The Japanese believe that the trilateral investment treaty concluded by Japan, China, and Korea in 2012 (entered into force in 2014) is applicable.<sup>18</sup> This treaty replaced the previous three BITs: Japan–China BIT (1988),<sup>19</sup> Japan–Korea BIT (2002),<sup>20</sup> and China–Korea BIT (2007).<sup>21</sup>

## **2. Summary of the National Treatment**

### **2.1. Basic Character of the National Treatment Clause**

The national treatment clause is one of the most popular and traditional standards stipulated in IIAs. There are four basic features. First, the national treatment clause aims at providing foreign investors with a level playing field, at least at the post-establishment phase.<sup>22</sup> At the same time, the national treatment clause ensures that foreign investors gain “market access on an equal footing” with nationals, but it can also function to limit the rights of foreign

<sup>18</sup> Agreement among the Government of Japan, the Government of the Republic of Korea and the Government of the People’s Republic of China for the Promotion, Facilitation and Protection of Investment, signed on 13 May 2012. Available at [[http://www.mofa.go.jp/announce/announce/2012/5/pdfs/0513\\_01\\_01.pdf](http://www.mofa.go.jp/announce/announce/2012/5/pdfs/0513_01_01.pdf)].

<sup>19</sup> Agreement between Japan and the People’s Republic of China concerning the Encouragement and Reciprocal Protection of Investment, signed in 1988 and entered into force in 1989. Available at [[http://www.meti.go.jp/policy/trade\\_policy/epa/bit/china\\_e.htm](http://www.meti.go.jp/policy/trade_policy/epa/bit/china_e.htm)].

<sup>20</sup> Agreement between the Government of Japan and the Government of the Republic of Korea for the Liberalisation, Promotion and Protection of Investment, signed in 2002 and entered into force in 2003. Available at [<http://www.mofa.go.jp/policy/treaty/submit/session154/agree-6-1.pdf>].

<sup>21</sup> Agreement on the Encouragement and Reciprocal Protection of Investments between the Government of the Republic of Korea and the Government of the People’s Republic of China, signed and entered into force in 1992. Available at [[http://arbitrationlaw.com/files/free\\_pdfs/korea-china\\_bit.pdf](http://arbitrationlaw.com/files/free_pdfs/korea-china_bit.pdf)]. This BIT was replaced by a new one, which was signed and entered into force in 2007 (not available).

<sup>22</sup> Campbell McLachlan, *International Investment Arbitration: Substantive Principles* (Oxford University Press, 2007), p.251; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Second edition, Oxford University Press, 2012), p.198. Combined with the most-favored-nation clause, the national treatment provides a level playing field for all investors, regardless of their nationality. Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policies and Practice* (Oxford University Press, 2009), p.157.

investors in circumstances where nationals have only limited rights.<sup>23</sup> Furthermore, antitrust concerns arise in respect to large operators, which possess a dominant position in the market.<sup>24</sup> Second, the national treatment clause is an obligation, imposed on the host States, not to discriminate against foreign investors from domestic or local investors. This obligation applies not only to the administrative acts of the host States, but also to the enactment and the application of the rules and regulations in the host States.<sup>25</sup> Third, the national treatment clause uses relatively homogeneous words. On the other hand, the practical implications can differ because of wide-ranging exemptions of certain business sectors.<sup>26</sup> Fourth, the case law of ISDS is not uniform in the interpretation and application of the national treatment clause because of several words commonly used (i.e., “in like circumstances”<sup>27</sup> and “no less favourable’.”). In particular, the appreciation of national treatment depends on the particular facts of the matter, which leads tribunals to make case-by-case findings.

## 2.2. Pre-Establishment and Post-Establishment Application

One remarkable difference in national treatment exists between “pre-establishment” and “post-establishment.” The former means the application of NT obligation before, or at the time of, the establishment of the investment. In this case, the host State is obliged to guarantee market access to foreign investors at the same level as domestic investors. A typical example of this is found in Article 1102 of NAFTA, which states the following:<sup>28</sup>

“1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”

Article 1102(1) stipulates on “investors” and Article 1102(2) relates to “investments.” Both paragraphs use the same expression of “in like circumstances” and apply to the same mode of investment (i.e., at the moment of “establishment and acquisition” of investment (pre-establishment) and “expansion, management, conduct, operation, and sale or other disposition” of investments (post-establishment)). The pre-establishment national treatment is one of the means of “liberalisation” of investment by way of opening the domestic market and allowing market access.

## 2.3. Japan–China–Korea Investment Agreement (2012)

Article 3 of the trilateral treaty stipulates the national treatment obligation as follows:

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<sup>23</sup> Andrea K. Bjorklund, “National Treatment,” in August Reinisch (ed.), *Standards of Investment Protection* (Oxford University Press, 2008), p.31.

<sup>24</sup> M. Sornarajah, *The International Law on Foreign Investment* (Third edition, Cambridge University Press, 2010), p.341. According to the author’s idea, however, the concern here is how to regulate the monopoly of foreign large investors by the way of anti-trust mechanism in the host State, which could amount to a manifest case of “regulatory taking.”

<sup>25</sup> Rudolf Dolzer and Christoph Schreuer, *supra* note 22, p.198.

<sup>26</sup> Rudolf Dolzer and Christoph Schreuer, *supra* note 22, p.199.

<sup>27</sup> In the US Model BIT, the expression “in like situations” has been changed to “in like circumstances.” See, US Model BIT (2012), Art 3. This change means that there are nuances between these two versions that deserve attention. Rudolf Dolzer and Christoph Schreuer, *supra* note 22, p.198.

<sup>28</sup> The words of NAFTA Article 1102 are almost same as the U.S. Model BIT 2012 (Article 3). The latter must have been transplanted to the former. It is worth referring to the previous U.S. Model BIT 1994, which was adopting the term “like situations,” not “like circumstance.” The U.S. changed the term in its 2004 Model BIT.

“1. Each Contracting Party shall in its territory accord to investors of another Contracting Party and to their investments treatment no less favorable than that it accords *in like circumstances* to its own investors and their investments *with respect to investment activities*.

2. Paragraph 1 shall not apply to non-conforming measures, if any, existing at the date of entry into force of this Agreement maintained by each Contracting Party under its laws and regulations or any amendment or modification to such measures, provided that the amendment or modification does not decrease the conformity of the measure as it existed immediately before the amendment or modification. Treatment granted to investment once admitted shall in no case be less favorable than that granted at the time when the original investment was made.

3. Each Contracting Party shall take, where applicable, all appropriate steps to progressively remove all the nonconforming measures referred to in paragraph 2. Note: The People’s Republic of China confirms that its measures referred to in paragraph 2 shall not be inconsistent with paragraph 2 of Article 3 of, and paragraph 3 of the Protocol to, the Agreement between Japan and the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investment, signed at Beijing, August 27, 1988 (emphasis added).”

First, this article admits the application of NT to both “investors” and “investments,” in the same way as Article 1102 of NAFTA (national treatment). Second, Art 3 adopts the same criteria as that of NAFTA (i.e., “in like circumstances”). Third, the national treatment can be applied only to “investment activities,” defined in Art 1(5), which states that “the term ‘investment activities’ means management, conduct, operation, maintenance, use, enjoyment, and sale or other disposition of investments.” Thus, it is clear that by a combination of Art 3(1) and Art 1(5), the national treatment under the Japan-China-Korea treaty does not cover the pre-establishment phase, but applies only to the post-establishment phase. This is a reflection of the preamble, which states (emphasis added): “Recognizing that the reciprocal promotion, facilitation and protection of such investment and *the progressive liberalization of investment* will be conducive to stimulating business initiative of the investors and increase prosperity among the Contracting Parties.” Clearly, the JCK treaty is not an investment liberalization treaty but merely an investment protection treaty.

#### 2.4. NT Clause in Japan’s IIA

As a typical example of Japanese NT clause, the Japan–Uzbekistan BIT Article 2(1) provides the combination of “pre-establishment” and “in like circumstances,” as follows:

“1. Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favorable than the treatment it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as ‘investment activities’).”

Almost all of the BITs contain the pre-establishment NT clause and, at the same time, use the expression of “in like circumstances,” as follows:

| IIAs                                    | Pre-establishment | In like circumstances |
|---|-------------------|-----------------------|
| Japan–Pakistan BIT (1998) <sup>29</sup> | △ Art 1 (6)       | × Art 3 (2)           |

<sup>29</sup> Agreement between Japan and the Islamic Republic of Pakistan concerning the Promotion and Protection of Investment, signed in 1998.

|   |              |              |
|---|--------------|--------------|
| Japan–Mongolia BIT (2001) <sup>30</sup>   | △ Art 1 (6)  | × Art 3 (2)  |
| Japan–Korea BIT (2002) <sup>31</sup>      | ✓ Art 2      | ✓ Art 2      |
| Japan–Singapore EPA (2002) <sup>32</sup>  | ✓ Art 73     | ✓ Art 73     |
| Japan–Vietnam BIT (2003) <sup>33</sup>    | ✓ Art 2 (1)  | ✓ Art 2 (1)  |
| Japan–Cambodia BIT (2007) <sup>34</sup>   | ✓ Art 2 (1)  | ✓ Art 2 (1)  |
| Japan–Indonesia EPA (2007) <sup>35</sup>  | ✓ Art 58 (g) | ✓ Art 59     |
| Japan–Thailand EPA (2007) <sup>36</sup>   | ✓ Art 93 (1) | ✓ Art 93 (1) |
| Japan–Lao BIT (2008) <sup>37</sup>        | ✓ Art 2(1)   | ✓ Art 2 (1)  |
| Japan–Peru BIT (2008) <sup>38</sup>       | ✓ Art 1(5)   | ✓ Art 3      |
| Japan–Uzbekistan BIT (2008) <sup>39</sup> | ✓ Art 2 (1)  | ✓ Art 2 (1)  |
| Japan–Swiss EPA (2009) <sup>40</sup>      | ✓ Art 85 (d) | ✓ Art 87     |
| Japan–India EPA (2011) <sup>41</sup>      | ✓ Art 3 (j)  | ✓ Art 85     |
| CJK Treaty (2012)                         | × Art 1 (5)  | ✓ Art 3      |
| Japan–Myanmar BIT (2013) <sup>42</sup>    | ✓ Art 1 (d)  | ✓ Art 2      |

## 2.5. China’s Stance

The national treatment is a far less popular standard in China’s investment treaties. Fewer than half of China’s BITs contain the national treatment provision.<sup>43</sup> In addition, China does not allow the pre-establishment national treatment, which may amount to the liberalization of investment and the free market access. This is why the JCK treaty also lacks the pre-establishment NT obligation. The same applies to the China–Canada BIT. Although Canada revealed a positive attitude toward the pre-establishment NT,<sup>44</sup> the China–Canada BIT merely contains the post-establishment NT.<sup>45</sup> In addition, Art 6(3) explains the concept of “expansion” of investment as follows:

<sup>30</sup> Agreement between Japan and Mongolia concerning the Promotion and Protection of Investment, signed in 2001.

<sup>31</sup> Agreement between the Government of Japan and the Government of the Republic of Korea for the Liberalisation, Promotion and Protection of Investment, signed in 2002.

<sup>32</sup> Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership, signed in 2002.

<sup>33</sup> Agreement between Japan and the Socialist Republic of Viet Nam for the Liberalization, Promotion and Protection of Investment, signed in 2003.

<sup>34</sup> Agreement between Japan and the Kingdom of Cambodia for the Liberalization, Promotion and Protection of Investment, signed in 2007.

<sup>35</sup> Agreement between Japan and the Republic of Indonesia for an Economic Partnership, signed in 2007.

<sup>36</sup> Agreement between Japan and the Kingdom of Thailand for an Economic Partnership, signed in 2007.

<sup>37</sup> Agreement between Japan and the Lao People’s Democratic Republic for the Liberalisation, Promotion and Protection of Investment, signed in 2008.

<sup>38</sup> Agreement between Japan and the Republic of Peru for the Promotion, Protection and Liberalisation of Investment, signed in 2008.

<sup>39</sup> Agreement between Japan and the Republic of Uzbekistan for the Liberalization, Promotion and Protection of Investment, signed in 2008.

<sup>40</sup> Agreement on Free Trade and Economic Partnership between Japan and the Swiss Confederation, signed in 2009. Available at [<http://www.mofa.go.jp/region/europe/switzerland/epa0902/agreement.pdf>].

<sup>41</sup> Comprehensive Economic Partnership Agreement between Japan and the Republic of India, signed in 2011.

<sup>42</sup> Agreement between the Government of Japan and the Government of the Republic of the Union of Myanmar for the Liberalisation, Promotion and Protection of Investment, signed in 2013.

<sup>43</sup> Norah Gallagher and Wenhua Shan, *supra* note 22, p.174.

<sup>44</sup> Canada 2004 Model BIT, Article 3.

<sup>45</sup> Agreement between the Government of Canada and the Government of the People’s Republic of China for the Promotion and Reciprocal Protection of Investments (signed in 2012). Available at [<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=eng>].

### Article 6: National Treatment

1. Each Contracting Party shall accord to investors of the other Contracting Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory.

“3. The concept of “expansion” in this Article applies only with respect to sectors not subject to a prior approval process under the relevant sectoral guidelines and applicable laws, regulations and rules in force at the time of expansion. The expansion may be subject to prescribed formalities and other information requirements.”

This article shows that the national treatment covers only the “expansion” of investment, which is not subject to a prior approval process. In other words, the prior approval process works for exempting some sectors from the application of national treatment. The intention of China, shown in this article, was to maintain the regulatory power of prior approval in some sensitive sectors.

### 3. National Treatment Clause Case Law

#### 3.1 Three-Step Approach

According to the muddled jurisprudence of the investment arbitration, there are three steps applied to the examination of national treatment.<sup>46</sup> First, the tribunals examine whether the foreign investors and domestic investors are placed in a comparable setting (i.e., “in like circumstances” or “in like situations”). Second, the tribunals examine whether the treatment accorded to foreign investors is at least as favorable as the treatment accorded to domestic investors. Third, the tribunals examine whether the differentiation by the host State can be justified by a legitimate regulation or any other reason.

#### 3.2. The First Requirement: In Like Circumstances

The core element of national treatment is to prohibit discrimination between domestic investors and foreign investors. Thus, the national treatment analysis usually requires identifying an “appropriate comparator” against which to measure the allegedly less favorable treatment.<sup>47</sup> In fact, in most IIAs, the national treatment clause is stipulated in similar expression (i.e., “in like circumstances.”) One problem arising from this expression is whether it is different from the similar words “like product” (WTO/The General Agreement on Tariffs and Trade (GATT) Art III). On this point, there have been discussions concerning the difference or convergence between the two texts. Because of the difference in purpose between trade law and investment law, some authors have pointed out that there must be some differences between the two expressions. The majority of jurisprudence relating to the national treatment in IIAs has preferred a relatively simple test of comparison with the most directly comparable local investor or investors in the same business sector.<sup>48</sup> In addition, the arbitral tribunals tend to widely interpret the basis or situation to which the NT should be applied (i.e., the notion of “sector”). In fact, the tribunal in *S.D. Myer* emphasized the notion of “sector,” “economic sector,” and “business sector,” as follows:

“The concept of ‘like circumstances’ invites an examination of whether a non-national investor complaining of less favorable treatment is in the same ‘sector’ as the national investor. The Tribunal takes the view that the word ‘sector’ has a wide connotation that includes the concepts of ‘economic sector’ and ‘business sector’.”<sup>49</sup>

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2. Each Contracting Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory.

<sup>46</sup> Rudolf Dolzer and Christoph Schreuer, *supra* note 22, p.199.

<sup>47</sup> Andrea K. Bjorklund, *supra* note 23, pp.29-30.

<sup>48</sup> Campbell McLachlan, *International Investment Arbitration: Substantive Principles* (Oxford University Press, 2007), p.253.

<sup>49</sup> *S.D. Myers v. Canada*, Partial Award (13 November 2000), para.250.

Here, the tribunal clarifies that the notion of “sector” is the basis on which NT should be applied and this notion includes the “economic sector” and the “business sector.” The next issue in question is how to define “business sector.” The case law in this regard is not yet uniform. In *Feldman*, the expression “in like circumstances” was interpreted to mean the same business, in this case the exporting of cigarettes.<sup>50</sup> In contrast, the tribunal in *Occidental* referred to local producers in general, and “this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.”<sup>51</sup> In *Grand River*, the tribunal examined the term “like circumstances” in light of the question of whether the compared entities were subject to “like legal requirements” in their regulatory treatment.<sup>52</sup> According to the case law, there is no uniform criterion that determines “in like circumstances” and thus, this requirement has been, and should be, judged on a case-by-case basis.

### 3.3 The Second Requirement: Differentiation

If a measure of the host State targeted foreign nationals, then this would be sufficient grounds to find differentiation based on nationality and a breach of the national treatment clause. In *Corn Products*, the tribunal stated the following:

“the existence of an intention to discriminate is not a requirement for a breach of Article 1102 (and both parties seemed to accept that it was not a requirement), where such an intention is shown, that is sufficient to satisfy the third requirement [treatment less favorable, see para.117]. But the Tribunal would add that, even if an intention to discriminate had not been shown, the fact that the adverse effects of the tax were felt exclusively by the HFCS producers and suppliers, all of them foreign-owned, to the benefit of the sugar producers, the majority of which were Mexican-owned, would be sufficient to establish that the third requirement of ‘less favorable treatment’ was satisfied.”<sup>53</sup>

#### No Requirement of Intent

National treatment is an objective obligation that does not require a subjective element of the host State. Namely, according to arbitral tribunals, proof of discriminatory intent of the host State is not required to establish a breach of the national treatment standard.<sup>54</sup> For example, in *S.D. Myers*, the arbitral tribunal concluded that although intent may be important, “protectionist intent is not necessarily decisive on its own.”<sup>55</sup> According to the tribunal in *Thunderbird*, a violation of the national treatment standard under NAFTA does not require the claimant to separately show that the less favorable treatment was motivated by nationality, and the fact of less favorable treatment will be sufficient.<sup>56</sup> Thus, claimants (foreign investors) are not required to prove discriminatory intent of the host State. Such a hurdle would be too high for most claimants to overcome.<sup>57</sup> The *Siemens* case is more explicit in this regard wherein the tribunal stated:

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<sup>50</sup> *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award (16 December 2002), para.171.

<sup>51</sup> *Occidental Exploration and Production Company v. The Republic of Ecuador*, UNCITRAL Arbitration (London Court of International Arbitration Administered Case No. UN 3467), Final Award (1 July 2004), para.173.

<sup>52</sup> *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, UNCITRAL Arbitration Rules, Award (12 January 2011), para.166.

<sup>53</sup> *Corn Products International, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility (15 January 2008), para.138.

<sup>54</sup> Christopher F. Dugan et al., *Investor-State Arbitration* (Oxford University Press, 2008), p.411.

<sup>55</sup> *S.D. Myers* [2000], para.254.

<sup>56</sup> *International Thunderbird Gaming Corporation v. The United Mexican State*, UNCITRAL Arbitration Rules, Arbitral Award (26 January 2006), para.177.

<sup>57</sup> Andrea K. Bjorklund, *supra* note 23, p.30.

“The tribunal concurs that intent is not decisive or essential for a finding of discrimination, and that the impact of the measure on the investment would be the determining factor to ascertain whether it had resulted in non-discriminatory treatment.”<sup>58</sup>

On the other hand, an intention or motivation of the host State to discriminate or differentiate may be required in some instances. The tribunal in *Genin* can be interpreted to require discriminatory intent as a prerequisite for the establishment of discrimination.<sup>59</sup> Also in *Methanex*, the tribunal decided that:

“In order to sustain its claim under Article 1102 (3), Methanex must demonstrate, cumulatively, that California intended to favor domestic investors by discriminating against foreign investors and that Methanex and the domestic investor supposedly being favored by California are in like circumstances.”<sup>60</sup>

On this point, a conflict among tribunals’ findings remains; therefore, uncertainties remain. In general, a successful national treatment claim is more likely to be based on discriminatory effect, rather than on discriminatory intent.<sup>61</sup>

### ***De facto* Differentiation**

Differentiations are said to cover both *de jure* and *de facto* differences. In this regard, the tribunal in *S.D. Myers* stated the following:

“the tribunal takes the view that, in assessing whether a measure is contrary to a national treatment norm, the following factors should be taken into account: Whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals; Whether the measure, on its face, appears to favor its nationals over non-nationals who are protected by the relevant treaty. Each of these factors must be explored in the context of all the facts to determine whether there actually has been a denial of national treatment.”<sup>62</sup>

The tribunal in *ADF* would have accepted *de facto* differentiation, as well as *de jure* differentiation, had respective evidence been shown by the claimant.<sup>63</sup> In contrast, a purely incidental differentiation resulting from misguided policy decisions does not suffice to show differential treatment.<sup>64</sup>

### **3.4. The Third Requirement: Justification**

It is widely accepted that differentiations are justifiable if rational grounds are shown. The tribunal in *S.D. Myers* stated “the assessment of ‘like circumstances’ must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.”<sup>65</sup> The government policies were considered necessary

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<sup>58</sup> *Siemens A.G. v. The Argentine Republic*, ICSID CASE No.ARB/02/8, Award (6 February 2007), para.321.

<sup>59</sup> *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, Case No. ARB/99/2, Award (25 June 2001), para.369.

<sup>60</sup> *Methanex Corporation v. United States of America*, UNCITRAL Arbitration Rules, Final Award of the Tribunal on Jurisdiction and Merits (3 August 2005), Part IV, Chapter B, para.12. However, as is often referred to, the tribunal in this case stated in para.1 of the same chapter that “an affirmative finding under NAFTA 1102 [...] does not require the demonstration of the malign intent alleged by Methanex.” It is thus difficult to understand what was the real intention of the Tribunal in these two parts of the award.

<sup>61</sup> Andrea K. Bjorklund, “The National Treatment Obligation,” in Katia Yannaca-Small (ed.), *Arbitration under International Investment Agreements: A Guide to the Key Issues* (Oxford University Press, 2010), p.443.

<sup>62</sup> *S.D. Myers* [2000], paras.252-253.

<sup>63</sup> *ADF Group Inc. v. United States of America*, ICSID Case No.ARB(AF)/00/1, Award (9 January 2003), para.157.

<sup>64</sup> *GAMI Investments Inc. v. the Government of the United Mexican States*, UNCITRAL Arbitration Rules, Final Award (15 November 2004), para.114.

<sup>65</sup> *S.D. Myers* [2000], para.250.

in the analysis of national treatment in *Pope and Talbot*, in which the tribunal stated that the national treatment obligation under NAFTA would not be violated if there was:

“a reasonable nexus to rational government policies that (1) do not distinguish, on their face or de facto, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.”<sup>66</sup>

In *ADF*, the tribunal failed to find a violation of the national treatment standard because a U.S. requirement to use locally produced steel for governmental projects applied equally to both national and foreign contractors.<sup>67</sup> Thus, national policies in favor of the domestic public interest can, under certain circumstances, constitute a rational ground for according less than national treatment to foreign investors.<sup>68</sup> However, the specific grounds are unclear.<sup>69</sup>

### 3.5. Comparison With “Like Products”

In regard to the national treatment, both commentators and tribunals have discussed the question whether “like circumstances” or “like situations,” used in IIAs are same as the “like product” criteria used in GATT/WTO.

In the precedent, including *S.D. Myers*,<sup>70</sup> *Pope and Talbot*,<sup>71</sup> and *Feldman*,<sup>72</sup> the tribunals acknowledged the importance of referring to the WTO jurisprudence in interpreting the term “like circumstances.” On the contrary, the recent case law of arbitral tribunals shows a distance from the WTO findings. In *Occidental*, the tribunal refused to apply the WTO holdings when interpreting the BIT clause because the WTO jurisprudence was concerned with a different expression, which could not be treated the same as “like situations” under the BIT.<sup>73</sup> A more precise understanding was shown in a case where the GATT jurisprudence is at best a subsidiary source of guidance for investment tribunals.<sup>74</sup> In the *Methanex* case, for example, the tribunal stated that:

[it] “would be open to persuasion based on legal reasoning developed in GATT and WTO jurisprudence, if relevant.”<sup>75</sup>

In the same paragraph, the tribunal concluded that it considered the GATT “like product” analysis as an inappropriate guidance in the context of the analysis of “like circumstances” in IIAs.<sup>76</sup> Thus, from this finding, it can be said that the GATT/WTO jurisprudence on “like products” should be regarded as a secondary source for interpreting the expression of “like circumstances” in IIAs.

## 4. Application of NT to the Issue of China’s AML

### 4.1. The Position of the U.S.

Faced with *prima facie* discriminatory treatment by Chinese competition authority, several countries, including the U.S., have attempted to insert the *pre*-establishment national treatment clause in IIAs, in order to regulate the mistreatment at the pre-establishment

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<sup>66</sup> *Pope and Talbot Inc. v. The Government of Canada*, Award on the Merits of Phase 2 (10 April 2001), para.78.

<sup>67</sup> *ADF* [2003], paras.156-158.

<sup>68</sup> It is said that this “rational nexus test” now constitutes an inherent part of the evaluation made by NAFTA tribunal when reviewing a potential breach of the national treatment provision. Norah Gallagher and Wenhua Shan, *supra* note 22, p.163.

<sup>69</sup> Rudolf Dolzer and Christoph Schreuer, *supra* note 22, p. 203.

<sup>70</sup> *S.D. Myers* [2000], paras.244-247.

<sup>71</sup> *Pope and Talbot* [2001], paras.45-63, 68-69.

<sup>72</sup> *Feldman* [2002], para.165.

<sup>73</sup> *Occidental* [2004], para.176.

<sup>74</sup> Andrea K. Bjorklund, *supra* note 23, p.36.

<sup>75</sup> *Methanex* [2005], para.6.

<sup>76</sup> *Methanex* [2005], para.6.

phase.<sup>77</sup> It is reported that the U.S. obtained a basic approval from China to include a pre-establishment NT clause in the future BIT.<sup>78</sup> In order to obtain the non-discriminatory market access in China, the U.S. maintains that the future BIT with China must contain a pre-establishment national treatment clause.

#### **4.2. Infant Industries in Developing Countries**

Developing countries commonly hold a social need to protect their own “infant industries,” which are still vulnerable, compared to powerful foreign companies. In the application of the national treatment clause, if host States have to treat all industries equally, infant industries would disappear before they obtain sufficient competitiveness. Legally speaking, however, the protection of infant industries cannot be an exception to the national treatment obligation. As expressed by Sornarajah,

“[u]nless the investment treaty so provided, there will be a violation of the treaty if the protection given to the local industry is not given to the foreign investors as well. A solution would be to exclude sectors which require protection from the scope of the treaty or to preserve regulatory controls relating to competition and similar factors from the scope of national treatment.”<sup>79</sup>

#### **4.3. The Chinese Perspective on NT and SOE**

It should be noted that China has been, and still is, reluctant to acknowledge the national treatment obligation. With Japan, China recognized this obligation in its BIT of 1988 (the first Japan–China BIT), but this was exceptional. There are two reasons that explain China’s reluctance. First, from the Chinese viewpoint, its domestic industries have been too weak to withstand international competition with foreign investors. If the NT was applied, the national industries should compete against international competitors on the same playing field and, therefore, Chinese industries would not have been sufficiently developed. Second, the central planned economy has been implemented in China since the 1950s.<sup>80</sup> Thus, there was no “market” or “competition” in China. In the early 1980s, there were only three categories of companies in China: SOEs, COEs (collectively owned enterprises), and privately owned businesses. These three were treated differently in terms of their operations (i.e., from the material supply to the products marketing). Thus, there was no uniform “national” treatment. Then, even if one of these companies was chosen as “comparator” in the context of NT, the foreign investors would find that the actual comparator treatment was not appropriately level.

It should be added that the domestic Chinese companies gained some merits, but burdens were imposed at the same time. It is necessary to understand the following situations in this regard:

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<sup>77</sup> It is said that “[t]alks on a potential BIT between China and the United States picked up in 2013 with China’s agreement to national treatment of US investors in the pre-establishment phase of investment, levelling the playing field for American and Chinese firms. Pre-establishment was one of the requirements listed on the updated US Model BIT in 2012—and the negotiators achieved it.” Sean Miner, “China–US Investment Treaty Would Strengthen Economic Relations,” *Op-ed in Caixin Online* [<http://piie.com/publications/opeds/oped.cfm?ResearchID=2721>] (21 November 2014).

<sup>78</sup> According to the U.S. Department of State, “[a]t the 2013 U.S.-China Strategic and Economic Dialogue, China agreed to conduct negotiations based on the concepts of ‘pre-establishment’ national treatment.” *See* Department of State: 2014 Investment Climate Statement June 2014, available at [<http://www.state.gov/documents/organization/228504.pdf>], p.24.

<sup>79</sup> M. Sornarajah, *The International Law on Foreign Investment* (Third edition, Cambridge University Press, 2010), pp.343–344.

<sup>80</sup> Norah Gallagher and Wenhua Shan, *supra* note 22, p.166.

“whilst an SOE probably enjoyed some benefits such as good access to public utility and supplies, they also undertook special obligations to the state, including child care, education, and medical care. Foreign investors would certainly not like to take on, these obligations yet they constituted part and parcel of the general treatment an SOE received. Indeed the reason that an SOE enjoyed certain special privileges was precisely because it also undertook such special obligations. A foreign investor could not reasonably argue that he/she should only enjoy the benefits without also undertaking the obligations.”<sup>81</sup>

Although China changed its policy in the 1990s and started to “create conditions for the implementation of national treatment granted to foreign investors,”<sup>82</sup> it is too early to demand full application of NT in China. Thus far, a full market economy is not yet realized, and the competitiveness of national industries has yet to improve.

#### 4.4. Change of the Chinese Policy on NT

The change of economic policy has been reflected and realized in the change of IIA policy.<sup>83</sup> This point is observed in the comparison between the first Japan–China BIT (1988) and the recent JCK treaty (2012).

The former BIT contained a NT clause (Art 3) as follows:

- “1. The 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 favorable than that accorded to nationals and companies of any third country.
2. The 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 favorable than that accorded to nationals and companies of the former Contracting Party.”

However, the protocol, attached to the BIT, stipulated as follows:

- “3. for the purpose of the provision of paragraph 2 of Article 3 of the Agreement, it shall not be deemed ‘treatment less favorable’ for either Contracting Party to accord discriminatory treatment, *in accordance with its laws and regulations*, to national and companies of the other Contracting Party, in case it is really necessary for the reasons of public order, national security or *sound development of national economy*.”<sup>84</sup>

Thus, it is clear that China could maintain some control of national industries by “its laws and regulations” for the purpose of securing its “sound development of national economy.” The Japan–China BIT admitted this exceptional treatment of China. In the new JCK treaty, this additional protocol disappeared but was replaced by the “non-complying measure” clause (Article 3 (2)). It states the following:

- “2. Paragraph 1 shall not apply to non-conforming measures, if any, existing at the date of entry into force of this Agreement [in 2014] maintained by each Contracting Party under its laws and regulations or any amendment or modification to such measures, provided that the amendment or modification does not decrease the conformity of the measure as it existed immediately before the amendment or

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<sup>81</sup> Norah Gallagher and Wenhua Shan, *supra* note 22, p.166.

<sup>82</sup> “CCCPC Decision on Some Issues Related to the Establishment of the Socialist market Economy,” published in the People’s Daily (7 November 1993) [not yet obtained].

<sup>83</sup> According to an author, since 2002, most of China’s new and renegotiated BITs have included provisions for full national treatment. Guiguo Wang, *International Investment Law: A Chinese Perspective* (Routledge, 2015), p.376.

<sup>84</sup> Agreement between Japan and the People’s Republic of China concerning the Encouragement and Reciprocal Protection of Investment (signed in 1988). Emphasis added.

modification. Treatment granted to investment once admitted shall in no case be less favorable than that granted at the time when the original investment was made.” Thus, as was the case in the previous BIT, the new treaty exempts the application of national treatment to the “non-conforming measures” existing under the contracting party’s laws and regulations.

#### **4.5. Assumed Result of the Use of ISDS**

If a case was submitted to an investment arbitral tribunal on the subject of the application of Chinese anti-monopoly law, what result could the foreign investors expect from this procedure? As the case law on the NT is not yet uniform and contradictory awards are existent, it is not easy to predict the result. However, it is possible to point out four elements, either favorable or unfavorable to foreign investors, including Japanese companies. First, there must be competitors, Chinese companies and Japanese companies in the same “sector.” The notion of “sector” can be interpreted widely to include “business sector” and “industry sector.” The problem exists of whether there are some Chinese “competitors,” which can be compared with foreign companies to which Chinese AML were applied. In addition, the arbitral tribunals tend to adopt a case-by-case approach; therefore, the result is not foreseeable. Second, if the first requirement was satisfied, a different treatment or unfavorable treatment seems to be easily shown and proved, as far as the difference between sanctioned companies and non-sanctioned companies is concerned. Third, there will be no need to prove the intent of the Chinese government to treat foreign investors unfavorably. The fact of disadvantageous treatment, analyzed in the second requirement, is sufficient to prove a breach of NT. Fourth, as to the possibility of justification, it becomes necessary to discuss Art 27(5) of Chinese AML, which allows an exemption on the basis of national economy. On this point, arbitrators may apply the notion of “public interest” in the competition regulation in China.

### **5. Other Possibilities and Considerations**

It is necessary to take into account other clauses of IIA in addition to national treatment, which can be applied to China (i.e., the fair and equitable treatment (FET) obligation and the requirement of transparency).

#### **5.1. Fair and Equitable Treatment**

The fair and equitable treatment clause stipulates an important obligation, imposed on the host State. Even though its scope and meaning are vague, the case law of ISDS provides some guidance as to what is required. In particular, FET contains the requirement of transparency and consistency in the administrative process of the host State. In this sense, this topic will be discussed below along with the issue of transparency.

#### **5.2. Transparency**

It should be noted that the JCK treaty contains an exceptional clause on the transparency of domestic procedures. Article 10 (Transparency) states as follows:

“1. Each Contracting Party shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative procedures and administrative rulings and judicial decisions of general application as well as international agreements to which the Contracting Party is a party and which pertain to or affect investment activities. The Government of each Contracting Party shall make easily available to the public, the names and addresses of the competent authorities responsible for such laws, regulations, administrative procedures and administrative rulings.

2. When a Contracting Party introduces or changes its laws or regulations that significantly affect the implementation and operation of this Agreement, the Contracting Party shall endeavor to provide a reasonable interval between the time when such laws or regulations are published or made publicly available and the time when they enter into force, except for those laws or regulations involving national security, foreign exchange rates or monetary policies and other laws or regulations the publication of which would impede law enforcement.
3. Each Contracting Party shall, upon the request by another Contracting Party, within a reasonable period of time and through existing bilateral channels, respond to specific questions from, and provide information to, the latter Contracting Party with respect to any actual or proposed measure of the former Contracting Party, which might materially affect the interests of the latter Contracting Party and its investors under this Agreement.
4. Each Contracting Party shall, in accordance with its laws and regulations:
  - (a) make public in advance regulations of general application that affect any matter covered by this Agreement; and
  - (b) provide a reasonable opportunity for comments by the public for those regulations related to investment and give consideration to those comments before adoption of such regulations.
5. The provisions of this Article shall not be construed so as to oblige any Contracting Party to disclose confidential information, the disclosure of which:
  - (a) would impede law enforcement;
  - (b) would be contrary to the public interest; or
  - (c) could prejudice privacy or legitimate commercial interests.”

This provision reflects the recent trend of IIA (i.e., requiring transparency in the host State’s administrative process). However, it should be pointed out that uncertainties remain with regard to the interpretation and application of this provision. For example, there has never been any case before the ISDS directly arising from this kind of transparency clause. As a result, the application of this clause to concrete situations is untested.

### **5.3. Requirement of Legality under the Host State’s Laws and Regulations**

Generally, the IIAs contain a clause that requires investors and investments to comply with the host State’s laws and regulations (i.e., the so-called “legality clause” or “in accordance with” clause). This clause normally stipulates that “investments must be established in accordance with the law of host State.” The aim of this clause is to preserve the regulatory control power of the host State vis-à-vis foreign investors and investments. If strictly applied, host States are empowered to admit or decline foreign investments at the establishment phase.<sup>85</sup> In this context, the most important clause to be applied to the AML issue is Art 1(4), which states as follows (emphasis added):

“the term “enterprise of a Contracting Party” means any legal person or any other entity constituted or organized *under the applicable laws and regulations of that Contracting Party*, whether or not for profit, and whether private-or government-owned or controlled, and includes a company, corporation, trust, partnership, sole proprietorship, joint venture, association or organization;”

This article has the same function as the legality clause, in the sense that “enterprise” must be constituted under the laws and regulations of the host State. For example, if a company was incorporated in breach of the AML of China, it cannot be regarded as an “enterprise”

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<sup>85</sup> The legality clause can be applied not only to the *establishment* of investment, but also to the *performance* of investment. The latter possibility depends on the wording of applicable IIA.

incorporated in accordance with this article. Consequently, if there is no “enterprise of a Contracting Party,” there can be no “investment” to be protected under the treaty.

## **6. SOE/NT Issue in Other Countries**

As we see above, the issue surrounding the SOE is one of the most controversial topics in the TPP negotiation. For the negotiating countries, especially Vietnam and Malaysia, the SOE is a sensitive issue. From a Japanese viewpoint, the IIA is applicable between Japan and these countries, and may solve the same problems that occurred in China.

### **6.1. Japan–Vietnam BIT (2003)**

The Japan–Vietnam BIT (2003)<sup>86</sup> admits the pre-establishment national treatment. Art 2 states the following:

“1. Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favorable than the treatment it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as “investment activities”).”

First, this BIT admits the pre-establishment national treatment. Second, one list is attached to this BIT,<sup>87</sup> which provides industrial sectors exempted from the application of Article 2. In this list, fifteen sectors from Japan<sup>88</sup> and eighteen sectors from Vietnam<sup>89</sup> are selected.

### **6.2. Japan–Malaysia EPA (2005)**

Art 75 of the Japan–Malaysia EPA (2005)<sup>90</sup> states the national treatment as follows:

“1. Each Country shall accord to investors of the other Country and to their investments treatment no less favorable than that it accords in like circumstances to its own investors and to their investments with respect to the establishment, acquisition, expansion, management, operation, maintenance, use, possession, liquidation, sale, or other disposition of investments (hereinafter referred to in this Chapter as “investment activities”).

2. This Article shall not apply to the establishment, acquisition and expansion of portfolio investments.

3. Notwithstanding the provisions of paragraph 1 of this Article, each Country may prescribe special formalities in connection with the establishment of investments by investors of the other Country in the former Country such as the compliance with registration requirements, provided that such special formalities do not impair the substance of the rights under this Chapter.”

First, as is clear from paragraph 1, the national treatment is also applicable to the pre-establishment phase, except for portfolio investments (para.2). Paragraph 3 also limits the scope of Art 75, especially the pre-establishment aspect, by allowing the contracting party to “prescribe special formalities.” Second, what is more important is “Annex 4, referred to in

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<sup>86</sup> Agreement between Japan and the Socialist Republic of Viet Nam for the Liberalization, Promotion and Protection of Investment (signed in 2003). Provisions of this BIT have been incorporated into the Japan–Vietnam EPA (2008). See Art 9 (4) of the EPA.

<sup>87</sup> Annex II Exceptional Sectors or Matters to Article 2 and Article 4, available at [[http://www.meti.go.jp/policy/trade\\_policy/epa/pdf/epa/vn\\_ex2\\_e.pdf](http://www.meti.go.jp/policy/trade_policy/epa/pdf/epa/vn_ex2_e.pdf)].

<sup>88</sup> Mining industry, Oil industry, Biological preparations manufacturing industry, etc.

<sup>89</sup> Legal services, Accounting, auditing and book keeping services, Taxation services, etc.

<sup>90</sup> Agreement between the Government of Japan and the Government of Malaysia for an Economic Partnership (signed in 2005).

Chapter 7 Reservation for Existing and Future Measures,”<sup>91</sup> attached to this EPA. This is a long list of sectors exempted from the application of Art 75 of the EPA. The Schedule of Japan states that the following sectors are among those exempt: Agriculture, Forestry and Fisheries, Finance, Heat Supply, Information, Communications (Telecommunications), and Manufacturing (Drugs and Medicines Manufacturing). The Schedule of Malaysia provides a broader list of exempted areas, including the following: reservations relating to SOE finance (No.7),<sup>92</sup> ethnicity based policy (No.9),<sup>93</sup> and the manufacturing sector (No.12)<sup>94</sup>. Clearly, Malaysia has exempted its sensitive industrial sectors from the national treatment obligation.

## Conclusion

In the legal sense, it may be alleged that China has breached its obligation of NT under the JCK treaty (2012), which was effective in 2014. Through this treaty, a Japanese company investing in China is entitled to make a claim against the Chinese government before the ISDS, including the ICSID arbitration. As cases submitted to the ICSID against China exist,<sup>95</sup> many other investors in the same situation should follow the arbitration process. On the other hand, as far as the NT clause is concerned, there remain many uncertainties regarding whether a foreign investor will prevail. In particular, the national treatment clause contains vague terminology, such as “in like circumstances,” on which the case law of ISDS is controversial and not well developed. At present, it is clear that Japanese and global investors should consider the possibility and availability of ISDS as a tool to deter or pressure China’s powerful economic policy. In addition, it seems necessary to take into consideration the possibility to use the transparency clause stipulated in the JCK treaty.

It should be noted, however, that from a long-term perspective, the recent practice of anti-monopoly in China will be able to bring a favorite consequence toward foreign companies (i.e., “the on-going anti-monopoly campaign is an important step China has taken to establish a law-ruled market economic system as well as participate in global economic rebuilding”).<sup>96</sup> Based on this estimation, if foreign investors have allegedly breached the national treatment obligation, then this could lead to the insufficient realization of the rule of law in China, which will be detrimental to future foreign investors. Thus, investors in the Chinese economy are required to consider what is needed in the short-term and what should be realized in the long-term.

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<sup>91</sup> “Annex 4 referred to in Chapter 7 Reservation for Existing and Future Measures.” Available at [<http://www.mofa.go.jp/region/asia-paci/malaysia/epa/annex4.pdf>].

<sup>92</sup> It states that “Malaysia reserves the right to Reservation: adopt or maintain any measure relating to the transfer or disposal of equity interests or assets of a state enterprise, a government entity, or a government-linked company or a Minister of Finance Incorporated company.”

<sup>93</sup> It states that “Malaysia reserves the right to Reservation: adopt or maintain any measure relating to Special preference to Bumiputera, Bumiputera status companies, trust companies and institutions.”

<sup>94</sup> It states that “Malaysia reserves the right to Reservation: maintain or impose export requirements on new projects or expansion or diversification of projects, consistent with national and social objectives and for the orderly development of manufacturing activities in Malaysia.”

<sup>95</sup> Now two cases against China have been submitted to the ICSID. First case was *Ekran Berhad v. People’s Republic of China*, ICSID Case No. ARB/11/15, based on Malaysia-China BIT, which has been already discontinued. Second case is *Ansung Housing Co., Ltd. v. People’s Republic of China*, ICSID Case No. ARB/14/25, based on China-Korea BIT, which is still pending before the ICSID.

<sup>96</sup> Zhang Monan, “Anti-trust Move Essential for Market Economy,” *China-US Focus* (11 September 2014), available at [<http://www.chinausfocus.com/finance-economy/anti-trust-move-essential-for-market-economy/>].