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Statistical Analysis on the Parties-driven Procedural Practices in the WTO Dispute Settlement

Cuiping Gan¹

Abstract: WTO's Dispute Settlement Mechanism (DSM), known as the "crown" of the multilateral trading system, is facing a procedural and institutional crisis due to the United States' continuous blockage of appointment of Appellate Body (AB) members. Since May 2020, parties to the dispute have reached agreed procedures for arbitration under Article 25 of the Dispute Settlement Understanding (DSU) as an ad hoc solution to appeal cases in the probable absence of an operational AB. This paper aims to offer a comprehensive observation and statistical analysis on three major types of procedural practices driven by disputing parties. The first type is the open hearings granted upon request by parties to a dispute by WTO panel/AB/Arbitrator. The second type is the bilateral procedural agreement(s) reached between the parties to a dispute regarding the "sequencing" issue arising out of applications under Articles 21 and 22 of DSU. The third is the above-mentioned agreed procedures between parties to a dispute for arbitration under Article 25 of DSU. Based on such practices, the author of this paper further explores the implications of such procedural practices on the prompt settlement of individual disputes as well as on the integrity and effectiveness of the WTO as a whole, and also continues to illustrate the possible historical, organizational and institutional reasons behind such parties-driven practices.

Key words: WTO Dispute Settlement; Parties to a Dispute; Parties-driven; Public Hearings; Sequencing Issue; Arbitration under Article 25

1. Introduction

The World Trade Organization (WTO) is currently facing challenges and even crisis with effective dispute settlements. The United States has been blocking new appointment to the WTO's Appellate Body (AB) on the ground that, in its view, the AB has been judicially active and exceeded its mandate. A dysfunctional AB, due to its inability to review appeals will "have a kill-off effect on the binding value of Panel rulings".² The WTO Members are making concerted efforts to consider temporary alternatives to preserve the binding nature of WTO dispute settlement.³ And the "autonomy to disputing parties"⁴ allowed in the DSM has enabled WTO members to reach bilateral agreements for arbitration under Article 25 of DSU as an ad hoc solution to the current crisis unresolved multilaterally. This offers an insightful starting point into the probing of the significance of procedural issues and parties-driven practices and evolution of the DSM in the absence of multilateral consensus. The rules-oriented multilateral trading system of the WTO with dispute resolution forming its core, has progressively developed since the late 1940s. It has successfully adapted to the realities of 21st century,

¹ Cuiping Gan, Ph.D., Lecturer, East China University of Political Science and Law.

² See Amrita Bahri, *Appellate Body Held Hostage: Is Judicial Activism at Fair Trial?*, 53 Journal of World Trade 293, 295 (2019).

³ See James Bacchus & Simon Lester, *the Rule of Precedent and the Role of the Appellate Body*, 54 Journal of World Trade 183, 185 (2020).

⁴ See Weihuan Zhou & Henry Gao, *Overreaching or Overreacting? Reflections on the Judicial Function and Approaches of WTO Appellate Body*, 53 Journal of World Trade 951, 978 (2019).

enjoying tremendous confidence among its membership. A total of 593 disputes had been initiated under the WTO dispute settlement system from January 1, 1995 to December 2019. The regular use of this system by its members is a clear indication of its effectiveness.⁵ The WTO adjudicators have developed instrumental and extensive jurisprudence, on both substantive and procedural issues, through their findings.⁶ The WTO is an evolving system and thus it is worth reflecting upon the implications of the formal and informal reforms that have characterized the WTO's dispute settlement.⁷ This paper focuses on the following three types of parties-driven procedural practices which have enabled the WTO to procedurally evolve and institutionally cope with the challenges of the past and the present. There is also an analysis of the implications of such procedural practices on the prompt settlement of disputes between the disputing parties as well as implications on the integrity and effectiveness of the WTO. In the final part of this paper, the author continues to illustrate the possible historical, organizational and institutional reasons behind such parties-driven practices allowed in the WTO.

2. Procedural Practices Driven by Parties to a Dispute

The three major types of procedural practices driven by parties to a dispute on a case-by-case basis in response to different procedural issues and challenges faced by the WTO to be analyzed in the paper include: (a) public panel/AB/Arbitrator's oral hearings granted by the WTO adjudicators at the request of parties; (b) bilateral procedural agreements reached by disputing parties regarding the "sequencing" issue arising from the application under Articles 21 and 22 of DSU; and (c) agreed procedures for arbitration under Article 25 of the DSU to appeal disputes before the return of the WTO Appellate Body back to normal operation.

(a) Public Hearings

The WTO's dispute settlement system is governed by DSU, which contains a minimum of 6 articles on confidentiality and Appendix 3 to the DSU contains two paragraphs on the confidentiality of the panel's working procedures.⁸ Over the first ten years after its establishment in 1995, WTO had a consistent practice of holding dispute settlement hearings behind closed doors. The WTO was criticized for its lack of openness not only towards its own members, but also towards the general public. However, the WTO membership was divided in opinion regarding the outward transparency and openness. It was widely believed by the WTO members that opening hearings would be impossible without amendments to the WTO rules.

With divergence among the WTO members on this issue, in 2005, parties to the dispute of the "European Communities - Continued Suspension", made a common request that the panel open its hearings for public observation. The panel acceded to that request.⁹ In 2008, three years after the public

⁵ See World Trade Organization, WTO Annual Report, p.127 (2019).

⁶ See Mitsuo Matsushita, *the Sutherland Report and Its Discussion of Dispute Settlement Reforms*, 8 Journal of International Economic Law 623, 625 (2005).

⁷ See Marc L. Busch & Eric Reinhardt, *Bargaining in the Shadow of Law: Early Settlement in GATT/WTO Disputes*, 24 Fordham International Law Journal 159, 169 (2000).

⁸ See Appendix 3 to DSU Working Procedures, para.2: The panel shall meet in closed session; para.3: The deliberations of the panel and the documents submitted to it shall be kept confidential.

⁹ See US - Continued Suspension, Communication from the Chairman of the Panels of August 1, 2005, WT/DS320/8, para.1; Canada - Continued Suspension, Communication from the Chairman of the Panels of August 1, 2005, WT/DS321/8, para.1.

panel hearing practice, the participants filed an appeal regarding the panel report of the said dispute, and filed a similar request for public hearing with the AB, who granted the request jointly made by the participants.¹⁰ On May 20, 2010, the Arbitrator under Article 22.6 of DSU, also for the first time, agreed to open its meeting at the common request of the parties in “US - Zeroing (EC)”.

Thus by June 2020, the WTO adjudicators, including panels, the AB, and Article 22.6 arbitrators, had opened its meetings with the parties for public observation on request: specifically 19 disputes with open panel hearings, 11 disputes with open AB hearings and 6 with open arbitration (see Table 1 below).

(i) Public panel hearings

Followed by a joint request made by the parties in the “European Communities - Continued Suspension”, namely, the European Communities (EC), the United States (U.S.) and Canada on June 13, 2005 and despite the resistance of the third parties in this dispute, the panels decided after careful consideration of the existing provisions of DSU, that the panel meetings with the parties “will be open for observation by the public through a closed-circuit TV broadcast. The meeting of the panels with the third parties will remain closed as not all the third parties have agreed to have it open for observation by the public.”¹¹ The WTO Secretariat was asked by the panels to make appropriate logistical arrangements for the open meeting. On September 12, 2005, the panel’s substantive meetings with the parties was open to the WTO members and the public. This was the first time in the history of WTO that a panel had decided to open its hearings for public observation.¹² The panels’ decision represented a “historic shift in policy” towards transparency.¹³

The most recent dispute available on the WTO website with public panel hearings is the “Canada - Sale of Wine”. At the request of the parties in dispute, namely Australia and Canada, the panel decided to open its first and second substantive meetings to public observation in July 2019 and December 2019, respectively. The panel’s meeting with the third parties in this dispute was also open to the public. The public observation was via a live closed-circuit television broadcast in English language, without interpretation of the hearing into other languages. The panel was at liberty to close the meeting at any time, either on its own initiative or at the request of either party, in speculation of a risk of breach of confidentiality or disruption of the meeting.¹⁴ The “Canada - Sale of Wine” case is pending and the final panel report is expected to be issued on August 17, 2020.¹⁵

(ii) Public observation of AB oral hearings

As mentioned above, the first dispute with panel hearings open to public, namely, “European

¹⁰ See US - Continued Suspension, WT/DS320/AB/R, Annex IV: Procedural Ruling of July 10 to Allow Public Observation of the Oral Hearing, para.10 and para.11; Canada - Continued Suspension, the WTO Appellate Body Report (2008), WT/DS321/AB/R, Annex IV: Procedural Ruling of 10 July to Allow Public Observation of the Oral Hearing, para.10 and para.11.

¹¹ See US - Continued Suspension, Communication from the Chairman of the Panels of August 1, 2005, WT/DS320/8, para.1; and Canada- Continued Suspension, Communication from the Chairman of the Panels of August 1, WT/DS321/8, para.1 (2005).

¹² See Lothar Ehring, *Public Access to Dispute Settlement Hearings in the World Trade Organization*, 11 Journal of International Economic Law 1021, 1022 (2008).

¹³ See *First Public WTO Dispute Settlement Hearing Under Way*, Bridges Trade News Digest Weekly, September 14, 2005.

¹⁴ See Registration opens for public hearing in “Canada — Measures Governing the Sale of Wine”, https://www.wto.org/english/news_e/news19_e/hear_ds537_18jun19_e.htm (accessed on May 28, 2020).

¹⁵ See Canada - Measures Governing the Sale of Wine, Communication from the Panel, WT/DS537/11/Add.4.

Communities - Continued Suspension”, went to the appeal stage. US, EC and Canada as the participants, made joint request to the AB to allow public observation of the oral hearing of this appeal. These participants argued that nothing in DSU or the Working Procedures for Appellate Review precluded the AB from authorizing public observation of the oral hearing.¹⁶ They suggested preference for simultaneous closed-circuit live television broadcast. As an alternative, they mentioned delayed television broadcast.¹⁷ The alternative modality would allow public observation while safeguarding the confidentiality protection enjoyed by the third participants. On July 10, 2008, the AB granted the request and authorized public observation via simultaneous closed-circuit TV broadcast. Oral statements and responses to questions by third participants, was not subject to public observation in order to maintain the confidentiality of their submissions.¹⁸

The most recent case with public observation of AB oral hearings is the “US - Supercalendered Paper”. In November 2019, the participants, Canada and US, requested for a simultaneous closed-circuit TV broadcast in a separate viewing room.¹⁹

(iii) Open arbitration hearings

The Arbitrator first agreed to open its meeting with the parties in “US - Zeroing (EC)” in May 2010.²⁰ The two most recent cases with open arbitration are: “US - Large Civil Aircraft (Second Complaint)” in January 2020,²¹ and “EC and Certain Member States - Large Civil Aircraft” in February 2019.²² The Arbitrator agreed to present an audio or a video recording of the non-confidential portions of the opening oral statements of the parties following a joint request of the parties to the disputes.

In the “US-Tuna II (Mexico)” dispute, at the request of one party US and over the other party Mexico’s objection, the Arbitrator agreed to broadcast to public viewing and video recording parts of the US statements at the Arbitrator’s meeting with the parties in December 2016. This was the first dispute in which the Arbitrator agreed to organize a partially open meeting at a party’s request and over the other party’s objection. The US argued that two Article 22.6 arbitrators had already held such public arbitrations in the past, one of which involved Mexico as a party.²³ Mexico opposed the US argument and stated that it was not in a position to accept open meetings in the dispute at hand. Mexico recalled that even in previous disputes where it did not object to open meetings, it had indicated that this was without prejudice to its systemic position regarding public observation of meetings in dispute settlement proceedings.²⁴ The Arbitrator authorized the partial opening of the arbitration after a joint communication with the parallel compliance panels in this dispute. The statements made by Mexico the US that directly or indirectly disclosed evidence or positions of Mexico had been redacted from the video-recording. At Mexico’s request, the Arbitrator held a preview screening of the redacted

¹⁶ See US - Continued Suspension, WT/DS320/AB/R, 2008, Annex IV: Procedural Ruling of July 10 to Allow Public Observation of the Oral Hearing, para.1.

¹⁷ Ibid, at footnote 1.

¹⁸ See Canada - Continued Suspension, WT/DS321/AB/R, Annex IV: Annex IV: Procedural Ruling of July 10 to Allow Public Observation of the Oral Hearing, para.11.

¹⁹ See US - Supercalendered Paper, WT/DS505/AB/R, para.1.9.

²⁰ See WTO meeting on US - Zeroing dispute opened to the public,

https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds294_e.htm (accessed on July 28, 2020).

²¹ See Registration opens for delayed broadcast of arbitration hearing in US-EU aircraft dispute, https://www.wto.org/english/news_e/news20_e/hear_ds353_05feb20_e.htm (accessed on July 29, 2020).

²² See Registration opens for delayed broadcast of arbitration hearing in US-EU aircraft dispute, at https://www.wto.org/english/news_e/news19_e/hear_ds316_15mar19_e.htm (accessed on May 11, 2020).

²³ It refers to the “US - COOL” (DS386) dispute, see US-COOL (Mexico), decision by the Arbitrator, WT/DS386/ARB (2015).

²⁴ See US - Tuna II (Mexico), Decision by the Arbitrator, WT/DS381/ARB, para.2.6-2.7 (2012).

video-recording for both parties. Afterwards, the redacted video-recording was broadcasted to the public. There was an English version followed by a French version, both of which were about 3 hours long.²⁵

However, in 2019 while hearing the “US - Washing Machines” dispute, the Arbitrator declined US’s request to partially open its oral hearings to the public.²⁶ The US had requested that the Arbitrator’s meeting with the parties be opened to other Members and the public, “in whole, if Korea agrees, or in part, if Korea does not”. Korea did not consent to such request. The US’s proposed set of working procedures provided for the protection and redaction of Business Confidential Information (BCI) only. Whereas for Korea, these working procedures, overlooked important procedures that were necessary for the protection of confidential information. The Arbitrator recalled that DSU does not “expressly contemplate” open meetings. Past arbitrators have determined that the confidentiality rules of Article 18 of DSU, which are expressly stated as being applicable to panel and AB proceedings, also apply to Article 22.6 proceedings. Article 18.2 does not oblige the Arbitrator to accept a request to partially open the meeting. Without the agreement of both parties on the fundamental issue of the scope of confidentiality, and for the purpose of prompt settlement of disputes, the Arbitrators have decided to conduct the Arbitration hearing in closed session.²⁷

Table 1: List of Disputes with Open Panel/AB/Arbitration Oral Hearings²⁸

No.	Short Title of Dispute	Parties	Date
1	US/Canada - Continued Suspension (DS320/DS321)	EC US Canada	Panel: Sep. 2005 and Oct. 2006 AB: July 2008
2	EC and Certain Member States - Large Civil Aircraft (DS316)	US EC	Panel: first substantive meeting in March 2007 and second in July 2007 Compliance Panel: May 2019 AB: Nov. and Dec. 2010 Arbitration: April 2019
3	US - Large Civil Aircraft (Second Complaint) (DS353)	EC US	Panel: Sep. 2007 and Jan. 2008 AB: Aug. and Oct. 2011 AB (21.5): first in May 2018 and second in Oct. 2018 Arbitration: Jan. 2020
4	EC - Bananas III (DS27)	Ecuador US EC	Panel: Nov. 2007 AB: Oct. 2008
5	US – Zeroing (EC) (DS294)	EC US	Panel: April 2008 AB: March 2009 Arbitration: May 2010
6	US - Zeroing (Japan) (DS322)	Japan US	Panel: Nov. 2008 AB: June 2009

²⁵ See Public broadcast of statements in US-Mexico tuna dispute,

https://www.wto.org/english/news_e/news17_e/hear_ds381_03mar17_e.htm (accessed on July 29, 2020).

²⁶ See US - Washing Machines, Decision by the Arbitrator, WT/DS464/ARB, Annex D-1, “Decision of the Arbitrator on the United States’ Request for an Open Hearing”, February 8, 2019.

²⁷ Id.

²⁸ Table 1 is formulated based on the case information retrieved from WTO website by using key word “public hearing” and listed in the chronological order of the scheduled Panel/AB/Arbitration public hearings.

			Arbitration: Oct. 2010
7	EC- IT Products (DS375/376/377)	US Japan Chinese Taipei EC	Panel: first with parties and third-party session in May 2009 and second in July 2009
8	Australia - Apples (DS367)	New Zealand Australia	Panel: June and July 2009 AB: Oct. 2010
9	US - COOL (DS384/DS386)	Canada Mexico US	Panel: first in Sep. 2010 and second in Dec. 2010 AB: May 2012 AB (21.5) Feb. 2015 Arbitration: Feb. 2015
10	Canada - Renewable Energy(DS412/DS426)	Japan EU Canada	Panel: first with parties and third parties in March 2012 and second with parties in May 2012 AB: March 2013
11	EC – Seal Products (DS400/DS401)	Norway Canada EC	Panel: first with parties in Feb. and second in April 2013; third-party session in Feb. 2013. AB: March 2014
12	US - Tax Incentives (DS487)	EU US	Panel: May 2016. AB: July 2017
13	US - Tuna II (Mexico)(DS381)	Mexico US	Arbitration: Dec. 2016 ²⁹ compliance panel: March 2017 ³⁰
14	US - Supercalendered Paper (DS505)	Canada US	Panel: first in March and second in June 2017 AB: Nov. 2019
15	US - Differential Pricing Methodology (DS534)	Canada US	Panel: first with parties and third-party session in Sep. 2018
16	EU - Additional Duties (DS559)	US EU	Panel: first with parties and portion of third-party session in Sep. 2019
17	US - Softwood Lumber VII (DS533)	Canada US	Panel: first in Feb. and second in Oct. 2019
18	US - Steel and Aluminum Products (DS548/DS552/DS556)	EU Norway Switzerland	Panel: Nov. 2019

²⁹ At the request of the United States, the compliance panels and the Arbitrator agreed to broadcast to the public a delayed and redacted video recording of parts of the United States' statements at the panels/Arbitrator's meeting with the parties.

³⁰ See supra note 25.

		US	
19	Canada - Sale of Wine (DS537)	Australia Canada	Panel: first in July and second in Dec. 2019

The above Table helps to observe that the QUAD countries, namely, the US, European Union (formerly EC) , Canada and Japan have successfully driven the WTO panel/AB/Arbitration oral hearings as disputing parties on a case-by-case basis in the DSM, especially when the WTO membership was divided regarding this outward transparency issue.

The EU and the US were the most frequent users in the early stage (1995-2013) , who had more chances to make an impact in the WTO dispute settlement mechanism. By the end of June 2020, EU has been the complainant in 104 cases, of which the greatest number of 35 are against the US; EU has been the respondent in 87 cases, of which 20 cases are filed by the US. Besides, EU has been the third party in 205 cases.³¹ The US has been the complainant in 124 case, of which the second largest number of 20 cases are filed against the EU and the largest number of 23 cases are against China;³² the US has been respondent in 155 cases, of which 35 are filed by EU.

The WTO adjudicators have maintained a fairly consistent jurisprudence regarding open hearings, except for in very rare circumstances as mentioned above. These practices have confirmed that it is the WTO adjudicators that ultimately decide, in due consideration of the parties' positions and the circumstances of the dispute settlement proceedings, to either open a meeting in fully or partially, or to keep it closed behind doors. Where both parties to a dispute agree, the WTO adjudicators tend to grant their joint request and adopt appropriate working procedures. Where parties to a dispute disagree, the WTO adjudicators tend to decline the request in all instances but one (i.e. the "US - Tuna II" dispute).³³

(b) Bilateral Solution of Sequencing by Procedural Agreements

The term "sequencing issue" refers to the correct interpretation and the eventual relationship between Article 21 and 22 under the DSU,³⁴ which means either the compliance panel proceedings under Article 21.5, or the retaliation proceedings under Article 22 will prevail. Article 21.5 is applied to decide whether the respondent member in the original panel proceeding has brought its charged measures consistent with the WTO agreements.³⁵ Under Article 22.6 of the DSU, "the DSB, under request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request", when the

³¹The source of the statistics is based on the data from:

https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm (accessed on June 20, 2020).

³² But the first complaint filed by the United States against China in the WTO was in 2005, which was settled by a mutually satisfactory solution reached.

³³ In the Case "US - Tuna II (Mexico)", the parallel compliance panel proceedings and Article 22.6 arbitration are and remain the only examples in which the WTO adjudicator granted one party's request for a partially open hearing, over the objection of the other party. See Decision by the Arbitrator, US - Tuna II (Mexico), footnote 31 and Add.1., Annex A-3.

³⁴ See Mauricio Salas & John H. Jackson, *Procedural Overview of the WTO EC- Banana Dispute*, 3 Journal of International Economic Law 145, 153 (2000).

³⁵ See Article 21.5 of the DSU: Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

Article 21.5 panel proceeding found that there was no measures taken by the respondent member or the measures taken by the respondent member were inconsistent with the WTO covered agreement. Article 22.6 does not refer expressively to Article 21.5, nor does it require a finding of non-compliance before a party can seek retaliatory actions.³⁶ This raises the so-called sequencing issue between these two provisions under the DSU: what is the order of application of Article 21.5 and Article 22.6 in the resolution of disputes? Must a determination of non-compliance precede the seeking of authorization to retaliate? Due to the “sloppy” drafting of DSU, there is a conflict between the timeframe under Article 21.5 procedure and that under Article 22.6. Pursuant to Article 22.6, the authorization for retaliation must be granted by DSB within 30 days of the expiry of the reasonable period of time. However, it is clear that it is not possible to obtain authorization for retaliation within 30 days, in cases where the complainant is required to first submit the disagreement on implementation to an Article 21.5 compliance panel.

(i) Sequencing issue triggered in “EC-Banana III”

The sequencing issue first arose in the “EC-Banana III” dispute. The complainant, US, insisted on its right to obtain authorization for retaliation under Article 22 which could be sought even in the absence of an Article 21.5 procedure. EC, the respondent party maintained that an Article 21.5 compliance panel must first establish that the implementing measures taken by EC were not WTO-consistent before unilateral retaliatory action foreseen in Article 22 could be enforced. “EC-Banana III” questioned the effectiveness and purpose of the untested DSU implementation provisions. This led to various “procedural twist” and “tactics” between the US and EC.³⁷ Eventually, a pragmatic compromise suggested by WTO Director-General Ruggiero to resolve the procedural dilemma was implemented in essence, though not in all details. Under this compromise, the Dispute Settlement Body (DSB) suspended the US’s considerations requesting for authorization to retaliate in exchange for the EU requested arbitration on the retaliation level.³⁸ Article 21.5 proceeding was consolidated into the Article 22.6 proceeding. Article 22.6 Arbitrator decided that the consistency of the implementing measure with the WTO covered agreement could be discussed in both Articles 22.6 and 21.5 proceedings.³⁹ This arbitral award confirmed the US right to retaliate before the completion of Article 21.5 compliance panel procedure. “EC-Banana III” is a landmark case in the WTO jurisprudence for several reasons, but mostly because of the “precedents being set in the procedural case-law of the WTO”.⁴⁰ Although the “EC-Banana III” approach to the sequencing issue nearly defused the crisis of the WTO dispute settlement mechanism triggered by this individual dispute, it met with disagreements and challenges from the WTO members. The sequencing of Article 21.5 in relation to Article 22.6 has not yet been resolved multilaterally.

(ii) Bilateral procedural agreement reached

After “EC-Banana III”, the dispute settlement practices, have resulted in the disputing parties reaching bilateral procedural agreements to “facilitate the resolution of the dispute and reduce the scope for procedural disputes”.

³⁶ See Sylvia A. Rhodes, *the Article 21.5/22 Problem: Clarification Through Bilateral Agreements?*, 3 Journal of International Economic Law 553, 555 (2000).

³⁷ See supra note 34, at p.165.

³⁸ See supra note 34, at p.158.

³⁹ See EC- Bananas, WT/DS27/ARB, para.4.15.

⁴⁰ See supra note 34, at p.165.

There are two kinds of procedural agreements on the sequencing issue. The first is that parties agree that procedures under Article 21.5 and Article 22.6 shall be commenced concurrently. Retaliation under Article 22.6 is then suspended until Article 21.5 compliance procedure is completed. If a respondent member is found under the Article 21.5 procedure, to have failed to comply with the original panel's recommendation and ruling, then the previously commenced and suspended Article 22.6 retaliation proceeding may be continued. This approach was used earlier and this kind of bilateral procedural agreements have been reached in about 12 disputes such as "Australia - Salmon", "Canada – Dairy", "Japan - Apples", "US - Softwood Lumber VI" and "US - Zeroing (Japan)" etc.⁴¹ Most of such agreements (7 out of 11 disputes) were reached before 2006 and the most recent such agreement was reached in 2009 in "US - Zeroing (Japan)". The second is that parties agree that Article 21.5 procedure shall be initiated first, and the respondent member may not block a request made by the complainant member for retaliation under Article 22.6 on the basis that such retaliation request falls outside of the 30-day time limit in Article 22.6. And the second kind of procedural agreements has become more prevailing and acceptable by disputing parties as it is more feasible to have Article 21.5 compliance panel proceeding precede Article 22.6 authorization to retaliate. A compliance panel must make a finding of non-existence of measures taken or non-compliance of the measures with the covered agreement before a party may seek authorization to retaliate in case of the other party's failure to comply. Such agreements have been reached in most of disputes listed in the following Table 2, including the first one of this kind reached between the US and Australia as early as in 1999 in "Australia - Automotive Leather II" and the second between Canada and Brazil also in 1999 in "Brazil–Aircraft".

By the end of June 2020, compliance panels have been established in more than 60 disputes and about 60 percent of such compliance panel reports were appealed.⁴² Parties to the dispute have reached 63 procedural agreements regarding sequencing issue (See Table 2 below).

Table 2: List of Disputes with Bilateral Procedural Agreement on Sequencing⁴³

No.	Short Title of Dispute	Parties	Date	Document
1	Australia - Salmon (DS18)	Canada Australia	late 1999	no procedural agreement available ⁴⁴
2	Australia - Automotive Leather II (DS126)	US Australia	Oct. 4, 1999	WT/DS126/8
3	Brazil - Aircraft (DS46)	Canada Brazil	Nov. 23, 1999	WT/DS46/13
4	Canada – Aircraft (DS70)	Brazil Canada	Nov. 23, 1999	WT/DS70/9
5	US - Shrimp (DS58)	India Malaysia Pakistan	Dec. 22, 1999	WT/DS58/16

⁴¹ Table 2 provides more information about the year, the involving parties and the document symbol of this kind of bilateral procedural agreements.

⁴² See Dispute settlement activity — some figures, https://www.wto.org/english/tratop_e/dispu_e/disputats_e.htm (accessed on June 20, 2020).

⁴³ Table 2 is formulated based on the case information retrieved from WTO website by using key word "procedural agreement" and "Articles 21 and 22 of the DSU" and listed in the chronological order of the signing dates of such bilateral procedural agreements on the sequencing issue.

⁴⁴ See Australia - Salmon, WT/DS18/RW, para.1.3 (2000).

		Thailand US		
6	US - FSC (DS108)	EC US	Oct. 2, 2000	WT/DS108/12
7	Canada - Dairy (DS103/DS113)	New Zealand US Canada	Dec. 21, 2000 Dec. 18, 2000	WT/DS103/14 WT/DS113/14 WT/DS103/24 ⁴⁵ WT/DS113/24
8	Turkey - Textile (DS34)	India Turkey	Mar. 8, 2001	WT/DS34/13
9	EC - Bed Linen (DS141)	India EC	Sep. 13, 2001	WT/DS141/11
10	Thailand - H-Beams (DS122)	Poland Thailand	Dec. 18, 2001	WT/DS122/10
11	Argentina - Hides and Leather (DS155)	EC Argentina	Feb. 25, 2002	WT/DS155/12
12	US - Steel Plate (DS206)	India US	Feb. 14, 2003	WT/DS206/9
13	Chile - Price Band System (DS207)	Argentina Chile	Dec. 24, 2003	WT/DS207/16
14	Japan - Apples (DS245)	US Japan	June 30, 2004	WT/DS245/10
15	US - Offset Act (Byrd Amendment) (DS217)	Australia Thailand Indonesia US	Dec. 23, 2004 Jan. 7, 2005 Jan. 11, 2005	WT/DS217/44 WT/DS217/45 WT/DS217/46
16	US - Softwood Lumber IV (DS257)	Canada US	Jan. 14, 2005	WT/DS257/18
17	US - Softwood Lumber VI (DS277)	Canada US	Feb. 23, 2005	WT/DS277/11
18	US - Softwood Lumber V (DS264)	Canada US	May 2, 2005	WT/DS264/18
19	US - Section 211 Appropriations Act (DS176)	EC US	June 30, 2005	WT/DS176/16
20	US - Upland Cotton (DS267)	Brazil US	July 5, 2005	WT/DS267/22
21	US - Hot-Rolled Steel (DS184)	Japan US	July 7, 2005	WT/DS184/19
22	US - Oil Country Tubular Goods	Argentina	Jan. 5, 2006	WT/DS268/14

⁴⁵ WT/DS103/24 and WT/DS113/24 are additional understandings between the parties regarding procedures under Articles 21 & 22 of the DSU.

	Sunset Reviews (DS268)	US		
23	US – Gambling (DS285)	Antigua and Barbuda US	May 23, 2006	WT/DS285/16
24	EC - Export Subsidies on Sugar (DS265/DS266/DS283)	Australia, Brazil Thailand EC	June 8, 2006	WT/DS265/36 WT/DS266/36 WT/DS283/17
25	US - Anti-Dumping Measures on Oil Country Tubular Goods (DS282)	Mexico US	July 11, 2006	WT/DS282/12
26	EC - Chicken Cuts (DS286/DS269)	Thailand Brazil EC	July 14, 2006 July 26, 2006	WT/DS286/18 WT/DS269/16
27	Mexico - Anti-Dumping Measures on Rice (DS295)	US Mexico	Jan. 16, 2007	WT/DS295/15
28	US – Zeroing (EC) (DS294)	EC US	May 4, 2007	WT/DS294/39
29	EC - Approval and Marketing of Biotech Products (DS291)	US EC	Jan. 14, 2008	WT/DS291/38
30	US - Zeroing (Japan) (DS322)	Japan US	Mar. 10, 2008	WT/DS322/26
31	Turkey - Rice (DS334)	US Turkey	May 7, 2008	WT/DS334/13
32	Japan – DRAMs (Korea) (DS336)	Korea Japan	Sep. 9, 2008	WT/DS336/18
33	Brazil - Retreaded Tyres (DS332)	EC Brazil	Jan. 5, 2009	WT/DS332/18
34	US - Stainless Steel (Mexico) (DS344)	Mexico US	May 18, 2009	WT/DS344/18
35	US - Continued Zeroing (DS350)	EU US	Dec. 19, 2009	WT/DS350/19
36	Colombia - Ports of Entry (DS366)	Panama Colombia	Feb. 23, 2010	WT/DS366/14
37	China - Intellectual Property Rights (DS362)	US China	April 8, 2010	WT/DS362/15
38	China - Publications and Audiovisual Products (DS363)	US China	April 8, 2011	WT/DS363/18
39	EC - IT Products (DS375/DS376/DS377)	US Japan Chinese Taipei EU	July 6, 2011	WT/DS375/17 WT/DS376/17 WT/DS377/15

40	Australia - Apples (DS367)	New Zealand Australia	Sep. 13, 2011	WT/DS367/21
41	EC and Certain Member States - Large Civil Aircraft (DS316)	US EU	Jan. 12, 2012	WT/DS316/21
42	US - Measures Affecting Trade in Large Civil Aircraft (DS353)	EU US	Jan. 12, 2012	WT/DS353/14
43	US - Orange Juice (Brazil) (DS382)	Brazil US	April 3, 2012	WT/DS382/11
44	US - Anti-Dumping and Countervailing Duties (China) (DS379)	China US	May 11, 2012	WT/DS379/14
45	Thailand - Cigarettes (Philippines) (DS371)	the Philippines Thailand	June 1, 2012	WT/DS371/16
46	EC - Fasteners (China) (DS397)	China EU	Oct. 25, 2012	WT/DS397/16
47	EU - Footwear (China) (DS405)	China EU	Oct. 25, 2012	WT/DS405/8
48	China - Raw Materials (DS394/DS395/DS398)	US EU Mexico China	Jan. 17, 2013	WT/DS394/20 WT/DS395/19 WT/DS398/18
49	US - COOL (DS384/DS386)	Canada Mexico US	June 10, 2013	WT/DS384/25 WT/DS386/24
50	US - Tuna II (Mexico) (DS381)	Mexico US	Aug. 2, 2013	WT/DS381/19
51	China - Electronic Payment Services (DS413)	US China	Aug. 19, 2013	WT/DS413/10
52	China – GOES (DS414)	US China	Aug. 19, 2013	WT/DS414/14
53	Canada – Renewable Energy (DS412/DS426)	Japan EU Canada	Mar. 24, 2014	WT/DS412/18 WT/DS426/18
54	China - Broiler Products (DS427)	US China	July 15, 2014	WT/DS427/9
55	China - Rare Earths (DS431/DS432/DS433)	US EU Japan China	May 21, 2015	WT/DS431/17 WT/DS432/15 WT/DS433/15
56	US - Countervailing and Anti-dumping Measures (China) (DS449)	China US	Aug. 21, 2015	WT/DS449/15
57	Argentina - Import Measures (DS438)	EU Argentina	Jan. 18, 2016	WT/DS438/24
58	Peru - Agricultural Products	Guatemala	April 8, 2016	WT/DS457/18

	(DS457)	Peru		
59	US - Countervailing Measures (China) (DS437)	China US	April 15, 2016	WT/DS437/19
60	China - Cellulose Pulp (DS483)	Canada China	May 2, 2018	WT/DS483/8
61	Indonesia - Chicken (DS484)	Brazil Indonesia	July 27, 2018	WT/DS484/17
62	Indonesia - Iron or Steel Products (DS490/DS496)	Chinese Taipei Viet Nam Indonesia	April 11, 2019 Mar. 22, 2019	WT/DS490/13 WT/DS496/14
63	Korea - Anti-Dumping Duties on Pneumatic Valves from Japan (DS504)	Japan Korea	June 15, 2020	WT/DS504/13

It is evident from the above Table 2, the first procedural agreement dated back to the year of 1999, which is apparent though the panel report pointing out the agreement between the complainant Canada and the respondent Australia.⁴⁶ The first available procedural agreement was signed between the US and Australia on October 4, 1999.⁴⁷ In the first two years of 1999 and 2000, there were altogether 7 disputes with such bilateral procedural agreements, involving Canada, Australia, US, Brazil, EU, New Zealand, India, Thailand and Malaysia etc., which set a trend for the ad hoc parties-driven solution to the sequencing issue. The WTO members who have reached the largest number of procedural agreements are: US (40 disputes in total, 15 disputes as complainant and 25 as respondent, EU (19 disputes in total, 11 as complainant and 8 as respondent), China (15 disputes in total, 5 as complainant and 10 as respondent), Canada (10 disputes in total, 7 as complainant and 3 as respondent), Japan (8 disputes in total, 5 as complainant and 3 as respondent), Brazil (8 disputes in total, 7 as complainant and 1 as respondent).

As EC noted: “in light of the practice followed consistently since 1999, it would appear that Members now broadly agree that completing the procedure established under Article 21.5 of DSU is a pre-requisite for invoking the provisions of Article 22 DSU, in case of disagreement among the parties about implementation.”⁴⁸

(c) Agreed Procedures for Arbitration and Other Procedural Practices

The US is the most frequent user of the WTO DSM, both as complainant and respondent. The US has won 85.7% of the cases it has initiated before the WTO since 1995, compared to a global average rate of 84.4% and China’s success rate at 66.7%.

The US’s continuous blockage in the appointment of AB members has put the DSM in crisis.⁴⁹ EU, China, Brazil, Canada, Australia and other over a dozen of countries and territories have worked closely to preserve the rules-based multilateral trading system and ensure the functioning of the WTO DSM. These members have launched the Multi-Party Interim Appeal Arbitration Arrangement (MPIA) pursuant to Article 25 of the DSU for appealing trade dispute rulings in the absence of an

⁴⁶ See Australia - Salmon, WT/DS18/RW, para.1.3 and para.1.7 (2000).

⁴⁷ See Australia - Automotive Leather II, WT/DS126/8, p.2 (1999).

⁴⁸ Communication from the European Communities, Contribution of the European Communities and its Member States to the Improvement of the WTO Dispute Settlement Understanding, TN/DS/W/1, March 13, p.4 (2002).

⁴⁹ See supra note 2, at p.299.

operational AB. The participating members, including China, are committed to pushing MPIA for smooth implementation and to resolve the paralysis of AB.⁵⁰

Shortly after advancing the temporary solution of MPIA, some of the WTO members have already agreed upon bilateral procedures for arbitration under Article 25 of the DSU for appealing disputes. There are four disputes in which parties have bilaterally agreed to procedures pursuant to Article 25.2 of the DSU. Parties to the disputes have agreed to enter into arbitration to decide any appeal from any final panel report issued to them. To be specific, procedural agreements on arbitration were reached between Australia and Canada in “Canada - Sale of Wine” (DS537), another between Canada and Brazil in “Canada - Commercial Aircraft” (DS522), the third between Mexico and Costa Rica in “Costa Rica - Fresh Avocados from Mexico” (DS524), and the fourth was between Colombia and EU in “Colombia - Anti-dumping Duties on Frozen Fries” (DS591).⁵¹

The main clauses of such procedures include: 1) These procedures were entered into to give effect to the communication JOB/DSB/1/Add.12 (Multi-Party Interim Appeal Arbitration Arrangement Pursuant to Article 25 of the DSU) (MPIA). 2) The arbitration may only be initiated if the AB is not able to hear an appeal. 3) Any party to the dispute may initiate arbitration in accordance with these agreed procedures. 4) The arbitration shall be initiated by filing of a Notice of Appeal with the WTO Secretariat no later than 20 days after the suspension of the panel proceedings. 5) The arbitrators shall be three persons selected from the pool of 10 standing appeal arbitrators composed in accordance with paragraph 4 of communication JOB/DSB/1/Add.12. 6) The selection from the pool of arbitrators will be done on the basis of the same principles and methods that apply to form a division of the Appellate Body under Article 17.1 of the DSU. The WTO Director General will notify the parties and third parties of the results of the selection. 7) Unless otherwise provided for in these agreed procedures, the arbitration shall be governed by the provisions of the DSU and other rules and procedures applicable to Appellate Review, in particular the Working Procedures for Appellate Review and the timetable for appeals as well as the Rules of Conduct. 8) The parties agree to abide by the arbitration award, which shall be final.⁵²

This multi-party interim arrangement and especially the bilateral agreed procedures between the parties in the dispute settlement have eased the WTO institutional crisis due to the US-provoked AB collapse. They have also enhanced certainty, predictability and prompt settlement of disputes.

The followings are the other major types of procedural practices driven by parties to a dispute:

(i) Extension of 60-day time period in Article 16.4

There have been at least 10 cases,⁵³ in which parties have reached procedural agreements regarding the time period under Article 16.4 of the DSU. Parties may agree that the 60-day time period in Article 16.4 will be extended to a certain date, and that a decision of the DSB on this extension will be sought at a meeting of the DSB, including in the first case “EC - Export Subsidies on Sugar”.⁵⁴

⁵⁰ See Ministry of Commerce of the People’s Republic of China, Online Regular Press Conference of the Ministry of Commerce, June 18, 2020.

⁵¹ See Colombia - Anti-dumping Duties on Frozen Fries, WT/DS591/3 (2020), Agreed Procedures for Arbitration under Article 25 of the DSU, July 15, 2020.

⁵² See Canada - Commercial Aircraft, WT/DS522/20(2020); Costa Rica - Fresh Avocados from Mexico, WT/DS524/5 (2020); Canada - Sale of Wine, WT/DS537/15 (2020); Colombia - Anti-dumping Duties on Frozen Fries, WT/DS591/3(2020), Agreed Procedures for Arbitration under Article 25 of the DSU.

⁵³ EC - Export Subsidies on Sugar; US – Zeroing (EC); Brazil – Retreaded Tyres; EC - Fasteners (China); EU - Footwear (China), etc.

⁵⁴ See EC - Export Subsidies on Sugar, the procedural agreements reached between Australia, Brazil and Thailand, WT/DS265/24, WT/DS266/24, WT/DS283/5, December 1, 2004.

There are disputes involving China in such procedural practices, both as complainant so far.⁵⁵ These procedural agreements have been reached because of the workload of the WTO AB, who was unable to finish their work within the DSU prescribed time period. Rights of the parties to the dispute with respect to adoption or appeal of the panel report are thus preserved.⁵⁶

(ii) Preliminary rulings on preliminary objections

It has become common for parties to make procedural objections or seek procedural rulings during the WTO panel or appellate proceedings. Filing preliminary objections has been regarded as the first defense war in the WTO dispute settlement. The parties to a dispute have requested the panels and sometimes the AB, to make preliminary rulings on their preliminary objections or other issues of preliminary feature. The preliminary objections include instances like: the WTO or its dispute settlement does not have jurisdiction; improper parties are present; the allegations clearly do not make out any case at all, etc. In WTO dispute settlement, the most frequently raised preliminary objections are targeted at the adequacy of the request for establishment of the panel. It has been a common feature of the WTO dispute settlement proceedings. In contrast to the explicit procedures and rules, regarding preliminary objections and preliminary rulings in ICJ and the ICSID framework, DSU or its appendix contain no such rules. However in practice, the parties to a dispute have filed requests for preliminary rulings and driven the panels to make such rulings. In the past years, it has been a common practice for the panels to request the DSB to circulate preliminary rulings in separate document from the WTO panel report to the whole WTO membership after consulting the parties.⁵⁷

3. Implications of and Reasons for Such Procedural Practices

The WTO has faced various challenges in the past and is facing a crisis currently. In absence of a multilateral consensus regarding some procedural and institutional crisis, the above discussed parties-driven practices have helped the WTO to cope with the challenges in DSM and to evolve progressively.

Successful open hearing practices were favorably received by many government and non-government actors. The achievement is remarkable and groundbreaking, not only because of the importance and benefits of public access to dispute settlement hearings in the opinion and interest of civil society, but also for the WTO as an institution, from an objective point of view. These practices have strengthened the “legitimacy and credibility” of this multilateral trading system,⁵⁸ when it was confronted with an external climate of political and economic uncertainty after the 11 September 2001 terror attacks and especially after the Seattle Ministerial when demands for greater transparency in dispute settlement became very pronounced.⁵⁹ WTO was under severe criticism in Washington because US had begun to lose disputes in the previous few years at the WTO.⁶⁰ In addition, the WTO has

⁵⁵ See EC - Fasteners (China), WT/DS397/6 (2011); EU - Footwear (China), WT/DS405/5 (2011).

⁵⁶ For example, EC - Fasteners (China), WT/DS397/6, procedural agreement between EU and China, January 13, 2011.

⁵⁷ See Canada- Wheat Exports and Grain Imports, WT/DS276/12 (2003); Australia - Apples, WT/DS367/7 (2008).

⁵⁸ See supra note 60, at p.1024.

⁵⁹ See supra note 7, at p.170.

⁶⁰ See Gabrielle Marceau & Amelia Porges (ed.), *a History of Law and Lawyers in the GATT/WTO: the Development of the Rule of Law in the Multilateral Trading System*, Cambridge University Press, p.54 (2015).

experienced institutional as well as cultural change and the “fundamental principle of due process and transparency as a key tenet of good governance” has “permeated” to the core of WTO.⁶¹

The sequencing issue triggered in the EC-Banana III dispute almost put the newly established WTO into crisis. However, it was first resolved by a challenged compromise between US and EC and then gradually by bilateral procedural agreements. The sequencing of Article 21.5 in relation to Article 22 has not been resolved multilaterally, but these bilateral procedural agreements are significant, because they facilitate prompt settlement of disputes and also suggest a trend for dealing with this sequencing issue. It also shows the commitment of the parties to disputes to the operation of the dispute settlement system.⁶²

The current institutional crisis due to the United States’ continuous blockage of appointment of AB members and dysfunction of AB, has also been eased in the short run by the agreed procedures for arbitration under Article 25, though a systemic solution is needed.

This paper further explores the possible reasons for these parties-driven practices to be allowed with the WTO DSM.

(a) GATT’s Historical Heritage

The first reason for WTO parties to a dispute being allowed to drive procedural innovation and evolution can be attributed to WTO’s inheritance of its predecessor GATT 1947’s procedures, rules and practices.

The WTO is a young international organization with a long history, whose origins lie in GATT 1947.⁶³ The WTO dispute settlement system is often praised as one of the most important innovations of the Uruguay Round. However, it was not a total innovation. To a great extent, it is the result of the evolution of rules, procedures and practices developed over almost half a century under the GATT 1947.⁶⁴ Many if not most, of the old GATT’s negotiators were “ambivalent or even hostile” to attempts to “judicialize” international trade, even though the purpose of the GATT was to establish a “transparent, predictable and rules-based system” for international trade. GATT has a “Janus-faced” approach to law: “a suspicion of formal legalism, but a deep commitment to rules and rules-based conduct.”⁶⁵ The fact that the previous GATT dispute settlement system was fundamentally based on diplomacy and politics sets important parameters for our understanding of the WTO dispute settlement evolution.⁶⁶

The GATT contained only two “meager” provisions on dispute settlement (Articles 22 & 23), which neither explicitly referred to dispute settlement nor provided for detailed procedures to handle disputes. However, the GATT Contracting Parties transformed in a highly pragmatic manner over a period of five decades, what was initially a rudimentary, power-based system for settling disputes through diplomatic negotiations into an elaborate, rules-based system for settling disputes through adjudication.⁶⁷

The GATT is characteristic of gradual evolution in its almost half a century’s dispute settlement

⁶¹ Ibid, at p.57.

⁶² See supra note 36, at p.557.

⁶³ See Peter Van den Bossche, *the Law and Policy of the World Trade Organization Texts, Cases and Materials* (2nd edition), Cambridge University Press, p.161 (2008).

⁶⁴ See World Trade Organization, *a Handbook on the WTO Dispute Settlement System*, Cambridge University Press, p.1 (2004).

⁶⁵ See supra note 60, at p.7.

⁶⁶ See Federico Ortino & Sergey Ripinsky (ed.), *WTO Law and Process: The Proceedings of the 2005 and 2006 Annual WTO Conferences*, British Institute of International and Comparative Law, p.62 (2007).

⁶⁷ See supra note 63, at p.170.

practices. The early days of GATT were dominated by a pragmatism-driven politico-diplomatic style of negotiated solutions. GATT has evolved from pragmatism to legalism.⁶⁸ The old GATT legacy of diplomacy and pragmatism is still clearly visible in the formal aspects of the decisions taken by the WTO bodies.⁶⁹ The GATT dispute settlement system had traditionally evolved through incremental reforms based on previous dispute settlement experiences and agreed practices. The dialectic interaction between dispute settlement practice and periodic review and agreed clarifications of dispute settlement procedures was expected to continue in the WTO.⁷⁰

The above analyzed procedural issues and practices in the past decades of WTO dispute settlement can be explained from its historical connection with the old GATT, which had a remarkably pragmatic, incremental and member-driven evolution despite its meagre treaty text. Such evolution has occurred, and is likely to continue to occur in the WTO through day-to-day and case-by-case practice that accumulates over time and often reflects ad hoc solutions to perceived problems.⁷¹

It has proven useful and wise to “remain faithful to the practices and traditions of flexibility”, to let the system evolve, slowly, in a manner that “allows practice to reveal whether a particular procedure works or not”, instead of making “irresponsible adventures and quick fixes”. Only when practice is well established and have proven its worth, would it be wise to “proceed to codify and include in treaty language”.⁷²

(b) WTO’s Evolutionary Organizational Culture

The WTO currently has 164 members, representing 98 percent of world trade governments.⁷³ The WTO is a fully independent international organization with its own particular “corporate” culture, which is rules-based and member-driven, and all decisions are made by the member governments, and the rules are the outcome of negotiations among members.

At the General Council meeting held from 17-19 July 2000, the Chairman of the General Council stated that: “First, within the framework of the WTO Agreement it seemed that Members generally did not see the need for any major institutional reform which could alter the basic character of the WTO as a member-driven organization and its decision-making process. It is a basic tenet of institutionalist theory that political institutions, once established, tend to be sticky over time and resistant to change. At the international level, where amendments to multilateral agreements often require consensus support from diverse signatory states, institutional reform is particularly difficult to achieve.”⁷⁴

In the WTO, like in national jurisdictions, changes are mostly the result of political outcomes and seldom a purely technical exercise of efficiency and excellence. “Changes happen because there is a set of perceived systemic and procedural problems that require action. There is gradual trial-and-error process of creating and improving the WTO dispute settlement system.”⁷⁵ In this view, the subsequent failure of member governments to agree to even minor changes in DSU may have been expected, given

⁶⁸ See Meinhard Hilf, *Power, Rules and Principles - Which Orientation for WTO/GATT Law?*, 4 Journal of International Economic Law 110, 114 (2001).

⁶⁹ See supra note 67, at p.159.

⁷⁰ See Ernst-Ulrich Petersmann, *WTO Negotiators Meet Academics: the Negotiations on Improvement of the WTO Dispute Settlement System*, 6 Journal of International Economic Law 237, 248 (2003).

⁷¹ See supra note 64, at p.102.

⁷² See supra note 60, at p.604.

⁷³ See supra note 5, at p.6.

⁷⁴ See James Smith, *Inequality in International Trade? Developing Countries and Institutional Change in WTO Dispute Settlement*, 11 Review of International Political Economy 542, 550 (2004).

⁷⁵ See supra note 60, at p.604.

the obstacles to collective decision-making in the WTO and the heterogeneous preferences of its membership.⁷⁶

The WTO's inception was the beginning of a long process of transition. The shift from the improvised old GATT 1947 institution to a formally established international organization raised many new legal questions, including some procedural questions which were crucial for the smooth and predictable functioning of the WTO dispute settlement system. Although the DSU provided the mandate and the fundamental rules, but many details needed to be filled in.⁷⁷ This dispute settlement system has "demonstrated its efficacy by evolving incrementally through practice without a formal change in the treaty". And the incremental change has occurred because of trade officials, who are known for "adhering to the 'member-driven' ideology of the WTO."⁷⁸

(c) WTO as a Rule-oriented, Quasi-judicial Forum

The WTO is a rule-oriented international trading system and the dispute settlement is the core of the system.⁷⁹ The Appellate Body is an essential component of the WTO's dispute settlement system. Important jurisprudential principles have been established with respect to both procedural and substantive issues.⁸⁰

The negotiation background of Uruguay Round displays that the WTO's original members, including the US and EC, did not initially agree on whether to have a judicial and rigid dispute settlement, as proposed by the US or to have a flexible dispute settlement mechanism, as proposed by the EC. DSU was finalized upon pushing by the US and upon EC's compromise to the US proposal. This led to the WTO dispute settlement procedures and rules which are characteristic of outstanding judicial rigidity and an accommodation of diplomatic means. The judicial rigidity is reflected for example, in the WTO's compulsory jurisdiction, automaticity in the establishment of WTO panel, and the automatic adoption of WTO panel and AB reports. The accommodation of diplomatic means are reflected in the preceding consultation procedures before panel proceedings and in a preference for mutually acceptable resolutions under the DSU framework.

It is this quasi-judicial characteristic, namely, a combination of political flexibility and legal integrity, which makes this a unique process for settling international trade disputes peacefully through force of argument rather than through argument of force.⁸¹

The WTO dispute settlement system is largely a member-to-member, bilateral enforcement mechanism focused on third-party adjudication. This bilateral nature of the WTO system is largely warranted by the bilateral nature of most of the WTO obligations themselves.⁸² In addition to being bilateral, however, the WTO system is also largely adversarial in a way that the parties to a dispute (not the "judge" or some higher form of public interest or rule of law) control the process. The disputing parties

⁷⁶ See supra note 74.

⁷⁷ See supra note 60, at p.644.

⁷⁸ See Robert Howse, *Moving the WTO Forward – One Case at a Time*, 42 Cornell International Law Journal 223, 227 (2009).

⁷⁹ See supra note 6, at p.624.

⁸⁰ See Mitsuo Matsushita, *A View on Future Roles of The WTO: Should There be More Soft Law in The WTO?*, 17 Journal of International Economic Law 701, 705 (2014).

⁸¹ See Dispute settlement force of argument, not argument of force, http://www.wto.org/english/thewto_e/minist_e/min03_e/brief_e/brief13_e.htm (accessed on July 10, 2020).

⁸² See Joost Pauwelyn, *The Limits of Litigation: Americanization and Negotiation in the Settlement of WTO Disputes*, 19 Ohio State Journal on Dispute Resolution 121, 129 (2003).

can settle at any stage during panel or AB proceedings, so they can withdraw complaints, and they can modify most of the procedures by mutual agreement. Crucially, the DSU makes it explicit that a “mutually acceptable” solution to a dispute is “clearly preferred” over a settlement imposed by litigation.

Panels usually agree to requests on procedural issues tabled by the parties jointly. However, the discretion of panels is limited to the extent that panels cannot modify the rules set out in the DSU itself. In the “EC-Hormones” dispute, the Appellate Body noted that panels enjoy “a margin of discretion to deal, always in accordance with due process, with specific situations that may arise in a particular case.”⁸³ In *India-Patents (US)*, however, the AB cautioned panels as follows: “Although panels enjoy some discretion in establishing their own working procedures, this discretion does not extend to modifying the substantive provisions of the DSU.”⁸⁴

(d) Imbalance of Power between Political and Judicial Arms

Since the establishment of the WTO, there has been a big shift of powers. The QUAD countries (US, the European Communities, Canada, and Japan) which had the power to decide, have declined in terms of its power and influence. The BRICS and the developed countries (the US and the European Union) face each other in confrontational way at the WTO and therefore, trade negotiations and compromises have become extremely difficult. This is roughly the state of affairs at the WTO and there is little hope at this time that this stalemate will be resolved in the near future.

However, the WTO has failed in rule making due to a fundamental change in the power structure within the WTO and also due to the tremendous increase in the number of the WTO Members in recent years. These two major reasons have made it difficult for WTO members to achieving any consensus.⁸⁵ The WTO dispute settlement system “has an enhanced role” in the presence of “political and diplomatic impasse” in the preservation of the legitimacy and efficacy of the system through evolving its practices.⁸⁶

4. Conclusion

Despite considerable achievements, the WTO has faced various challenges in the past and continues to face crisis that are unmatched in its relatively short history of a quarter of a century. WTO members are making concerted efforts to cope with the current deadlock and crisis of the WTO. Many members are weighing an array of creative interim options to keep the two-stage dispute settlement operational while searching for a permanent arrangement. Being resilient and resourceful, this organization has served its members well and will continue to do so in the future.⁸⁷ At a time of slowing global economic growth and political uncertainty, the WTO is even more essential, with its rules providing fairness and preventing discrimination. Defending and improving the global trading system is

⁸³ See *EC – Hormones (US)*, WT/DS26/AB/R; *EC- Hormones (Canada)*, WT/DS48/AB/R, footnote 138.

⁸⁴ See *India-Patents (US)*, WT/DS50/AB/R (1997), para.92. In this case, the Appellate Body reversed a decision by the Panel that it would consider all claims made prior to the end of the first substantive meetings. All parties had agreed with this Panel decision.

⁸⁵ See *supra* note 80.

⁸⁶ See *supra* note 78, at p.228.

⁸⁷ See Roberto Azevêdo, the WTO at 25: A Message from the Director-General, https://www.wto.org/english/t_hewto_e/dg_e/dge.htm (accessed on May 11, 2020).

needed now more than ever.⁸⁸ While there are some grounds for criticism and reform of the dispute settlement system, there is much satisfaction with the system and the most important principle is to “do no harm” to it. Therefore, the best policy should be to maintain the existing system and, even if changes are to be made, there should be no fundamental change of the structure of the dispute settlement system.⁸⁹

After a careful examination of the three major types of procedural practices driven by parties to disputes such as open hearing, sequencing, arbitration under Article 25 of DSU, and the historical, organizational and institutional reasons behind, it is fair to conclude that these seemingly small incremental changes in practices have allowed the WTO to progress and evolve in the presence of an impasse in the multilateral diplomatic negotiations during the past decades, currently and possibly in the future to remain effective and legitimate in a world of constant change. The United States, as the architect and the most frequent WTO member user, should not have held the Appellate Body “hostage” and put the WTO in peril. It should be responsible to preserve the proper functioning of the WTO and if not, the other major WTO members such as the EU, China, Brazil and Canada would not allow the WTO to collapse.

⁸⁸ See Deputy Director-General Alan Wolff, the Multilateral Trading System Will Endure and Will Adapt, https://www.wto.org/english/news_e/news19_e/news19_e.htm (accessed on May 11, 2020).

⁸⁹ See *supra* note 6, at p.623.

Rethinking and Reforming the Investor-State Dispute Settlement Mechanism in the Context of Global Governance

Mingqian Li¹

Abstract: As an important element of International Investment Agreements (IIAs) for bringing claims before an independent forum to settle investment disputes against the host state, the Investor-State Dispute Settlement (ISDS) could be deemed as a vehicle not only for investment liberalization but also for enhancing global governance system. The emergence and reform of the ISDS mechanism, reflects further development of global governance theory and practice. This article adopts global governance as the analytical framework, addressing the legitimacy questions surrounding global governance. The current concerns and backlash against the ISDS is thus viewed as an example of “legitimacy gap” in global governance. This article then reflects on the current reform models proposed by the U.S. and the EU in response to the challenges faced by the ISDS. In the context of global governance, references to principles of good governance, such as democracy, participation and transparency, ensure that the reformed ISDS is capable of coping with the legitimacy issue, perform its public governance role, and fulfill its function as depoliticizing foreign investment disputes to some extent. Further, the struggles over the ISDS reform have displayed that global investment governance reform is subject to the interest pursuit of leading countries or dominant regions. The legitimacy enhancement is not independent on power politics; instead, it is shaped by power shifts in the international relations.

Key Words: Investor-State Dispute Settlement; Global Governance; Arbitration; Legitimacy; Investment Court

1. Global Governance: A Framework for ISDS Analysis

The term “global governance” is understood as “the exercise of authority across national borders as well as consented norms and rules beyond the nation state, both of them justified with reference to common goods or transnational problems”.² It is not only a hot academic topic but also has policy implication in political practice.³

It comes to the fore as an empirical fact to signal the need for establishing a framework encompassing the gradually strengthened links, exchanges, and interaction among countries.⁴ In the rapid process of globalization, issues and problems that were once only local and had limited social effect have now correspondingly and rapidly evolved into global concerns. Ecological crisis, environmental pollution, population explosion, resource shortage, international terrorism, transnational crimes and pandemics are acutely influencing the global community.⁵ These crises have made people realize that there is no way to solve these problems without a global cooperative approach. “Global

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² See Michael Zürn, *A Theory of Global Governance: Authority, Legitimacy, and Contestation*, Oxford University Press, pp.3-4 (2018).

³ See Katherine Morton, *Political Leadership and Global Governance: Structural Power Versus Custodial Leadership*, 2 Chinese Political Science Review 477, 493 (2017).

⁴ See Thomas G. Weiss, *Global Governance: Why? What? Whither?*, Polity Press, pp. 5-9 (2013).

⁵ See Jinseop Jang & Jason McSparren, et al., *Global governance: present and future*, 2 Palgrave Communications 1, 5 (2016).

governance” has thus emerged as a handy reference and a catch-all phrase to refer to the enlarged and deepened cooperation to deal with global issues and protect common interests of “global villagers” not just between states but also by a variety of state and non-state actors.

(a) Dimensions to Unfold Global Governance

There are several dimensions to unfold the functioning of global governance. First of all, it aims to solve public issues that transcend national borders. With the rapid development of internet and communication technology, the emergence of numerous public issues has led to the realization that the global society has common interests higher than the domestic interests of various countries that is called the global public interests.⁶ Although it is difficult to define global governance in a specific and precise way, it is generally believed that many global problems can no longer be solved solely by the traditional state actors. Efforts among countries to negotiate bilateral or multilateral treaties, or reach informal arrangements are not enough.⁷ Solving global public problems requires more diverse participation.

Secondly, it has expanded its scope to involve other actors besides the traditional state actors. “Governance” is not the same as “control” or “government”, but refers to a new, pluralistic, democratic, and more inclusive management mechanism, under which various actors manage their common affairs,⁸ to address issues that beyond national borders or have threatened local and global communities, and to reconcile the conflicting or divergent interests on the global level.⁹ As far as non-state actors are concerned, International organizations, non-governmental organizations, non-profit organizations, multinational and global companies, and private actors (such as the Bill Gates Foundation) have become governance entities at par with the state in terms of global governance. In practice, these non-state-actors develop guidelines and agreements that affect governments on the global scale. A new power structure of the international community has emerged due to the prominent role played by the non-state actors. For example, on one hand, the WTO, as an international organization, has regulatory and jurisdictional powers that directly affect national policies while on the other hand, the influence of NGOs is not to be underestimated.¹⁰ The wide scope of NGOs allows them to seek solutions to problems in specific fields, with access to specialized information and richer resources in certain areas (e.g. environmental monitoring, disease control) in comparison to the national governments.¹¹

Thirdly, it involves authority sharing.¹² Global governance is an ongoing process involving granting of powers and authority to some recognized groups or individuals. Global governance has led to decentralization of political authority at global level.¹³ Certainly, this is not to say that state actors have lost their authority completely but have come to the share their traditional authority with various non-state actors after accepting the recognition, obedience, and loyalties from the people.¹⁴ Thus, pluralistic

⁶ See Michael M. Bechtel & Federica Genovese, et al., *Interests, Norms and Support for the Provision of Global Public Goods: The Case of Climate Co-operation*, 49 British Journal of Political Science 1333, 1355 (2017).

⁷ See David Kennedy, *The Mystery of Global Governance*, 3 Ohio Northern University Law Review 842, 845 (2008).
⁸ See James N. Rosenau, *Governance without Government: Order and Change in World Politics*, Cambridge University Press, p.5 (1992).

⁹ See supra note 5, at p.45.

¹⁰ See Andrew T. Guzman, *Global Governance and the WTO*, 45 Harvard International Law Journal 303 (2004).

¹¹ See Eric De Brabandere, *Pragmatism in International Law: Non-State Actor Participation in International Dispute Settlement*, in J. d’Aspremont, ed., *International Legal System, Multiple Perspectives on Non-State Actors In International Law*, Routledge, p.342 (2011).

¹² See Julia Calvert, *Civil Society and Investor-state Dispute Settlement: Assessing the Social Dimensions of Investment Disputes in Latin America*, 23 New Political Economy 46, 65 (2018).

¹³ See Kenneth W. Abbott & Duncan Snidal, *International regulation without international government: Improving IO performance through orchestration*, 5 The Review of International Organizations 315, 344 (2010).

¹⁴ See supra note 8, at p.5.

and layered actors, national, supra-national, sub-national have performed their authorities in different realms of global governance.¹⁵ It is observable that a civil society has emerged to mobilize the public to carry out transnational and global activities, and to bring the needs and voices of the people to the international decision-making arena.¹⁶ It is in this sense that the governance authority has been shared.

(b) Key Deficiencies of Global Governance

As analyzed above, global governance refers to various public or private institutions and individuals, including state and non-state actors who work to solve global public issues, advance global public good, and promote global public interests by formulating and implementing binding formal or informal mechanisms.¹⁷ The major characteristics of global governance include public, diverse actors, fragmentation of authority, yet there are several deficiencies during carrying out such a multi-level, network-based coordination and action in various fields on a global scale.¹⁸ The deficiencies mainly concern legitimacy—a basic attribute of global governance.¹⁹ Legitimacy can be defined as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions”.²⁰

One of the doubts over the legitimacy of the global governance actors is their capacity to provide global good,²¹ such as global peace, functioning market, sustainable development or standards for climate protection. The implementation of large multilateral agreements at the government level in global governance failed to produce the expected impact, becoming a “government failure” in the process of solving urgent global problems.²² Furthermore, the different priorities and considerations over the definition of the term “public” are likely to impinge on the provisions of public good. The legitimacy of the global governance mechanisms is maintained through effectively providing public good.²³ The gap of economic status among the actors of global governance will hinder the formation of global consensus to a certain extent.²⁴ One case in point is the global economic governance, the governance in the fastest growing field of globalization. However, it is precisely in this field where people’s dissatisfactions and criticisms against globalization and global governance are the most concentrated.²⁵ There is an argument that global governance is shaped and directed by large multinational corporations,

¹⁵ See Tanja A. Börzel & Thomas Risse, *Governance without a State: Can It Work?* 4 Regulation & Governance 113, 134 (2010).

¹⁶ See supra note 12, at p.47.

¹⁷ See Gerry Stoker, *Governance as theory: Five propositions*, 50 International Social Science Journal 17, 28 (1999).

¹⁸ See Zhiyun Liu, *Global Governance and International Law*, 5 Journal of Xiamen University 87, 94 (2013).

¹⁹ See Michael Zürn, *Global Governance and Legitimacy Problems*, The G-20 Architecture in 2020 --Securing a Legitimate Role for the G20, <https://www.uvic.ca/research/centres/globalstudies/assets/docs/publications/GlobalGovernanceandLegitimacyProblems.pdf> (accessed on August 2, 2020).

²⁰ See Mark Suchman, *Managing legitimacy: Strategic and institutional approaches*, 20 Academy of Management Review 571, 610 (1995).

²¹ See Allen Buchanan & Robert Keohane, *The Legitimacy of Global Governance Institutions*, 20 Ethics & International Affairs 405, 437 (2006).

²² See Robert Keohane, *Governance in Partially Globalized World*, 95 American Political Science Review 1, 13 (2001).

²³ See Jean d’Aspremont, Eric De Brabandere, *The Complementary Faces of Legitimacy In International Law: The Legitimacy of Origin and the Legitimacy of Exercise*, 34 Fordham International Law Journal 190, 235 (2011).

²⁴ See supra note 17, at p.28.

²⁵ See Randall Germain, *Strengthening Economic Governance by Addressing Enduring Political Barriers*, in *Rebalancing Global Economic Governance - Opportunities for China and the G20 beyond 2015*, <http://en.sis.org.cn/uploadfile/2015/0630/20150630070020278.pdf> (accessed on August 11, 2020).

and hence it lacks the motivation to serve the public.²⁶ Without “public”, the global imbalance, both either economically or politically, is less likely to be curbed.

In addition, there are rising concerns over the “democracy deficit” of the institutions of supranational level or subnational level.²⁷ with the diffusion of political power traditionally exercised by the state actors, non-state actors have continuously increased their cross-border connections in global politics and have become increasingly powerful. Sadly, great powers do not necessarily come with great responsibilities. The negative effects of non-state actors during the diffusion of authority are standing out, in terms of environmental pollution, disregard and violation of labor rights and commercial bribery. These charges are often against powerful transnational corporations. Moreover, many NGOs are criticized for their bureaucratization and opaque decision-making mechanisms.²⁸ This has been calling attention to the accountability principle, which is the requirement of modern democracy.

(c) ISDS as A Global Governance Mechanism

According to the theory of global administrative law, most of the substance of global governance can be defined as “administrative”.²⁹ Leading scholars of global administrative law Benedict Kingsbury and Stephan Schill argue that International Investment Arbitration is a form of global governance,³⁰ because the arbitration tribunal has established appropriate standards for the state’s actions against investors, and it serves as an agency to review the government’s policy. This paper agrees that International Investment Arbitration is not only a dispute resolution system, but also a global governance mechanism, for it satisfies the characteristics analyzed above.

ISDS involves transfer of authority or “sharing authority”. As a dispute resolution institution, its core function is to resolve disputes between investors and countries arising from foreign investment activities.³¹ The arbitration tribunals have been empowered by investment treaties concluded between states to review the host country’s actions and to award damages against the country if it constitutes a violation of the treaty.³² In other words, the arbitral tribunals exercise the judicial powers of the national or international courts and thus becoming a powerful supranational regulatory institution, sharing public powers traditionally monopolized by the state actors.

ISDS relates to public domain and contributes to public good. Investment disputes often focus on political issues or sensitive industries such as the host state’s public security, national security interests or environmental threats.³³ There are conflicts between the private law rights of investors on one side and the public interests and public policies of the host country on the other. The arbitration tribunal resolves investment disputes by exercising public powers assigned or granted by the state. While

²⁶ See Tim Bartley, Transnational Corporations and Global Governance, 44 Annual Review of Sociology 145, 165 (2018).

²⁷ See Eva Erman, *The Political Legitimacy of Global Governance and the Proper Role of Civil Society Actors*, 24 Res Publica 133, 155 (2018).

²⁸ See Tuo Cai & Zhenye Liu, *Reform of Global Governance and Innovation of International Rule of Law*, China University of Political Science and Law Press, p.77 (2014).

²⁹ See Benedict Kingsbury & Nico Krisch et al., *The emergence of global administrative law*, 68 Law and Contemporary Problems 15, 62 (2005).

³⁰ See Benedict Kingsbury, Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, New York University Public Law and Legal Theory Working Papers, No.146 (2009) http://lsr.nellco.org/nyu_plltwp/146 (accessed on August 2, 2020).

³¹ See David Gaukrodger & Kathryn Godor, *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*, OECD Working Papers on Investment No.3 (2012).

³² See Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 European Journal of International Law 121, 150 (2006).

³³ See Stephan Schill ed., *International Investment Law and Comparative Public Law*, Oxford University Press, pp.3-37 (2010).

defining what activities are sovereign acts, what is the appropriateness of the government actions; the arbitral tribunals have affected customary international law in sub-fields such as trade law and human rights, as well as the perception and expectations of public policy.

ISDS has a worldwide effect of governance. Although Investment Arbitration awards are only legally binding on the individual parties, their influence is no longer limited to the parties in one particular dispute, but extends to non-disputing parties or third parties that are not parties to the arbitration.³⁴ After the arbitration tribunal has interpreted or reasoned its decision in reviewing state's measures, standards such as, understanding of fair and equitable treatment, gradually established for the public to refer to.³⁵ These standards will not only guide the country's future actions, but are also often cited by other foreign investors or host states as a legal weapon.

The arbitral tribunal is a global governance institution that exercises public power by making arbitral awards, and setting standards for the host states' regulation of foreign investors. The legitimacy of Investment Arbitration not only lies in the legitimacy of the arbitral tribunal, which is a private mechanism exercising sovereign powers (that is, judicial powers), but also depends on the other actors participating in the investment arbitration mechanism.³⁶ Specifically, the contracting states that exercise the legislative power of the investment treaty, international organizations, NGOs and citizens that committed to promote human rights protection during foreign investment are all playing certain parts in the investment arbitration system. However, based on recent backlash against the ISDS, it is believed that the current mechanism and arrangement of investment arbitration are not strong enough to address political and economic issues arising out of foreign investment as an accountable and effective global governance institution.

(d) Good Governance

Scholars have gradually focused their discussions on how to promote global governance more effectively, tackle the governance failure and react to its legitimacy crisis.³⁷ As the legitimacy of the governance mechanism lies in the validity of political decisions and the societal acceptance,³⁸ growing attention has been put on the issue of authority acceptancy. Many scholars and international organizations have put forward concepts such as "meta-governance", "effective governance" and "good governance", to enhance the acceptance of authorities of governance institutions and attain compliance with their rules and decisions, thus to enhance legitimacy of global governance.³⁹

Good governance is the process of social management to maximize public interests.⁴⁰ It is not only the goal of current global governance transformation, but its focus on such issues as legitimacy, accountability and transparency, is aimed to increase the consensus and support of citizens. In order to

³⁴ See supra note 32, at p.150.

³⁵ See supra note 30, at p.146.

³⁶ See Charles N. Brower & Stephan Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of Investment Law?* 9 Chicago Journal of International Law 471, 492 (2009).

³⁷ See Andrew Moravcsik, *Is there a 'Democratic Deficit' in World Politics? A Framework for Analysis*, 39 Government and Opposition 336, 363 (2004).

³⁸ See Benjamin Cashore, *Legitimacy and the Privatization of Environmental Governance: How Non-State Market-Driven (NSMD) Governance Systems Gain Rule-making Authority*, 15 Governance 503, 529 (2002).

³⁹ See Jan Kooiman & Svein Jentoft, *Meta-Governance: Values, Norms and Principles, and the Making of Hard Choices*, 87 Public Administration 818, 836 (2009); Charles P. Oman & Christiane Arndt, *Measuring Governance*, OECD Development Centre Policy Brief, No. 39 (2010).

https://www.oecd-ilibrary.org/development/measuring-governance_5km5z9nnxwxw-en (accessed on August 2, 2020).

⁴⁰ See Matt Andrews, *The Good Governance Agenda: Beyond Indicators without Theory*, 36 Oxford Development Studies 379, 407 (2008).

serve as basis for the ISDS reform and to coordinate and balance the diverged, sometimes even conflicting interests, it is of imperative to outline characteristics of good governance.⁴¹

Participation is the cornerstone of good governance. Embracing participation means respecting diverse views of different actors and enhancing mutual understanding. The emergence and increasingly important role of civil society is a good example. As the influence of civil society grows in terms of authority and resources, they will not only significantly affect their national governments' conduct but also actively engage in networks of transnational relations.⁴² Civil society networks have been increasingly participating in the process of formulating international norms and rules. Their interests, values and requirements are shaping the international policies as well. Their participation is not only the recent development of international law, but the key to deal with the democratic deficit of global governance.⁴³ Without doubt, their exclusion from the governance is contrary to the normal understanding of global governance, let alone good governance.

Rule of law is one basic requirement of good governance. It means that the law is the highest criterion for public political management, all government officials and citizens must act in accordance with the law and everyone is equal before the law. In globalized society, full respect for the law means acting in the manner specified by clarity and stability, strict compliance with procedures, respecting the legal certainty and normative frameworks binding domestically and internationally.⁴⁴ It also requires an independent adjudicatory institution where disputes could be solved impartially.

Transparency refers to the openness of political information. Every citizen has the right to access to information on government policies, relevant to his or her own interests, including legislative activities, policy making and implementation, administrative budgets, public expenditures, and other relevant political information. Transparency requires political information be made known to citizens through various media in a timely manner so that citizens can effectively participate in the public decision-making process and effectively supervise the public management process.⁴⁵ The higher the degree of transparency, better the realization of good governance.

Public administrators and regulatory bodies must respond promptly and responsibly to demands and appeals of citizens without undue delay. Citizens should also be consulted regularly and proactively. Good governance requires that systems and procedures be dedicated to serving all stakeholders within a reasonable time frame.

Good governance needs to reconcile different interests of various actors to reach a broad consensus in society on what is most in line with the interests of the entire society and how it is to be achieved. The policy-making should entitle all groups, especially the most vulnerable, the opportunity to improve or maintain their well-being.⁴⁶ Accordingly, inclusiveness ensures a greater sense of legitimacy.

Accountability, where people should be responsible for their own actions, is a key element of good

⁴¹ These dimensions of "good governance" are based on the categories for "good governance" set out by the United Nations Economic and Social Commission for Asia and the Pacific, "What is Good Governance?", in Robert B. Albritton & Thawilwadee Bureekul, *A Comparative Survey of Democracy, Governance and Development*, Working Paper Series, No.47, <http://www.asianbarometer.org/publications/0946d0ff1f760afb5dc8ab0aac77a255.pdf> (accessed on August 2, 2020).

⁴² See supra note 12, at p.260.

⁴³ See supra note 16, at p.607.

⁴⁴ See Theresa Reinold & Monika Heupel, *Introduction: The Rule of Law in an Era of Multi-level Governance and Global Legal Pluralism*, in Monika Heupel & Theresa Reinold ed., *The Rule of Law in Global Governance*, Palgrave Macmillan, pp.1-25 (2016).

⁴⁵ See Anne Peters, *Towards Transparency as a Global Norm*, in Andrea Bianchi and Anne Peters eds., *Transparency in International Law*, Cambridge University Press, p.607 (2013).

⁴⁶ See Vivien Schmidt & Matthew Wood, *Conceptualizing throughput Legitimacy: Procedural Mechanisms of Accountability*, Transparency, Inclusiveness and Openness in EU governance, 97 *Public Administration* 727, 740 (2019).

governance.⁴⁷ In public administration, it specifically refers to duties and corresponding obligations associated with some certain actors when they perform certain functions.⁴⁸ Not only government agencies, but also the private sectors and civil society organizations, must be accountable for their conducts when they are performing public powers or representing public.

Good governance means that procedures and systems can meet the needs of society while reducing the management cost to the maximum extent. The concept of good governance is incompatible with ineffective or inefficient management activities. The higher the degree of good governance, more the effectiveness and efficiency of management.

To realize the democratization of global governance, it is necessary to consider the growing inequality among different sectors within a state, amongst states and between states and non-state actors. Therefore, in the absence of a global government, the question of how to coordinate the relations between developed and developing countries, both large and small countries, as well as the Global North and Global South, has become the main agenda to achieve democracy in global governance.⁴⁹

In case of the ISDS, the arbitration tribunal exercises its power and influence as a global governance regime by reviewing actions and measures of the host states. The awards and enforcements will have an impact on the future behavior or behavior expectations of the states and investors, as well as the perception and expectations of public policy and public interest. The concerns and doubts over investment arbitration are essentially arising from the lack of public participation, accountability for the exercise of power, among other reasons. Thus, the emergence of ISDS is an example and reflection of global governance. The global governance could also be the framework to analyze the challenges facing the ISDS, and to provide guidelines for the ISDS reform.

2. ISDS: Promises and Challenges

The ISDS is a highly depoliticized method of solving international investment disputes with an aim to overcome the shortcomings of traditional dispute resolution approaches, such as host state local relief, and home state diplomatic protection.⁵⁰ In this section, the emergence, development and challenges of the ISDS will be considered.

(a) Efforts to Depoliticize the Investment Disputes

The emergence of ISDS is a reflection of the driven factors of global governance.⁵¹ In the field of international investment, the rapid development of ISDS brought about by globalization has not only promoted the economic growth and technological progress of capital-importing countries, but has also caused many disputes.⁵² However, these foreign investors lack the capacity to claim compensation

⁴⁷ See Veerle van Doeveren, *Rethinking Good Governance*, 13 Public Integrity 301, 318 (2011).

⁴⁸ See supra note 46, at p.731.

⁴⁹ See Stephan Schill, *Reforming Investor-State Dispute Settlement: A (Comparative and International) Constitutional Law Framework*, 20 Journal of International Economic Law 649, 672 (2017).

⁵⁰ See Ibrahim F. I. Shihata, *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA*, 1 ICSID Review - Foreign Investment Law Journal 1, 25 (1986).

⁵¹ For the detailed report on state-to-state investment settlement, see Nathalie Bernasconi-Osterwalder, *State-State Dispute Settlement in Investment Treaties Best Practices Series*, The International Institute for Sustainable Development (2014).

<https://www.iisd.org/sites/default/files/publications/best-practices-state-state-dispute-settlement-investment-treaties.pdf> (accessed on August 2, 2020); See Wolfgang Alschner, *The Impact of Investment Arbitration on Investment Treaty Design: Myth versus Reality*, 42 The Yale Journal of International Law 1, 66 (2017).

⁵² See Oliver Morrissey & Manop Udomkerdmongkol, *Governance, Private Investment and Foreign Direct Investment*

against alleged illegitimate government actions such as direct expropriations or nationalization.. Whether they choose to establish a business relationship with the private or public sector of the host state, the host state's arbitrariness and hostility is always a risk factor for the investors.

In the era of emphasizing national governments, the relationship between investors and the host state is mainly adjusted by the domestic laws of the host state. Investment disputes between investors and the host state must exhaust local remedy before admitting the investor's home state request for diplomatic protection against the host state employing international law,⁵³ or apply for settlement of investment disputes through inter-state arbitration to protect its nationals. However, diplomatic protection is the discretion of the home state, not an obligation that the home state must perform to safeguard its overseas investors. Additionally, the initiation of dispute settlement between states is mainly restricted by the diplomatic situation.⁵⁴ This traditional public approach is commonly referred to as the "politicization" of investment dispute settlement.⁵⁵

However, the diplomatic protection that overemphasizes politics and relies heavily on "politicians" in the home state is no longer the preferred protection model for the interests of foreign investors.

With more frequent cross-border capital flows, and the more complexity of investment disputes, international investment law has occupied an increasingly important position in the economic development of many countries. This is especially true for developing countries that have human and natural resources but lack the capital and technology of most industrial developed countries.⁵⁶ In order to ensure that foreign investors are confident to invest, these developing countries will naturally be more than willing to conclude a series of bilateral investment agreements (BITs) with foreign investors that may restrict sovereignty to some extent and provide protection for foreign investors.⁵⁷ States eager for liberalization reform may provide higher protection standards, higher compensation measures for possible expropriation, or even temporarily sacrifice its own environment or labor rights.⁵⁸ Such investment agreements often provide that the host state has the duty to protect foreign investors from illegitimate exercise of power and ensure a reliable mechanism for resolving investment disputes. The idea is that the host state and the foreign investor become contracting parties on an equal basis, granting investors rights to arbitrate against host state government before an independent institution.

On March 18, 1965, the official text of the Convention on the Settlement of Investment Disputes between States and The Private Sector of Other States (ICSID Convention), drafted under the auspices of the World Bank, was accepted for signature. The Convention formally established the International Centre for the Settlement of Investment Disputes (ICSID), thus providing a model for the settlement of public-private disputes. A tribunal had been formed in which foreign investors do not have to resort to the diplomatic protection of their home state or submit to the administrative or judicial authorities of the host state.⁵⁹

This pattern was widely adopted in BITs or free trade agreements (FTAs). Thus, depoliticizing investment disputes had replaced the diplomatic protection model which relied on the traditional

in Developing Countries, 40 *World Development* 437, 445 (2012).

⁵³ See *supra* note 46, at p.2.

⁵⁴ See Ben Juratowitch, *The Relationship between Diplomatic Protection and Investment Treaties*, 23 *ICSID Review – Foreign Investment Law Journal* 10, 13 (2008).

⁵⁵ See Anthea Roberts, *State-to State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority*, 55 *Harvard International Law Journal* 1, 70 (2014).

⁵⁶ See *supra* note 52, at p.440.

⁵⁷ See Karl P. Sauvant ed., *Yearbook on International Investment Law and Policy*, Oxford University Press, p. 649 (2012).

⁵⁸ See Sonia E. Rolland, *The Return of State Remedies in Investor-State Dispute Settlement: Trends in Developing Countries*, 49 *Loyola University Chicago Law Journal* 387, 404 (2017).

⁵⁹ See *supra* note 51, at p.6.

state-actors, and has become more inclusive. In 2018, at least 71 treaty-based ISDS cases were initiated, and as of 1 January 2019, the total number of known ISDS cases pursuant to international investment agreements (IIAs) had reached 942. To date, 117 countries are known to have been respondents to one or more ISDS claims.⁶⁰

(b) Unease with Current ISDS

International investment has served as an important engine of global economic development. The investment dispute settlement mechanism promotes the flow of capital between countries and plays a significant role in preventing the investor's home state from interfering in the host state's sovereignty through diplomatic channels. As analyzed above, avoiding the politicization of investment disputes is central to the design of the ISDS. However, the increase of foreign investment comes with political concerns and challenges surrounding the role played by the ISDS system.⁶¹ In some cases, foreign corporations have been accused of using the ISDS to attack a wide array of domestic policies on climate, financial, mining, medicine, energy, pollution, water, labor rights and otherwise, which have seriously hindered the development of international investment.⁶²

The initial suspicion towards the ISDS came largely from countries in South America, whose concerns focused on the perceived threat to their sovereignty, especially economic sovereignty. For example, in 2008 Ecuador adopted a new constitution, of which Article 422 prohibits Ecuador from ceding its sovereign jurisdiction to international arbitration by treaty or other international instruments.⁶³ Accordingly, Ecuador initiated a series of measures to terminate the Bilateral Investment Treaty (BIT) it had previously signed. Later in 2008, Ecuador ended its BIT with nine countries: Cuba, Dominica, El Salvador, Honduras, Nicaragua, Paraguay, Romania and Uruguay.⁶⁴ In 2009, Bolivia's constitution declared that foreign investments shall cease to enjoy diplomatic protection or more favorable treatment than domestic investment, and it also banned foreign investors resort to international arbitration.⁶⁵

Gradually, the United States (U.S.) and the European Union (EU), the traditional strong supporter of the ISDS, began to oppose the ISDC out of concerns on the right to regulate. One of the high-profile cases is the *Philip Morris Asia Limited v. Australia*.⁶⁶ Wherein the subsidiaries of tobacco giant Philip Morris filed investment treaty arbitrations against Uruguay and Australia after the two countries enacted legislative controls over cigarette packaging. This case has aroused controversy over the conflict between foreign investment protection and the host state's public health regulatory rights.⁶⁷ It signifies the doubts and widespread calls to rethink and reform the ISDS system within older generations of international investment treaties. Specifically, the initial investor-state investment treaty arbitrations have

⁶⁰ See UNCTAD, *Fact Sheet on Investor-State Dispute Settlement Cases In 2018*, 2019. https://unctad.org/en/PublicationsLibrary/diaepcbinf2019d4_en.pdf (accessed on August 1, 2020).

⁶¹ See Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 Fordham Law Review 1521, 1625 (2005).

⁶² See *supra* note 36, at p.1625.

⁶³ See Alexander B. Avtgis, *Rethinking Article 422: A Retrospective on Ecuador's 2008 Constitutional ISDS Recalibration*, 2 Indiana Journal of Constitutional Design, Article 2 (2016), Available at: <https://www.repository.law.indiana.edu/ijcd/vol2/iss1/2> (accessed on August 2, 2020).

⁶⁴ See César Coronel Ortega, *Ecuador and ISDS – A Rough Journey and a Possible New Beginning*, Investment Claims, <https://oxia.oupilaw.com/page/674>. (accessed on August 2, 2020).

⁶⁵ See *Opening the Door to Foreign Investment? An Analysis of Bolivia's New Investment Promotion Law*, <https://www.iisd.org/itn/2014/08/11/opening-the-door-to-foreign-investment-an-analysis-of-bolivas-new-investment-promotion-law/> (accessed on August 2, 2020).

⁶⁶ See *Philip Morris Asia Limited v. The Commonwealth of Australia*, PCA Case No. 2012-12 (2012).

⁶⁷ See Sergio Puig & Gregory Shaffer, *A Breakthrough with the TPP: The Tobacco Carve-out*, 16 Yale Journal of Health Policy, Law and Ethics 327, 333 (2016).

been charged with protecting the interests of foreign investors unilaterally but fail to consider the public interests of the host State in a balanced manner.⁶⁸

The core of the ISDS is that investment arbitration tribunals use arbitration as a private law method to resolve disputes of a public law nature. This “depoliticizing” form of investment dispute settlement, once held in high expectations to be one mechanism of global governance, has now fallen into an awkward position. On the one hand, recourse of the ISDS still holds a prominent place in international investment. On the other hand, recurring concerns and challenges have illustrated that the ISDS is facing structural defects and a legitimacy crisis.⁶⁹

3. Problems Faced by the ISDS

The increasing trend of investment liberalization and the growing number of BITs have seen an ongoing debate over the problems exposed during investment arbitration.⁷⁰ Investment tribunals encountered diverse arguments raised by host states, foreign investors, and non-state parties (in amicus briefs), regarding their capacity and legitimacy. The most often repeated criticism is that the current ISDS tribunal lacks legitimacy to resolve international investment disputes involving public interests, to review the host state’s actions and exercise of legislative power, judicial power, or administrative power, to apply its interpretive power with substantial latitude, and to impose huge amounts of compensation on the state.⁷¹

The main aspects of this “legitimacy gap” or “legitimacy crisis” faced by the ISDS system allegedly include: (1) the arbitral tribunal has been entrusted with wide powers; (2) there is lack of transparency during arbitration processes; (3) there is lack of accountability in the investment arbitration mechanism; (4) the current arbitration system is thought to be in favor of foreign private investors.

Firstly, the arbitral tribunal has been entrusted with wide powers.⁷² The wide range of International Investment Arbitrations (IIAs) provide for a series of investment protection standards designed to protect investors from improper state intervention or regulation, such as prohibition of expropriation, fair and just treatment, national treatment, most-favored-nation treatment, etc. By interpreting these standards, the arbitrators decide whether there is a breach of investment treaty provisions, and elaborate on how to exercise public power in terms of capital transfer, taxation, land use, and providing services. When reviewing these government measures, arbitrators will consider the legislation, decide the fairness of government supervision, specify the content of property rights, and impose awards of huge amount penalty on the state. In many international investment treaties, there are relatively vague and ambiguous provisions on many core rights of investors, which offer the arbitral tribunals’ wide discretion to interpret the government policies related to human rights, environmental protection, public health, and even national security. In other words, the international investment rule of law is significantly being developed and interpreted in the investment arbitration community. Challenges against their powers have led to a series of high-profile investment disputes.

⁶⁸ See Kyla Tienhaara, *Regulatory Chill and the Threat of Arbitration: A View from Political Science*, in Chester Brown, Kate Miles ed., *Evolution in Investment Treaty Law and Arbitration*, Cambridge University Press, p.2 (2011).

⁶⁹ See supra note 61, at p.1545.

⁷⁰ See Anna Herranz-Surrallés, “Authority Shifts” in *Global Governance: Intersecting Politicizations and the Reform of Investor–State Arbitration*, 8 *Politics and Governance* 336, 347 (2020).

⁷¹ See Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 *American Journal of International Law* 179, 207 (2010).

⁷² See Sophie Nappert, *International Arbitration as a Tool of Global Governance: The Use (and Abuse) of Discretion*, 2017. The Oxford Handbook on International Governance, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=2994914> (accessed on August 2, 2020)

Secondly, there is concern over the transparency during arbitration.⁷³ In international commercial arbitration, it is generally believed that the existence of the dispute, the main issue of the dispute, the identity of the arbitrator, the materials submitted, and the final award must be kept confidential unless the parties to the dispute agree to make it public. However, this feature of confidentiality is transplanted to investment arbitration involving public interest considerations, and therefore, the meaning of some government policies will ultimately be determined in a secretive manner. As the investment treaty itself does not provide mandatory disclosure of all information related to investment arbitration, where there is conflict between publicity and the autonomy of the parties in which the parties to the dispute maintain the confidentiality of the arbitration, arbitration rules applicable tend to support confidentiality. Therefore, fragmentation of external supervision, limited internal remedies, lack of public participation, and information asymmetry would be triggered.

Citizens of the host state, out of concerns regarding their national public interest, require supervising the entire process of dispute settlement involving public interest and exercise their right to know and participate. Additionally, the host state has its own set of duties and obligation towards its citizens, and the domestic law obliges the publication of necessary information. Process transparency and information disclosure can ensure that the host state's government fulfills its "good governance obligations" to protect the citizens' welfare and their right to know. Besides, it may result in huge public financial expenditures in the host state. Once the lawsuit is lost, the state has to pay expensive fees and bear the liability for compensation. All of these costs will ultimately be borne by the host state's taxpayers, leading to call for greater transparency in arbitration proceedings and for the participation of non-arbitral parties through *amicus curiae*.

The third aspect involves the issue of accountability. Like all mechanisms based on legal rules, the arbitration forums are believed to play an important role in the process of interpreting and developing the rules of international law.⁷⁴ They are expected to invoke principles that have been generally accepted, and to ensure that investment disputes are settled coherently. However, appointed on a case-by-case basis in accordance with investment treaties, arbitrators who are short of tenure guarantees and are also vulnerable to other forms of commercial influence, seem to be problematic. Besides, since there is no obligation to follow precedents, arbitral tribunals in this ISDS network are independent of each other, and therefore have the discretion to make decisions based on their own interpretation over the various principles of foreign investment law.⁷⁵ Among arbitration tribunals, there are inevitable differences in viewpoints and even conflicting reasons in the awards. Therefore, due to lack of accountability, there is lack of consistency among arbitral awards. This is the reason why some voices call for the establishment of an investment arbitration appeal mechanism to conduct a more comprehensive and effective supervision of the tribunal's arbitration award.⁷⁶ It is expected that the appeal mechanism will ensure that the arbitrations meet the purpose of investment treaties by setting uniform and appropriate review standards, to maintain the consistency and predictability of arbitration awards, and thus promote the legitimacy and authority of the arbitral tribunal.

Last but not least, the ISDS system is accused of overprotection of investors and hence restriction of the host country's regulatory rights and sovereign policy space for foreign investment.⁷⁷ Investment

⁷³ See Virginia Haufler, *Disclosure as Governance: The Extractive Industry Transparency Initiative and Resource Management in the Developing World*, 10 *Global Environmental Politics* 53, 73 (2010).

⁷⁴ See Malcolm Langford & Daniel Behn, *Managing Backlash: The Evolving Investment Treaty Arbitrator*, 29 *European Journal of International Law* 551, 580 (2018).

⁷⁵ See *supra* note 72, at p.580.

⁷⁶ See Mark Feldman, *Investment Arbitration Appellate Mechanism Options: Consistency, Accuracy, and Balance of Power*, 32 *ICSID Review - Foreign Investment Law Journal* 528, 544 (2017).

⁷⁷ See Stephen Schill, *Crafting the International Economic Order: the Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator*, 23 *Leiden Journal of International Law* 402, 403 (2010).

treaties aimed at promoting the liberalization and facilitation of international investment, certainly attach importance to the protection of foreign investment and investors. However, the series of the ISDS claims have presented a powerful deterrent effect on governments who are considering the introduction of public health measures in the interest of their citizens, or who are adopting some control measures responding to domestic financial crisis.⁷⁸ Additionally, some scholars believe that no matter how well the arbitrators complete their work, because of the objective link between interpreting the treaty and promoting the development of arbitration industry, their interpretation of the law will have an inherent tendency that is not conducive to the interests of the host country,⁷⁹ and they will be inclined to focus on particular facts of the dispute and downplay the weight of public interest issues.⁸⁰ Out of the public health concern, Chapter 29 of the Trans-Pacific Partnership (TPP) states, the tobacco industry is to be excluded from investor-state arbitration, and Article 22 of the Revised Free Trade Agreement between Singapore and Australia also excludes the tobacco industry from investor-state arbitration, which seems to be more effective in guaranteeing the host country's exercise of public health control.⁸¹ Although the history of existing investment arbitration tribunals shows that the "exclusion clauses" designed to preserve regulatory space for the host states have been interpreted in a narrow manner. Some cases such as *Sedelmayer v Russian Federation*, *Telenor Mobile Communications AS v Republic of Hungary*, *Saipem S.p.A v The People's Republic of Bangladesh* and other investor-host arbitration cases show that even BITs where there are provisions inserted to circumvent or limit the jurisdiction of the arbitral committee to resolve the compensation issue, the current arbitration tribunal is more willing to uphold the investors' compensation claim. These factors have evoked deep concerns over the ISDS forum's unduly restricting regulatory space.⁸²

Behind the growing unease with the ISDS, the existing tension between the public governance function and its role as a private dispute settlement mechanism is easily visible. The main reason behind this is that it was modeled on the private dispute settlement when the ISDS system was designed. , Thus it focused on protecting interests of investors and was very cautious about the possibility of the host states, mainly developing countries, to interfere with investment.⁸³ Only the investor was granted unilateral privilege to bring arbitration claims for alleged violations of treaty provisions. Moreover, as the ISDS mechanism is based on the design of the international commercial arbitration system, the emphasis was put on procedural confidentiality in the arbitration procedure with limited public participation, resulting in a lack of representation of public interests and public supervision. The above criticisms have witnessed increasing international concerns and scholarly attention to the role of power in shaping the ISDS, and the implications for global governance.

Power is a critical concept for understanding, explaining, and influencing the current ISDS mechanism. The legitimacy crisis originates from the gaps between public function and private institutions, the imbalances of powers between state and non-state actors, between the rights and responsibilities of foreign investors, between the autonomy and limitations on arbitral tribunals, the

⁷⁸ See Christine Cote, *A Chilling Effect? The Impact of International Investment Agreements on National Regulatory Autonomy in the Areas of Health, Safety and the Environment*, PhD thesis, The London School of Economics and Political Science (LSE), p.173 (2014).

⁷⁹ See M Sornarajah, *The Clash of Globalizations and the International Law on Foreign Investment*, Presentation to the Center for Trade policy and Law, Ottawa, September 12, p.18 (2002), cited by Gus Van Harten, *Investment Treaty Arbitration and Public Law*, Oxford University Press, p.173 (2007).

⁸⁰ See Moshe Hirsch, *Invitation to the Sociology of International Law*, Oxford University Press, p.149 (2015).

⁸¹ See supra note 67, at p.331.

⁸² See Simon, F. *EU Asserts "Right to Regulate" As Part of Energy Charter Treaty Reform*, <https://www.euractiv.com> (accessed on August 1, 2020).

⁸³ See Gus Van Harten, *Private Authority and Transnational Governance: The Contours of the International System of Investor Protection*, 12 *Review of International Political Economy* 600, 623 (2005).

disparities of powers between capital exporting states, mainly traditional developed countries, and capital importing states, mainly traditional developing countries, and the tensions between the pursuit of economic profit and protection of regulatory space and human rights. Although the depoliticized investment dispute settlement mechanism is still supported by the politicized power structure, the ISDS reform is only possible when the political power structure is adjusted to emulate the aims of good governance.

4. Reforming the ISDS: To What Extent?

Since its emergence, the International Investment Arbitration mechanism has been widely adopted by the ISDS, but as mentioned above, it has been controversial due to issues such as overprotection of investors, challenges against the host state's public policies and inconsistency in treaty interpretation by arbitral tribunals. The widespread criticism of investor-state arbitration led the common acknowledgement that "the current question is not about whether to reform, but how to reform."⁸⁴

Indeed, there are many efforts already focusing on the ISDS reform. Reform proposals, however, diverge widely from complete withdrawal from the system to institutionalizing it further through the creation of an appellate mechanism or a permanent investment court.⁸⁵ This article proposes that the framework of global governance will provide a different perspective as compared to the pure international legal theory of perceived backlash and resultant reform proposals. The widespread concern and criticism against the current ISDS should be aligned and reformed under the requirement of good governance to tackle the legitimacy gap. Further, the competing approaches to reform the ISDS reflects the efforts of leading countries or leading regions to expand their power in global governance, in this case, in the economic realm.

(a) U.S.'s Approach to Enhance the Transparency

The United States has taken the lead in adjusting the International Investment Arbitration mechanism and promoting the development of a new liberal international investment legal system. It mainly focuses on the reforms to enhance the transparency and third-party participation in arbitration mechanism, in response to the backlash against the investor-led international investment arbitration mechanism.⁸⁶

Transparency reform is mainly reflected in the actions of the North American Free Trade Agreement (NAFTA), the United Nations Commission on International Trade Law (UNCITRAL), and the International Center for Investment Dispute Resolution (The International Center for Settlement of Investment Disputes, ICSID). As early as 2001 and 2003, the NAFTA Trade Commission issued a statement requesting that the transparency of the NAFTA dispute resolution process be improved. Since then, increasing the transparency of procedures has gained attention, both inside and outside the region.⁸⁷ The second working group of UNCITRAL began to pay

⁸⁴ See supra note 82, at p.623.

⁸⁵ See European Parliament, *Negotiations for a convention establishing a multilateral court for the settlement of investment disputes*, European Parliament.

https://www.europarl.europa.eu/doceo/document/CRE-8-2017-11-29-ITM-023_EN.html (accessed on August 1, 2020).

⁸⁶ See Kiran Nasir Gore & Charles Camp, *The Rise of NAFTA 2.0: A Case Study in Effective ISDS Reform* (2019), in Alan Anderson & Ben Beaumont ed., *The Investor-State Dispute Settlement System: Reform, Replace or Status Quo?* Kluwer Law International (2020 Forthcoming). Available at <https://ssrn.com/abstract=3502291> (accessed on July 6, 2020).

⁸⁷ See supra note 86, at p.750.

attention to the improvement of the transparency of arbitration procedures in 2007. In 2009, it was prepared to “prioritize” the transparency reform. In 2014, the UNCITRAL Rules on the Transparency of Arbitration Based on Treaties between Investors and Countries was adopted. The “UN Convention on Transparency” (also known as the “Mauritius Convention”) was passed in 2017.⁸⁸

The efforts of improving transparency included disclosure of court hearings and third-party participation. Especially in sensitive cases involving public health, environmental protection, and labor protection, many civil societies and non-governmental organizations representing public interests have been applying for participation in investment arbitration as “amicus curiae”. The third party is expected to participate in investment arbitration by providing written opinions to the arbitral tribunal, and presenting relevant information, legal interpretations, and related opinions to the arbitral tribunal, thereby indirectly affecting the tribunal’s ruling.⁸⁹ For example, in *Methanex Corp v. United States*, several NGOs were concerned with issues such as drinking water and public health, and these third parties had submitted their brief as “amicus curiae”, that is, “friends of the court”.⁹⁰ In the end, the arbitral tribunal accepted their participation in the proceeding due to environmental, human rights and other interests that they advocate were likely to exceed the limits of one national government and were of public welfare on a global scale. Some scholars regard International Investment Arbitration as a means of global governance through which the participation of third parties to restrict the illegitimate exercise of both state power and private entity rights.

Allowing the amicus curiae submission as the non-dispute parties to provide expertise, incorporated broader public policy considerations into the dispute settlement process, to correct democratic deficits and enhance public supervision, is an active step towards implementing transparency.⁹¹ However, the focus has always been on private law aspects of investment relations, and all the reform measures are proposed within the framework of depoliticizing strategy for investment arbitration. From the perspective of the U.S., the central idea of dispute settlement is still investor-centered depoliticizing mechanism, modeled on commercial arbitration. Under this “depoliticized” investor-centered protection mechanism, investors can decide the composition of arbitral tribunals. The ad-hoc nature with its changing pools of arbitrators will inevitably lead to built-in inconsistency in the interpretation of the treaty clauses and previous award outcomes.⁹²

Therefore, the ISDS reform led by U.S. is not fundamental but could be explained as the effort of U.S. to maintain its global influence over investment governance. At present, this model has been adopted by a line of IIAs. China also adopted this model in China-Canada Investment Promotion and Protection Agreement signed in 2014 and the China-Australia Free Trade Agreement signed in 2015.

(b) EU’s Role in Establishing Investment Court

Concerned about the arbitration mechanism, that lacks public participation but determines public

⁸⁸ Gabrielle Kaufmann-Kohler & Michele Potestà, *Can the Mauritius Convention serve as a model for the reform of investor-State arbitration in connection with the introduction of a permanent investment tribunal or an appeal mechanism? Analysis and roadmap*, available at https://uncitral.un.org/sites/uncitral.un.org/files/mediadocuments/uncitral/en/cids_research_paper_mauritius.pdf (accessed on August 1, 2020).

⁸⁹ See Gary Born & Stephanie Forrest, *Amicus Curiae Participation in Investment Arbitration*, 34 ICSID Review - Foreign Investment Law Journal 626, 665 (2019).

⁹⁰ *Methanex Corp. v. United States of America*, UNCITRAL (Originally published in 2011 in International Investment Law and Sustainable Development: Key cases from 2000-2010; republished on this website on October 18, 2018.) <https://www.iisd.org/itn/2018/10/18/methanex-v-united-states/> (accessed on July 6, 2020).

⁹¹ See supra note 89, at p.665.

⁹² See supra note 61, at p.1558.

powers, along with the growing controversy over the ISDS, the European Union (EU) has adjusted its position with the investor-state arbitration and returned the disputes to the courts.⁹³ For the EU, arbitration used to resolve disputes involving public law is the privatization of global justice. To solve this problem, it is necessary to establish an International Investment Court with judges on a fixed term, rather than continue to rely on the ad-hoc panel appointed by the parties, because the judges do not have the motive to compromise their decision-making in order to be appointed again in the future.

In September 2015, the European Commission proposed several noteworthy changes to the traditional investment provisions and procedures, including the creation of an Investment Court System (ICS), in the form of extensive curtailments on how, when, and where investors could challenge government decisions.⁹⁴ The ICS proposal is an EU-led foreign investment dispute settlement reform. The European Commission clearly intends that its current ICS reform proposals will eventually result in the establishment of a “Multilateral Investment Court”.⁹⁵ Along this spirit, the EU-Vietnam Free Trade Agreement (FTA) is also notable, because it includes the design of the new investment court mechanism.⁹⁶ Therefore, Vietnam has become a test case for the new dispute settlement mechanism between the government and foreign investors.

One main feature of the EU model is the formation of an independent court to replace arbitration panels. For example, the investor-state dispute settlement mechanism provided in the Canada-EU Comprehensive Economic and Trade Agreement (CETA) also has established a Tribunal, and the members of which will be appointed by an EU-Canada Joint Committee.⁹⁷

The unique feature of this “fundamental” reform is that the mechanism for appointing judges means deprivation of the parties’ previous right to choose arbitrators. This is also where the permanent arbitral court model gains its legitimacy. Since the permanent arrangement can avoid the arbitrary interpretation of the *ad-hoc* arbitral tribunal over public policies of the EU and its member countries, thereby realizing the “re-politicization” of investor-state disputes to some extent. This host-centered permanent court model is still at the exploratory stage. However, some scholars believe that this will “make the international investment system more democratic”, thereby ensuring that “compared to the current arbitration system, [it is] more independent and fairer.”⁹⁸

Another point standing out is that EU’s plan has emphasized the right to regulate by the host government. Existing criticism points out that Investment treaty arbitration institutionalizes favoring investors, which leads to public suspicion and distrust towards the entire International Investment Arbitration mechanism. EU’s ISDS reform proposal pays more attention to protecting the regulatory power of the host country, and correspondingly, it restricts the autonomy of investors to a certain extent. For example, the Transatlantic Trade and Investment Partnership (TTIP) explicitly includes the host country’s regulatory power clause for the first time, clarifying that the state’s regulatory rights over public interest issues should be fully reserved, and investment protection clauses should not be interpreted as restricting the government’s commitment to change the legal framework. One of the most notable developments is that under the ICS, the right to select judges from the court of first instance and

⁹³ See Lisa Diependaele & Ferdi De Ville et al., *Assessing the Normative Legitimacy of Investment Arbitration: The EU’s Investment Court System*, 24 New Political Economy 37, 61 (2019).

⁹⁴ See Thomas Dietz & Marius Dotzauer, et al., *The Legitimacy Crisis of Investor-State Arbitration and the New EU Investment Court system*, 26 Review of International Political Economy 749, 772 (2019).

⁹⁵ See supra note 94, at p.770.

⁹⁶ See *Guide to the EU - Vietnam Trade and Investment Agreement*, https://eeas.europa.eu/sites/eeas/files/eu_fta_guide_final.pdf (accessed on July 6, 2020).

⁹⁷ See *Investment Provisions in the EU-Canada free trade agreement (CETA)*, http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf (accessed on July 1, 2020).

⁹⁸ See Robert W. Schwieder, *TTIP and the Investment Court System: A New (and Improved?) Paradigm for Investor-State Adjudication*, 55 Columbia journal of transnational law 178, 227 (2016).

the court of appeal belongs to the signatory states to the treaty, and the investors no longer enjoy this right.

(c) Analysis over the US-EU Proposals

The criticism of the ISDS has origins in the friction with principles of good governance, i.e. transparency, rule of law, participation and the responses to this criticism could be framed within the same value system. Drawing on the global governance framework not only provides us with another perspective to rethink all these practices and plans a response to these criticisms against ISDS, but also offers guiding principles for its further development.

Firstly, in the EU's permanent arbitral forum model, proposals on transparency and third-party participation of arbitration procedures are similar to that of the U.S. proposal. This requirement of democratic legitimacy will increase the acceptance of both parties to the dispute, and the citizens in the host state.

Secondly, the debates over the qualification of arbitrators, the set-up of an independent forum, even a multinational investment court, are the responses to the requirements of accountability. As said earlier, the investment arbitral institutions are ad-hoc, that is, there is a high possibility of inconsistency among the interpretations and positions of arbitrators.⁹⁹

Thirdly, to eliminate the conflicts of interests, there is a need to avoid assumption of dual roles by one individual-as an arbitrator in one case and as an advocate in another, to ensure that he/she can perform adjudication independently. Recent investment treaties have increasingly strengthened the rules on arbitrators' professional qualifications, information disclosure, conflicts of interest, codes of ethics and other rules.¹⁰⁰ Under the US model, the investors retain the autonomy to choose arbitrators, and put emphasis on confidentiality and efficiency. On the other hand, with a view to ensure regulatory space in public interest and retain state control over the ISDS system, EU proposed to establish ICS with a stable list of judges who are responsible for interpretations of vague provisions.

The above stated are the endeavors of the U.S. and the EU to ensure that the ISDS mechanism could strike a balance between investment facilitation and protection of the host's right to regulate, only with different emphasis and approaches. For the U.S., due to the concerns over transparency issue, enhancement of transparency has become the main strategy while the EU has a more fundamental reform plan with establishing a separate investment court.

The aim of the ISDS reform and normative change is not to restrict investment protection and investment freedom, or strengthen government intervention, but to reflect a balanced development trend. Although as the above analysis shows, both ISDS reform options have their limits. As far as the transparency issue is concerned, "friends of the court" in some cases may request many additional rights, such as access to all documents and participation in the entire arbitration hearing, potentially leading to many negative outcomes. Since most international investment cases involve public interests of the host country, releasing relevant data and materials will inevitably have a major impact on the host country, not to mention, the exposure of important decision-making information of the country's political, economic, and social development. Moreover, the intervention of "friends of the court" will increase the costs of the parties in arbitration cases, reduce the efficiency of the cases, and burden the arbitration tribunal with more workload, thus leading to the disappearance of the advantages of arbitration over litigation.

In view of the potential conflicts of interest among arbitrators, which may affect their independence,

⁹⁹ See supra note 93, at p.40.

¹⁰⁰ See supra note 61, at p.1599.

neutrality and impartiality during arbitration, the EU has proposed to replace the ISDS arbitrators with fixed term judges, since judges have no incentive to compromise their decision-making to then be appointed again in the future.¹⁰¹ However, there are also built-in doubts and inherent problems in the design of the ICS, most notably the possibility that its judges would be beholden to the state's interests. As mentioned above, the protection of the regulatory power of the host country is one of the most important topics, but there is no consensus to define the scope of this regulatory power. As each country has different economic, political and social conditions, it is impossible to enumerate what constitutes "public health and safety" and "public morality" in an exhaustive manner. In the context of the ICS, it will depend on the judge's discretion. Facing burdensome costs of possible compensation, the parties, however, cannot choose the judges, but are subject to their final decisions. Additionally, even with the establishment of a permanent investment court, the validity of previous awards conflicting with each other cannot be decided in a decisive manner.

Clearly, the United States and the European Union have different understanding towards the ISDS reform. For one thing, the U.S. and EU differ on the nature of the International Investment Arbitration mechanism. The ISDS reform, in the eyes of the U.S., is of imperative to be carried out within the framework of neoliberal international investment legal system with a shift to the embedded liberal paradigm. Investment protection and facilitation is still the top priority. This is backed by the reason that the U.S. has occupied a leading position in the global economy as the largest investor and the largest recipient of Foreign Direct Investment (FDI) with an aim to establish an open and rules-based system that has positive net benefits for the United States and foreign investors.¹⁰² The U.S.'s direct investment position abroad, or cumulative level of investment, increased from \$5.80 trillion at the end of 2018 to \$158.6 billion to \$5.96 trillion by the end of 2019, according to statistics released by the Bureau of Economic Analysis (BEA).¹⁰³ It is observable that the U.S. government has been taking active measures to facilitate and promote investment, believing the investment activities are prominent for economic growth. Accordingly, it has focused on protection of investors' rights and interests from change of investment environment.

Compared to the investor-centered reform, EU tends to emphasize on maintaining sovereignty and protection of the host state's "regulatory space" as the ISDS has more features of public law as most of the current international investment disputes are over public policies.

EU's position is backed by historical and social reasons. After the 1999 financial crisis, the EU member states such as Belgium, Greece, and Cyprus wherein investors were facing challenges of fiscal policy adjustments. The European Commission was forced to formulate specific policies to avoid public policies of member states becoming the targets of the ISDS. Besides, Germany and France expressed strong opposition to the inclusion of the ISDS clause,¹⁰⁴ because they believe that the ISDS clause will only improperly limit the right of their own governments' to regulate the public interest.¹⁰⁵ Finally, the European Parliament and the European Commission decided to keep the investment arbitration mechanism but to reform it substantially, by strictly defining the qualification and term of arbitrators and fixing the list of arbitrators. This is the reason why EU's current ISDS reform focuses more on the

¹⁰¹ See supra note 94, at p.750.

¹⁰² See James K. Jackson, *U.S. Direct Investment Abroad: Trends and Current Issues*, Congressional Research Service, <https://fas.org/sgp/crs/misc/RS21118.pdf> (accessed on July 6, 2020).

¹⁰³ Direct Investment by Country and Industry, 2019, at <https://www.bea.gov/data/intl-trade-investment/direct-investment-country-and-industry> (accessed on July 6, 2020).

¹⁰⁴ Cécile Barbière, translated by Samuel White, *France and Germany to form united front against ISDS*, <https://www.euractiv.com/section/trade-society/news/france-and-germany-to-form-united-front-against-isds/> (accessed on July 6, 2020).

¹⁰⁵ See Erik Voeten, *Populism and backlashes against international courts*, Perspectives on Politics, <https://doi.org/10.1017/S1537592719000975> (accessed on August 6, 2020).

goals of protecting the environment, health, labor rights and sustainable development. In other words, safeguarding sovereign public policy space of host countries is EU's main consideration at the current stage.

Furthermore, the different positions of the US and EU have displayed the struggle for leadership in the field of global investment governance reform. Responding to the prolonged legitimacy crisis faced by the ISDS mechanism is the direct basis for the proposal of ICS. However, its implication is more than problem-solving. The world today is in a critical stage of reshaping the international investment mechanism. Emerging powers have become an important force that promote the adjustment of the international investment economic and trade, and even political patterns. Against this background, traditional capital exporting countries and regions once dominated by the development of international investment rules, are making use of the ISDS reform to maintain their leading role. The European Commission has stated that the ICS advocated in the TTIP proposed text will be used as a model for subsequent bilateral investment agreements and free trade agreements, including all the agreements with Asia. Once the ICS is established, it will inevitably have a significant impact upon the Asian countries.¹⁰⁶

At the same time, the competing proposals to the ISDS reform could thus be interpreted as endeavors to expand the leading state's or region's influence, both economically and politically. Although global governance is in full swing, the state actors continue to occupy a strong place. Their roles may be different, but cannot be overlooked. On the contrary, global governance strengthens both visible and invisible functions and powers of states. In this sense, to fill the legitimate gap of the ISDS system under the guidance of good governance principles, what is more important is to adjust the power structure of international society and build the consensus among various governance actors.

5. Conclusion

The world today is undergoing profound change. The issues that transcend traditional national borders are now dealt with by various state and non-state actors who are simultaneously interacting and pursuing their objectives span multiple fields, countries, and scales—sub-national, national, regional and global.¹⁰⁷ Global governance, according to this view, was “less state-centric and more the sum of crazy-quilt patterns among unlike, dispersed, overlapping, and contradictory” political actors.¹⁰⁸ In other words, global governance is characterized by an enormous variety of actors, policies, values, and interests. However, due to some actors, such as an institution or a sub-national actor, falling short at fulfilling key principles of democracy,¹⁰⁹ “governance deficit” is seen.

For a long time, the ISDS has been accused of inconsistent rulings, favoring the interests of investors, ignoring the public interests of the host states, the questionable impartiality of arbitrators, or the lack of transparency. The backlash against some arbitral awards reflect that the current mechanism is structurally unable to effectively deal with the risks, especially social risks, that are brought by international investment. This kind of criticism against investment arbitration leads to a widespread call for reforms, and more importantly, the improvement of good governance of investment disputes.

¹⁰⁶ See Umair Hafeez Ghori, *The International Investment Court System: The Way Forward for Asia?* 21 International Trade and Business Law Review 205, 220 (2018).

¹⁰⁷ See Tanja A. Börzel & Thomas Risse, *Governance without a State: Can It Work?* 4 Regulation & Governance 113, 134 (2010).

¹⁰⁸ See James N. Rosenau & J. P. Singh, *Information Technologies and Global Politics: The Changing Scope of Power and Governance*, State University of New York Press, p.285 (2002).

¹⁰⁹ See Gabriel Siles-Brügge, *Transatlantic investor protection as a threat to democracy: The potency and limits of an emotive frame*, 30 Cambridge Review of International Affairs 464, 488 (2017).

Given the impact on the future conduct of governments, the ISDS could be analyzed as a form of governance. It is the essence of “good governance” required to balance the public interests of the host country and the private interests of foreign investors. The participation of the public entities and NGOs in the arbitration procedures of international investment disputes is necessary to restrict the excessive expansion of private interests of foreign investors and protect the public interests of the host country, enhance the societal participation, expand the influence of non-state actors, and encourage transparency. Moreover, the “good governance” standard in “global governance” also prevents the international arbitral tribunal from making decisions inconsistently or arbitrarily. That is the reason why reforms by EU, emphasize on replacing arbitral tribunals with an independent ICS to ensure accountability and consistency.

Global governance is “a dynamic process in which legal, political and economic arrangements unleash interests, change the balance of force, and lead to further reinvention of the governance scheme itself.”¹¹⁰ To achieve an ISDS system that serves better participation, transparency, accountability, inclusiveness, rule of law, and other principles of good governance, it is imperative to consider the ISDS as a mechanism to exercise public governance function and a route to resolve commercial-nature disputes. As David Kennedy says, our world is an “ongoing project of regulation and management” as the actual global governance regime is never short of power-relations.¹¹¹ The future of the ISDS reform depends on the perception of the leading actors, mostly the U.S. and the EU, and on the objectives, functions, and interests of the ISDS and even the international investment regimes. The question of adopting the U.S. model focusing on transparency enhancement under the existing framework or the EU proposal to “re-politicize” the investment dispute rests with the power structure. In this sense, closing the legitimacy gap of this “depoliticized” mechanism still cannot decouple from politicization. With regard to global governance, it is not enough to just pay attention to authority diffusion, instead, there is a need to explore ways to improve the political structure of global governance, in which the leading countries’ pursuit interests could collaborate with other governance actors.

¹¹⁰ See supra note 7, at p.832.

¹¹¹ See Michael Barnett & Raymond Duvall ed., *Power in global governance*, Cambridge University Press, pp.1-32 (2005).

Tax Information Exchange and China's Countermeasures

Tianjian Ouyang¹

Abstract: In the context of global economic integration, the Tax Information Exchange system has developed gradually; especially the establishment of the automatic exchange mechanism for tax information is a milestone in international tax cooperation. In this development process, the OECD, the EU and the US troika are the main driving forces. The core connotation lies in the exchange of financial account information. In the era of big data, massive intelligence is automatically exchanged, and data collection is used to find the collection and management clues which had become the main mode of exchange. For China, as a responsible big country, is actively participating in the Tax Information Exchange system and perfecting the domestic laws. However, we must be soberly aware of the hidden concerns behind the Tax Information Exchange system for China's status of being a developing country has not yet changed. Therefore, it is necessary to recognize the dual status of the investment country and the country under investment in China, and actively participate in the formulation of rules and enhance international the right to speak, and through the top-level design, to prevent the "capital escape" caused by the exchange of information, but also to prevent unfair tax treatment for the enterprises going abroad because of the exchange of information, and actively strengthen the revision of domestic laws to ensure the two Connect.

Key words: Tax Information Exchange; International Development; China's Response; Development Path.

For a long time, the widespread tax havens have caused the phenomenon of changing the status of tax residents to evade tax obligations, which has provoked challenges for tax authorities in various countries. In this "cat and mouse game" of tax avoidance and anti-avoidance, the tax authorities of various countries have gradually gained the upper hand with the breakthrough of Tax Information Exchange.² At the G20 Hangzhou Summit in 2016, the leaders of participating countries called in the communiqué that "all relevant countries that have not yet committed to adopting the standards for automatic exchange of tax information, including all financial centers and jurisdictions, should make commitments as soon as possible that standards for automatic exchange of information should be implemented and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters should be signed and ratified no later than 2018".³ This appeal acted as a catalyst in the development of tax information exchange, worldwide.⁴ For example, Article 5 of the Convention states that, "At the request of the applicant State, the requested State shall provide the applicant State with any information referred to in Article 4 which concerns particular persons or transactions." This article aims to analyze the necessity of Tax Information Exchange and the trend of world tax information exchange, to illustrate the challenges faced by China and the countermeasures under this wave based on China's practice, and to revamp China's future role in the international Tax Information Exchange genealogy.

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² See Terr Leonard B. etc, *Resolving International Tax Disputes: APAs, Mutual Agreement Procedures, and Arbitration*, 29 Tax Management International Journal 24, 55 (2012).

³ See Yue Peng, *Personal Data Protection Issues on the Automatic Exchange of Tax Information*, 36 Science of Law 156, 168 (2017).

⁴ See Renren Zhou, *The Logic of Reform*, CITIC Press, p.30 (2013).

1. Institutional Implications of Tax Information Exchange

As early as a hundred years ago, scholars made speculations about global Tax Information Exchange.⁵ The reason why Tax Information Exchange has been a focus in international tax cooperation since the beginning of the century is that it is an important way to effectively curb tax avoidance.

(a) Institutional Arbitrage: Negative Effects of Information Isolation

Statistics show that in 2016 alone, OECD countries lost \$52.6 billion in tax avoidance and arbitrage.⁶ This has had a great impact on all major economies in the world.⁷ However, tax competition and institutional arbitrage are unavoidable. This is fundamentally caused by the inconsistency of the tax system. Taxation is the externalization of a country's fiscal and legal system and even ideology. As explained by the American economist Douglass North, international taxation consists of a multi-layer structure from recessive to explicit,⁸ each layer of taxation is a reflection of the comprehensive national conditions.⁹ In other words, as long as different countries have inconsistency or inconsistencies in the layers, there will be gaps between systems and arbitrage space will be created for international tax avoidance. Although international organizations such as the Organization for Economic Co-operation and Development (OECD) have always called for coordinated reform and flat development of the tax system in countries around the world. However, these institutional differences, rooted in the political and economic system of a country, cannot be eliminated. Tax havens, therefore, using the lowland effect in their taxation system, attracts a large number of taxpayers to evade their tax obligations by means of changing the status of tax residents.

"Sunlight is the powerful disinfectant". Tax Information Exchange can be an effective prescription for eliminating harmful international tax competition and cracking down these tax havens. In the European Union's summary of certain features of tax havens, it is specifically mentioned that "lack of effective exchange of relevant information with other governments on their taxpayers, minimal or no disclosure on financial dealings and ownership of assets".¹⁰ Thus, after the tax authorities of a country have fully grasped the information that taxpayers of the country are engaged in commercial activities in tax havens, they can use domestic laws to recover taxes from these taxpayers. Under global economic integration drive, it is evidently very expensive to collect tax information by applying the strength of one country alone. The core of Tax Information Exchange is to enable tax officials of various countries to understand and verify the tax-related activities of taxpayers and to lay down the scope of these activities in time, through an effective Tax Information Exchange network.¹¹ The establishment of the Tax Information Exchange mechanism would enable tax departments to effectively control the economic behavior

⁵ See Vito Tanzi, *Globalization, Technological Development, and the Work of Fiscal Termites*, 26 Brook International Law Review 1261, 1284 (2015).

⁶ See OECD, *Consumption Tax Trend 2016*, OECD Publishing, p.19 (2007).

⁷ See Green Robert A, *International tax dispute resolution: Breaking the impasse*, 27 International Tax Review 58, 59 (2012).

⁸ See Douglass C. North, *Institutions*, 17 The Journal of Economic Perspectives 30, 73 (1991).

⁹ See Michelle Bertolini & Pamela Weaver, *Mandatory Arbitration within Tax Treaties: A Need for a Coherent International Standard*, 35 The ATA Journal 131, 212 (2013).

¹⁰ See Listing of tax havens by the EU, <http://www.europarl.europa.eu/cmsdata/147404/7%20-%2001%20EPRS-Briefing-621872-Listing-tax-havens-by-the-EU-FINAL.PDF> (accessed on October 31, 2018).

¹¹ See Huishu Fu, *Study of Legal Issues on Tax Information Exchange System*, Masses' Publishing House, p.31 (2011).

of domestic taxpayers and tear the mask off tax avoidance.

(b) Cooperation Trend: How Can Tax Information Exchange Achieve World

Consensus

In order to eliminate harmful tax competition, tax information work has gradually moved from the sphere of isolation to cooperation. In fact, Tax Information Exchange has many natural advantages in international tax cooperation.¹² Firstly, Tax Information Exchange is a tax cooperation based on sovereign respect. Under the trend of world economic integration, the tax jurisdiction of each country is gradually expanding to a point of conflicts and taxation is related to the sovereignty of a country. For a long period, there have been various arguments in international tax cooperation about the countries unwillingness to abandon the taxation sovereignty and tax benefits, and such conflicts often cannot be resolved once intensified. Taking the transfer pricing dispute as an example, 67% of cases have been completely resolved, 8% of cases have been partially resolved, and 25% of cases haven't been resolved at all.¹³ The Tax Information Exchange is based on the equality of the exchange countries, and after tax authorities of a country have obtained corresponding information, they could resolve international disputes by turning them into domestic procedures, thus reducing the possibility of invading tax sovereignty.

Secondly, the exchange of tax information has a legitimate basis in international laws. This is because the exchange of tax information between countries and between international organizations is in conformity with the principle of reciprocity in international laws. After years of appeal by international organizations such as the OECD, tax agreements between countries have ultimately included information exchange articles, based on which upgrading the tax information exchange system is justified.

Thirdly, in the era of big data, the establishment of an efficient comparison mechanism for Tax Information Exchange cannot be surpassed by other tax cooperation.¹⁴ Tax information exchange has a rather large base. It can provide all data to meet the requirements without leaving a dead end. A country's tax authorities can quickly then find the key points of auditing from this data under modern information comparison technology. The efficiency of which cannot be compared to the traditional tax cooperation, and thus, it is favored by tax authorities of the countries.

(c) Practical Demands: Realistic Basis for China to Join the Tax Information

Exchange System

By 2019, more than 100 countries have joined the Common Reporting Standard (CRS). Even the tax havens like the Caymans have gradually begun to sign bilateral tax treaties with countries around the world and join the tax exchange system. As far as China is concerned, the curtain of a new round of fiscal and tax system reform is slowly opening.¹⁵ The reform of the tax collection and administration system,

¹² See Sharon, C. A. *Treaty arbitration: Where art thou?* 3 Tax Management International Journal 1, 84 (2016).

¹³ See supra note 9, at p.230.

¹⁴ See Julien Chaisse, *Invest-State Arbitration in International Tax Dispute Resolution*, 24 Virginia Tax Review 33, 52 (2016).

¹⁵ See Atanaska Filipova Slancheva, *Automatic exchange of tax information: initiation, implementation and guidelines*

especially the reform of the international tax cooperation system, undoubtedly plays an essential part in this round of reform. Compared to the beginning of reform and opening up, China's status in the international tax structure has peacefully changed from a single capital importing country to a complex capital importing and exporting country.¹⁶ On one hand, China still needs supports from foreign investment in many areas, but the structure of foreign investment is becoming more and more complicated.¹⁷ "Many offshore investment models are coming to China to invest in low-tax-rate areas or tax havens have made real investors' information confusing and greatly increased the difficulty of China's tax authorities in conducting foreign-related tax collection and administration."¹⁸ On the other hand, the in-depth pursuit of the "Belt and Road" Initiative and the further advancement of China's new era of reform and opening up have encouraged a large number of Chinese-funded enterprises to "go global" and make investment, and domestic capital is fully distributed globally.¹⁹ Therefore, it is not uncommon for Chinese-funded enterprises to use affiliated companies to change the status of taxpayers and to transfer profits globally in order to avoid China's tax obligations. This is particularly evident in enterprise income tax. The general enterprise income tax rate in China is 25%, which is at the upper middle level in the world. Taking the countries along the "Belt and Road" as an example, the enterprise income tax rates in most of the countries are lower than that in China. The lowest, for example, Turkmenistan, is only 8%.²⁰

Table 1: Enterprise Income Tax Rate Countries along the Belt and Road

Enterprise Income Tax Rate	Countries
≤10%	8% Turkmenistan 9% Montenegro 10% Bosnia and Herzegovina; Mongolia; Qatar; Kyrgyzstan; Macedonia; Bulgaria; Hungary; Syria
10%~15%	12% Moldova 13% Tajikistan 15% Albania; Iraq; Palestine; Lebanon; Kuwait; Georgia; Serbia; Latvia; Lithuania; Oman; Jordan
15%~20%	16% Romania 17% Singapore 18% Belarus; Ukraine; Croatia 18.5% Brunei 19% Hungary; Poland; Czech; Slovenia 20% Yemen; Thailand; Turkey; Saudi Arabia; Kazakhstan; Armenian; Russia; Cambodia; Vietnam; Uzbekistan; Estonia

in *Bulgarian context*, 33 Problems and Perspectives in Management 851, 928 (2017).

¹⁶ See Mario Zuger, *Arbitration under Tax Treaties: Improving Legal Protection in International Tax Law*, IBFD, p.13 (2003).

¹⁷ See Yang Gao, *Achievements and challenges of tax information exchange in China*, 24 International Taxation 11, 17 (2014).

¹⁸ See Dongmei Qiu, *Latest Trend of Automatic Exchange of Tax Information and China's Response*, 38 Science of Law 45, 63 (2017).

¹⁹ See Ministry of Finance, China's non-financial outbound direct investment in 4,309 overseas companies in 153 countries and regions worldwide amounted to US \$ 74.09 billion in January - August period of 2018, up by 7.8% year on year, *China's outbound investment and cooperation from January to August in 2018*, <http://www.mofcom.gov.cn/article/i/jyj/1/201809/20180902787042.shtml> (accessed on November 3, 2018).

²⁰ See Yang Xiao, *The development and response of tax transparency and information exchange*, 24 International Taxation 35, 40 (2017).

20%~25%	21% Slovakia 22% Azerbaijan 22.5% Egypt 24% Malaysia; Laos 25% Indonesia; Nepal; Myanmar; Iran; Israel
25%~30%	28% Sri Lanka 30% Bhutan; Philippines; India; Pakistan
≥30%	35% Bengal 46% Bahrain

According to China's tax law, under the "deduction according to countries but not items" credit policy, an "going global" enterprise still has to make up for the difference between domestic and foreign taxation to China's tax authorities. However, if there is no Tax Information Exchange and taxpayers fail to report on their own initiative, it will be difficult for China's tax authorities to fully master their transactions.

At the same time, some high-net-worth individuals have evaded China's tax obligations by transferring assets to tax havens through trusts and funds, which has eroded China's tax base and severely damaged China's tax sovereignty. However, traditional bilateral tax treaties are complex and uncertain and thus, the vigorous promotion of Tax Information Exchange will help China's tax authorities grasp more taxation clues. It is not only a "following action" of China's participation in international tax cooperation, but a "timely need" of China's economic development. Joining the scheme dominated by western world does have a few negative effects on China. The way to actively resolve this problem will be discussed in detail below.²¹

2. Evolution and Development of Tax Information Exchange System

(a) The OECD, the US and the EU are the Main Driving Forces

In recent years, the main clue of International Tax Cooperation has gradually shifted from preventing double taxation to anti-avoidance cooperation.²² Tax Information Exchange is a vital limb for the anti-tax avoidance cooperation. In the development process, the OECD, the US and the EU are the main driving forces. One of the most important contributions of the OECD to the Tax Information Exchange is that it has promoted the expansion of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The convention was originally formulated by the European Commission and in 1988 the OECD was only open to member countries of these two organizations. After the 2008 financial crisis, however, leaders of many countries became more aware of the importance of Tax Information Exchange.²³ Therefore, at the G20 summit in 2009, with the strong promotion of the OECD and G20 leaders, the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, after the amendment, was open to all countries. As of October 29, 2018, 126 countries, including China, have

²¹ See Yuxi He, *New trend of tax treaties in China*, Science, 21 Technology and Economic Cooperation 31, 36 (2018).

²² See R Eccleston, *Revolution or evolution: sovereignty, the financial crisis and the governance of international taxation*, 50 Journal of Applied Law and Policy 517, 586 (2013).

²³ See David M. Kemme & Bhavik Parikh et., *Tax Havens, Tax Evasion and Tax Information Exchange Agreements in the OECD*, 21 European Financial Management 230, 242 (2017).

signed the convention,²⁴ which covers the world's major economies. Thus, tax havens have become the legal basis for further promoting the exchange of tax information. The convention requires its member-states to automatically provide tax information to the other party in accordance with the Common Reporting Standard which is what we often call the CRS system.²⁵ Although China is not a member of the OECD, but as its tax observer state, China is to a large extent affected by OECD's tax policy.

In addition to the Tax Information Exchange system advocated by the OECD, the advent of the *Foreign Account Tax Compliance Act* (FATCA) in the United States has also facilitated International Tax Information Exchange. The United States is not yet a member of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, but the FATCA passed by the US government in 2010 and formally implemented in 2014, has played a vital role in promoting the Tax Information Exchange. The FATCA requires the contracting states to sign an agreement with the United States to provide the US with timely information on the US account income and tax information related to asset information in overseas financial institutions in order to safeguard the US tax sovereignty. Many countries have gradually realized the value of cooperation with the United States, ranging from obtaining tax fraud information, grasping immigration trends, controlling capital flight, and cracking down on economic crimes. Therefore, they have started cooperating with the United States.²⁶ But the biggest problem of FATCA is that the information it provides is one-way.²⁷ The US government is not obliged to provide tax information to counterparts on a peer-to-peer basis. However, other governments could use the information of their domestic residents' financial accounts opened in the US; and the FATCA clearly states that a formal 30% withholding tax will be imposed on investors from countries outside the FATCA contracting states. Under the pressure, many developing countries choose to sign the FATCA agreement with the United States despite the constitutional risks.²⁸

Besides, the European Union also vigorously promotes Tax Information Exchange. In the Directive on Administrative Cooperation, amended on January 1, 2015, the Article 8 states automatic exchange of tax information is formally implemented.²⁹ While the Savings Tax Directive promulgated by the European Commission in 2005, contains the content of Tax Information Exchange, the Directive on Administrative Cooperation expands the exchange scope to various financial accounts and becomes the agreement with the most extensive range on global tax information exchange that even exceeds the scope of the US FATCA. Of course, the shortcomings are obvious. Irrespective of the Directive on Administrative Cooperation or the Savings Tax Directive, the scope of application is limited to the EU and it is not effective for European tax havens that are not members of the EU, such as Switzerland, Morocco, San Marino, Liechtenstein, and Andorra. This is also the important reason that the EU actively cooperates with the OECD to promote the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*.³⁰

The developments of the past decade have formed a situation of information exchange,³¹ jointly promoted by the EU, the US and the OECD. Coupled with the Panama Papers and the Liechtenstein

²⁴ https://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf (accessed on November 6, 2018).

²⁵ See Sofia Stavridi, *FATCA and CRS: The End of an Era*, 27 Int'l Tax Rev 30, 45 (2016).

²⁶ See Lina Ye, *Evolution and Refection on the Financial Institution's Information Disclosure and Exchange System*, 21 Taxation Research 120, 122 (2016).

²⁷ See Maya Ganguly, *Tribunals and taxation: an investigation of arbitration in recent US tax conventions*, 29 Wisconsin International Law Journal 735, 772 (2012).

²⁸ See Jose Rubens Scharlack, *FATCA and CRS Compliance: Brazil's Trend towards Automatic Exchange of Information*, 12 US-China Law Review 665, 675 (2015).

²⁹ See Alec Sweet Stone, *The Evolution of International Arbitration*, Oxford Press, p.86 (2016).

³⁰ See Mariano Giralt, *The CRS and Its Impact on the Financial Services Industry*, 9 Int'l Tax Rev 26, 29 (2015).

³¹ See Lixin Yuan & Yanrong Huo, *Research on anti-tax avoidance of high net worth people in China*, 29 International Taxation 59, 64 (2020).

LGT Bank information leakage incidents, countries around the world discover that a large number of hidden transactions still exist under powerful tax collection and administration. The major economies in the world thus reach a consensus on the exchange of tax information.

(b) Financial Account Exchange as the Focus

In Tax Information Exchange, what exactly is “information” or what type of “information” is to exchange, is a question that must be considered by rule makers. If we collect and exchange relevant information for each transaction, it will inevitably increase the workload of tax authorities. Therefore, we must control it from the source. The non-resident taxpayers’ financial accounts are gathering centers of information. According to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, the financial institution of a contracting state is obliged to collect information on financial accounts opened in the institution by the residents of the other party in the jurisdiction, and submits it to the tax authority of the jurisdiction where the financial institution is located. After obtaining the information, the tax authority will provide the information to each residence country where the account holders are located as required by encryption in a specific format. The tax authority of the receiving party decrypts and matches the information to obtain an understanding of the financial assets of its residents overseas, which strengthens cross-border tax supervision at one time and improves taxpayer compliance.³² It is also because financial information exchange is the core of Tax Information Exchange therefore; financial institutions become the main participants in tax information exchange.

It should be emphasized that the term ‘financial institutions’ cannot be interpreted in a narrow sense. Except for traditional banks, according to the *Administrative Measures for the Due Diligence of Tax-Related Information on Non-resident Financial Accounts* the scope of financial institutions includes deposit institutions, custodian institutions, investment institutions, specific insurance institutions and their branches. These institutions often serve as custodians of taxpayers’ overseas funds. The founders of overseas accounts are often anonymous. They set up corporate partnerships or trusts in tax havens to open accounts in their name. In this case, tax authorities and financial institutions are required to identify these account holders.³³ They should determine whether their holders are positive or negative by adhering to the “substance over form” principle. If negative, the tax authorities and financial accounts need to penetrate the company and find out the actual controller behind and guarantee that the actual controller will not be left out.

(c) Automatic Exchange - the Main Procedural Principle

According to the definition of the OECD, “exchange of information” includes Exchange upon Request, Spontaneous Information Exchange and Automatic Exchange of Information.³⁴ The so-called Spontaneous Information Exchange refers to the exchange of information in which the tax authority of a country actively provide tax information obtained in the tax work and such information is considered to be beneficial to other countries to the other party in the contracting states. It is the information method that is readily agreed upon by countries in tax treaties, in the traditional tax cooperation model. Also, Exchange of Information on Request is commonly seen in traditional Tax Information Exchange

³² See supra note 18, at p.63.

³³ See supra note 30, at p.29.

³⁴ See OECD, *Automatic Exchange of Information: What it is, How it Works, Benefits, What Remain to be Done*, OECD Press, p.5 (2017).

methods. It has a targeted feature: often, tax authorities of a country obtain corresponding clues in investigating specific tax cases and follow them to seek help from other countries.³⁵ As the transaction structure becomes more complex, tax authorities in various countries cannot find effective clues in time, so they opt for the Automatic Exchange of Information (AEOI) for taxation. The basic process of AEOI can be divided into seven steps: (1) Payer or paying agent collects information from the taxpayer and/or generates information itself; (2) Payer or paying agent report information to the tax authorities; (3) Tax authorities consolidate information by country of residence; (4) Information is encrypted and bundles are sent to residence country tax authorities; (5) Information is received and decrypted; (6) Residence country feeds relevant information into an automatic or mutual matching process; (7) Residence country analyses the results and takes compliance action as appropriate. The biggest difference between Exchange upon Request and Automatic Exchange of Information is that the former is a passive request after a clue is found, while the latter is to initiatively find clues in a mass of information that meet the condition. The characteristics of AEOI including bundle exchange, strict schedule and effectiveness which have greatly improved the efficiency of tax inspection and made it the mainstream of the current Tax Information Exchange system.

3. China's Response and Hidden Concerns in Tax Information Exchange

(a) Macro-Cooperation: China is an Active Participant in Tax Information Exchange

As mentioned earlier, China is an emerging investment country and a traditional country under investment and Tax Information Exchange is an important part of China's current fiscal and tax system reform. As a responsible big country, China has long been the main promoter and participant of Tax Information Exchange. Soon after China and Japan signed the first bilateral tax agreement in 1983, China signed bilateral tax agreements with 106 countries in the world by October 2018. These agreements all include information exchange articles and provisions that have rarely been used in practice in the past decades.

By applying the rule of law in fiscal and tax work and the progress of international tax cooperation, China has gradually changed the situation of passive acceptance in terms of International Tax Information Exchange and initiated cooperation requests since the beginning of the 21st century. Data show that in the 1990s, China mainly carried out Special Tax Information Exchange and checked about 80 Special Information requests from over ten countries like the US and the UK. The requests for special information exchange submitted to foreign countries were limited to 6 countries including Japan and the US, and the annual tax in arrears paid back was only several million Yuan.³⁶ By 2012, China had used more than 400 pieces of foreign Special Information and 85 pieces of Spontaneous Information to directly inspect and make up for tax in arrears (including late fees and fines), which exceeded 1 billion Yuan for the first time, reaching 1.08 billion Yuan with the largest case valuing 190 million Yuan.³⁷ China has not only vigorously promoted the automatic exchange of international tax information, but actively participated in it since it was recently promoted worldwide.

On July 1, 2015, the Standing Committee of the National People's Congress officially ratified China's accession to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and implemented the same on January 1, 2017. In December 2015, China signed the Multilateral

³⁵ See supra note 17, at p.17.

³⁶ See Ciqiang Li, *On the Innovation and Legislative Improvement of the Tax Collection and Administration System in the Shanghai Free Trade Zone*, 26 *Taxation and Economy* 81, 87 (2016).

³⁷ See supra note 35, at p.17.

Competent Authority Agreement on Automatic Exchange of Financial Account Information. Approved by the State Council, the new standard for Automatic Exchange of Tax Information has been implemented from September 2018 between China and other contracting states.³⁸ In order to ensure the implementation of the policy, six departments, including the State Administration of Taxation, issued the Administrative Measures for the Due Diligence of Tax-Related Information on Non-resident Financial Accounts on May 9, 2017 in order to help implement international obligations of automatic exchange of information.

(b) Mechanism Establishment: Connect with Domestic Laws under Fiscal and Tax

Reform

As we all know, the relationship between tax treaties and domestic legislation has long been complicated in international sphere of tax laws.³⁹ A basic principle is that in cases where the agreement is in conflict with the rules of domestic laws, the agreement should take precedence. However, facts often do the opposite. In the practice of international tax laws, it is not uncommon for a government to fail to fulfill its international commitments due to the contradiction between domestic laws and tax treaties. Many countries even use the provisions of domestic laws to overturn tax treaties.⁴⁰ Therefore, in the context of fiscal and tax system reform, China's legislators take the opportunity of reform to make certain amendments to domestic laws to ensure that they are in line with international laws. This would facilitate China to effectively fulfill the obligation of a big economy. Specifically, the amendments made in China's domestic laws are mainly reflected in the following aspects.

The first is the revision of the Individual Income Tax Law of the People's Republic of China in 2018, wherein the standard for resident taxpayers and non-resident taxpayers was modified to be in line with the international standard. In the Individual Income Tax Law of the People's Republic of China, the original "one-year standard" was replaced by the "183-day standard", that is, a person who has a residence or has lived in the People's Republic of China for at least 183 days can be considered a resident taxpayer and has unlimited tax liability in China. Prior to this revision of the law, only Argentina, Japan and China adopted the one-year standard, and Hong Kong, Switzerland and other tax havens adopted the standard of less than 183 days. Most of the remaining countries adhered to the 183-day standard. This revision clarifies the subject of international Tax Information Exchange, expands the scope of the subject of information exchange, and prevents some taxpayers from using the loopholes created in international standard by China's tax resident standard.

The second is the addition of a Taxpayer Code Assignment system during the revision of the *Individual Income Tax Law*. For Chinese citizens, the ID numbers are taxpayers' identification numbers, and for non-Chinese citizens, the tax authorities assign codes. This change lays the foundation for the full coverage of natural person taxpayers for Tax Information Exchange, and provides institutional guarantee for big data comparison. Following the official implementation of Automatic Exchange of Tax Information, a large amount of transaction information will be exchanged to China, which will require the big data comparison to match valuable information among them. The code assignment system for

³⁸ See Shaoying Chen, *The Principle of Tax Integrity and Innovation of the Tax Collection and Administration System--From the Perspective of China (Shanghai) Pilot Free Trade Zone*, 38 Journal of Liaoning University (Philosophy and Social Science Edition) 33, 36 (2016).

³⁹ See Fuqiang Zhang, *On the Improvement of the Legislation of the Presumption Right of Taxpayers' Honest Tax Payment*, 33 Academic Research 46, 52 (2011).

⁴⁰ See Brian J. Arnold & Michael J. McIntyre, *International Tax Primer*, Aspen Publishers, INC., p.170 (2004).

natural person taxpayers largely avoids the inefficiencies caused by manual comparison such as duplication of names. It is a collection and administration system adopted by developed countries. In fact, this reform has long been moved, it was put forward in 2015 when the Law of the People's Republic of China on the Administration of Tax Collection was revised.⁴¹ This will become an important basis for the Exchange of Tax Information.

The third is, a series of procedures to implement the specific obligations of International Tax Information Exchange formulated by the State Administration of Taxation of China considering China has always been an active participant in International Tax Information Exchange. For example, China formulated the Working Regulations for the International Exchange of Tax Intelligence (for Trial Implementation) (No.3 [2001] of the State Administration of Taxation) in 2001. Thereafter in 2006, China revised and improved the regulations in terms of the categories and scope of information exchange, confidentiality mechanism and management procedures.⁴² In view of the confidentiality issue, both taxpayers and the international community are paying close attention to during information exchange, China also promulgated the Rules on the Confidentiality of Tax Information Exchange in 2002 (Letter No. 931 [2002] of the State Administration of Taxation). In addition, a large number of departmental regulations have also been introduced in order to deal with the detail issues in the exchange of information. As for the international legislation, apart from bilateral tax treaties and multilateral conventions, the Chinese government has signed the special Tax Information Exchange Agreements (TIEA) with 20 tax havens including Bermuda, the Cayman Islands and Switzerland, and has signed the Arrangement on the Avoidance of Double Taxation with Hong Kong and Macao, which elaborates the rights and obligations in the process of information exchange and lays the foundation for conducting further cooperation in Tax Information Exchange. It is also beneficial for China to create the character of a great power of responsible.

(c) Hidden Concerns: Reflections on the Stance of Developing Countries

This paper contemplates China to be at a critical period of global information exchange, especially the automatic exchange. This paper aims to point out a few hidden concerns with regards to China's fully integrated information exchange system, that deserve further consideration.

(i) China should strengthen the power of making international rules

It is necessary to keep in mind China's status as a developing country as China fully participates in international tax cooperation and the automatic exchange of information. Firstly, it is evident that the promoters and the actual rule makers of the Automatic Exchange of Information mechanism are either developed countries or international organizations mainly composed of developed countries. Considering the Asia-Pacific region as an example, among 36 countries and regions, there are 20 developing countries, but only 7 of these developing countries have joined the Automatic Tax Information Exchange system. These 7 countries also include three G20 members of China, India and Indonesia. Clearly, developed and developing countries are not entirely consistent in their positions of international tax cooperation. The majority of developing countries lack "the right to speak" in the Tax Information Exchange system, however they cannot be independent of this system. In fact, it is not that developing

⁴¹ Article 8 of the Revised Draft of Law on the Administration of Tax Collection (Consultation Paper) states: "The state implements a uniform taxpayer identification number system."

⁴² See Jianwen Liu, *On the Development of the Shanghai Free Trade Zone Reform from the Perspective of the Rule of Law and Taxation*, 34 Legal Forum 48, 53 (2014).

countries do not need anti-tax avoidance.⁴³ On the contrary, developed countries have more severe anti-avoidance situation than developing countries, and they need more effective means to plug loopholes.⁴⁴ However, many developing countries are unable to catch the world trend in their domestic legal framework. Furthermore, they lack collection and administration capabilities as well as technical supports, which makes it equally difficult to go on or retreat, leading to the “escape” of foreign investment and affecting the domestic economy.⁴⁵ Although China has made remarkable achievements in economic development in recent years, China’s status as a developing country has not changed. We should see that our value in international tax governance is not that compatible with the value of developed countries and we must strive to build rules that are more suitable to China’s real interests.

(ii) Prevention of the “crowd out effect” after comprehensive implementation of the AEOI

A crowd-out effect may emerge after the formal implementation of the Automatic Information Exchange system. The crowd-out effect here is two-fold. As far as foreign-invested enterprises are concerned, the principal purpose of investing in China, Hong Kong and Macau, is to enjoy a lower tax rate. It goes without saying that Hong Kong and Macau are tax havens. The preferential tax policies set by many local governments in China have also become important factors that attract foreign investments. After the tax information is automatically exchanged, these foreign-funded enterprises will face the wave of paying tax in arrears set by their own tax authorities, thus leading to a “capital escape”. Whereas the high-net-worth people, usually choose to join the nationalities of tax havens, but they habitually reside and carry out daily business activities in China. In the past, China’s tax authorities were unaware of these people. However, once China’s tax authorities gather the information, these high-net-worth people may withdraw from our territory on a massive scale, completely depriving China of the opportunity to tax them. Furthermore, all other countries not participating in Tax Information Exchange have introduced “Citizenship and Residency by Investment Schemes” (CRIS). As long as taxpayers provide a certain amount of investment or financial support, the regional government will help them submit sufficient “evidence” to the financial institution to “prove” that the taxpayers are citizens or residents of the area and thereby they can escape their original tax resident status and tax obligations.⁴⁶

(iii) Increasing risk of unfair tax burden on enterprises going abroad

Accompanied by the comprehensive implementation of the “Belt and Road” Initiative and the construction of the Free Trade Zones, China has changed the situation of a traditional country under investment with a large number of companies going abroad to make investments. These overseas investment companies, which often set up their headquarters in China, are resident taxpayers in China and set up business entities overseas through a complicated or simplified structure. Multinational enterprises in operation often choose to collect taxes at a place where the tax rate is more favorable. The consolidated collection is generally an internal transaction which is called the “transfer pricing”. According to the Base erosion and profit shifting (BEPS) Action Plan, under the automatic information exchange system, it is necessary to submit a country-by-country report to the opposite country, that is, to

⁴³ See Tianyong Liu, *The Global Financial Account Tax Information Exchange Standard (CRS)*. 46 China Taxation 9, 11 (2019).

⁴⁴ See Kerrie Sadiq, Adrian Sawyer, *Developing Countries and the Automatic Exchange of Information Standard – A One-Size-Fits-All Solution*, 31 Austl. Tax F 99, 130 (2016).

⁴⁵ See supra note 38, at p.36.

⁴⁶ See Andres Knobel & Frederik Heitmüller, *Citizenship and Residency by Investment Schemes: Potential to avoid the Common Reporting Standard for Automatic Exchange of Information*, 7 Tax Justice Network 1, 15 (2018).

report the income, tax payment, the distribution of business activities and the list of its member entities of the enterprise group. The Multilateral Competent Authorities Agreement for the Automatic Exchange of Country-by-Country Reports (“CbC MCAA”) states that the information from country-by-country reports cannot be used to replace transfer pricing assessments for individual transactions. Thereafter, the prices based on complete functional analysis and comparability analysis, in addition to the information, is not sufficient in itself to form a solid basis to determine whether the pricing is reasonable or not. However, many countries can first conduct in-depth inspections on this basis, and then adjust the groups’ transaction structure to reduce the reasonable tax-saving space of enterprises and increase the tax burden. In other words, the disclosure of multinational enterprise transaction arrangements in country-by country reports may become the trigger of vicious taxation competition. This requires the introduction of a “safety valve” provisions in the process of signing international treaties and the formulation of domestic laws in order to properly protect the lawful rights and interests of enterprises going abroad.

(iv) The supporting rules for tax information exchange needs to be improved

For the successful implementation of the international commitments, China’s domestic laws need to be improved to integrate with international agreements.⁴⁷ First, China’s current regulatory documents on international tax cooperation have a low level of effectiveness and their scope is limited to the departmental level regulations of. The most authoritative one is the Administrative Measures for the Due Diligence of Tax-Related Information on Non-resident Financial Accounts (hereinafter referred to as the Administrative Measures) issued by the six ministries and commissions including the Ministry of Finance and the State Administration of Taxation in May 2017, but the Law of the People’s Republic of China on the Administration of Tax Collection and its Detailed Rules have not yet provided regulations for international tax cooperation, which means that the issue remains blank at laws and administrative regulations. This in turn leaves an impact on the degree of compliance in the application of specific laws, that is, in a situation where the Law on the Administration of Tax Collection does not confer financial institutions with the obligation to provide information automatically, the legality of the Administrative Measures has yet to be proven and it will conflict with confidentiality matters in other departmental laws like the Law of the People’s Republic of China on Commercial Banks, which needs to be coordinated by higher-level legislation.⁴⁸ Furthermore, if high-level laws can regulate the international tax cooperation, it will also contribute to demonstrating China’s efficient statutory taxation in the international community.⁴⁹ The degree of rule of law is an important measure when the international organizations inspect the implementation of *The Convention*. That being said, the gaps in the protection of taxpayer rights continue to exist. As an “infringement law” that “infringes” the property rights of taxpayers, the tax law should be modest restraint. It is necessary to address questions regarding giving, the taxpayers’ certain participation rights and the rights to appeal for remedies in International tax cooperation, otherwise it will pose tremendous pressure upon the taxpayer, especially the multinational enterprises.

⁴⁷ See supra note 17, at p.17.

⁴⁸ Id.

⁴⁹ See Peixin Luo, *Good Law for Good Governance: A Brief Introduction to Social Credit Legislation*, 30 Law Science 104, 112 (2016).

4. The Pathway towards China's Full Integration into Tax Information

Exchange System

In the new era, China is moving towards the center of the world stage and is continuously making greater contributions to mankind. "With continuous increase of the national strength, China will assume more international responsibilities and obligations within its capacity, be committed to building a community of shared future for all mankind and make greater contribution to the lofty cause of human peace and development."⁵⁰ Be it from international obligations prestige or from the perspective of China's own fiscal and taxation interests, China's active participation in international Tax Information Exchange is the general direction that China must adhere to. The following points should be achieved in the future.

(a) Actively Participate in Formulating Rules for Tax information Exchange

As mentioned earlier, the right to speak in international Tax Information Exchange is still reserved for developed countries. Especially after the US implementing the FATCA program, the majority of developing countries represented by China are in a relatively passive position. To turn from passive to active, China is actively participating in the construction of Tax Information Exchange system advocated by international organizations such as OECD and G20.⁵¹ The Multilateral Convention on Mutual Administrative Assistance in Tax Matters has permanent coordinating bodies and the contracting states are permitted to recommend amendments or revisions to the convention according to the charters.⁵² Our government should actively participate in the policy formulation while insisting on equality and mutual benefit. In this process, we should fully recognize the dual status of developing country and the country under investment, and we must stand our ground on issues such as resident status.⁵³ On the other hand, in the course of China's foreign investments, we should make full use of platforms like the Belt and Road Initiative or sign bilateral agreements on Tax Information Exchange with countries involved in the Belt and Road Initiative; or utilize regional international organizations such as the Shanghai Cooperation Organization to build regional Tax Information Exchange system.⁵⁴ As a major investment country, China must fully consider the tax sovereignty in formulating rules, and focus on preventing tax base erosion to build a flexible tax information exchange mechanism.

⁵⁰ See The Publicity Department of the CPC Central Committee, *Thirty Lectures on Xi Jinping's Thoughts on Socialism with Chinese Characteristics in the New Era*, Learning Press, p.39 (2018).

⁵¹ See Niels Diepvens, Filip Debelva, *The Evolution of the Exchange of Information in Direct Tax Matters: The Taxpayer's Rights Under Pressure*, 24 EC Tax Review 210, 219 (2015).

⁵² See Jiang Lin, *Exploration and Innovation of China's Tax Collection and Administration System Reform—Taking Nansha District of Guangdong Pilot Free Trade Zone as an Example*, 49 Friends of Accounting 25, 29 (2016).

⁵³ See Marcel Schaper, *Data Protection Rights and Tax Information Exchange in the European Union: An Uneasy Combination*, 23 Maastricht Journal of European and Comparative Law 514, 530 (2016).

⁵⁴ See Saturnina Moreno González, *The Automatic Exchange of Tax Information and the Protection of Personal Data in the European Union: Reflections on the Latest Jurisprudential and Normative Advances*, 25 EC Tax Review 146, 161 (2016).

(b) Take Special Tax Measures for “Escaped Capital”

Under the guise of information exchange, many “high-net-worth people” are still evading their tax obligations by changing their resident status.⁵⁵ At present, some countries, such as Spain and Portugal, have introduced laws stating that changing the nationality for the purpose of tax avoidance will not directly lead to the loss of a taxpayer’s original resident status and he will still be obligated to pay tax in his own country.⁵⁶ In fact, the Enterprise Income Tax Law of the People’s Republic of China and the newly revised Individual Income Tax Law of the People’s Republic of China have set general anti-avoidance clauses in lieu of this issue. In order to prevent the behavior of changing status with a view to evade tax obligations the tax authorities are empowered to “tear the mask of tax avoidance” through general anti-avoidance clauses,⁵⁷ and levy tax on its future economic behavior. In the era of big data, it is technically feasible to implement this, although it required legislators to formulate specific procedures and standards.⁵⁸ On the other hand, it is recommended to allow taxpayers to actively disclose their previous illegal and non-compliant tax planning and then exempt them from corresponding criminal liability and administrative responsibilities in the case that they make up for tax payments in full and on time before launching the automatic information exchange system.⁵⁹ This conforms to the criminal policy of “combining punishment and leniency”.⁶⁰ There are also legal bases for “exemption for first offenders” in the *Criminal Law of the People’s Republic of China* and *Law of the People’s Republic of China on the Administration of Tax Collection*, which is a necessity for the smooth implementation of the Tax Information Exchange system. Currently, many countries in the world stipulate the “voluntary disclosure” system in the transitional period.⁶¹ The OECD report states that the period before countries begin/implement the automatic information exchange will be the “golden period” for implementing voluntary disclosure programs. According to the Global Forum on Transparency and Exchange of Information for Tax Purposes, as of 2016, approximately \$ 55 billion worth tax payments have been repatriated to the residence countries through voluntary disclosure programs or similar incentives.⁶² In this regard, reference can be made to the transition period arrangements in the formulation of China’s 2007 *Enterprise Income Tax Law of the People’s Republic of China* to ensure a smooth implementation of the policy.

(c) Protecting the rights and Interests of Chinese Enterprises Stationed/Established Abroad

It is necessary that China’s tax authorities provide timely policy assistance to guide overseas enterprises through risk management. At present, the State Administration of Taxation has prepared a

⁵⁵ See Daqing Wang, *A Unified Regulatory Pattern: A Future Direction for the Development of Global Financial Regulation*, 26 *Research on Economics and Management* 180, 184 (2010).

⁵⁶ See Dan Yu, *On the Function of Invoice*, China Social Science Press, p.178 (2016).

⁵⁷ See Tianjian Ouyang, *Reconstruction of General Anti-Avoidance Rules from the Perspective of Comparative Law*, 39 *Science of Law* 150, 158 (2018).

⁵⁸ See Xia Wang, *Research on the Legal System of Tax Preferences*, Law Press, p.36 (2012).

⁵⁹ See Shouwen Zhang, *Commentaries on the Taxation Law*, Peking University Press, p.40 (2005).

⁶⁰ See Graeme S. Cooper, *Tax Avoidance and the Rule of Law*, IBFD Publications BV, p.302 (1997).

⁶¹ See Karen B. Brown, *A Comparative Look at Regulation of Corporate Tax Avoidance*, Springer, p.179 (2012).

⁶² See Global Forum on Transparency and Exchange of Information for Tax Purposes: Tax Transparency: 2016 Report on Progress, <https://www.oecd.org/tax/transparency/GF-annual-report-2016.pdf>.

series of publicity materials such as the Guidelines for Taxation of Enterprises Going Abroad for the reference of global enterprises. It is suggested that the State Administration of Taxation compile publicity materials, improve the work of risk warning and provide good tax payment services for the latest trend and policy analysis of China's participation in the automatic exchange of international tax information.⁶³ Secondly, China's tax authorities should promptly intervene in communication and coordination and initiate the Mutual Agreement Procedure (MAP) when Chinese overseas enterprises are subjected to unfair tax treatment due to the disclosure of their country data.. The International Tax Arbitration mechanism can also be introduced to remedy the enterprises' interests, as and when required. Thirdly, when signing the information provisions in bilateral tax treaties with different countries, we should select the scope of information exchange flexibly.⁶⁴ For example, when signing relevant treaties with major countries for investment, it is not appropriate to expand the content of country-by-country reports infinitely. At the same time, we should restrict the scope of using country-by-country reports and define the consequences of invalidity when the reports are improperly used. Fourthly, in times when China's global enterprises face malicious information exchange with the country under investment, it is necessary to discuss the possibilities of finding a "blocking mechanism" by implementing domestic law. For instance, whether the national security guarantee in the National Security Law of the People's Republic of China can be expanded to apply to the field of tax information exchange, the ultimate goal of which is to "balance the free flow of information with the protection of information security."⁶⁵

(d) Further Improvement of Domestic Laws and Regulations

China's current amendments to the Individual Income Tax Law can be described as taking a substantial step forward in Tax Information Exchange. However, various other laws, such as the Law of the People's Republic of China on the Administration of Tax Collection call for similar improvements.⁶⁶ First, it is recommended to set up a special chapter on International Tax Cooperation in the Law of the People's Republic of China on the Administration of Tax Collection. At present, China has not formulated the "Basic Law of Taxation", instead the Law of the People's Republic of China on the Administration of Tax Collection has played the role of the Basic Law. The revision of Law on the Administration of Tax Collection is near at hand, so it is necessary to make provisions on the content, procedures, confidentiality obligations, and other administrative and criminal related liability issues so as to promote the transformation from international law to domestic law. Under the said law, the State Council and the State Administration of Taxation are authorized to formulate administrative laws and regulations as well as rules for improvement. Second, it is proposed to modify the financial laws and regulations, such as the Law of the People's Republic of China on Commercial Banks, the Supervision Law of the People's Republic of China on Commercial Banks, and the Regulations on the Administration of Savings, so as to make their confidentiality clauses adaptable to the new development of Tax Information Exchange. Thus, form a rule system with confidentiality as the principle and disclosure as an exception. Third, we should formulate corresponding rules under the wave of Tax Information Exchange for taxpayers who are trying to change the nationality or habitual residences to

⁶³ See supra note 55, at p.184.

⁶⁴ See Jerome B. Libin, *Congress Should Address Tax Avoidance Head-on: The Internal Revenue Code Needs A GAAR*, 30 Virginia Tax Review 339, 354 (2010).

⁶⁵ See Duoqi Xu & Lianjie, *Protection of Taxpayer Information in International Tax Information Exchange*, 32 Taxation Research 82, 85 (2018).

⁶⁶ See supra note 60, at p.353.

avoid the exchange obligation.⁶⁷ It should be clarified that the behavior of changing status, with the main purpose of tax avoidance, does not necessarily result in the loss of the tax payment duty and rules of general anti-avoidance clauses will be applicable in this case. Fourth, we should do well in the protection of taxpayer rights in the context of tax information exchange.⁶⁸ On one hand, the taxpayers' right of privacy must be protected from leaking during the exchange process; and on the other hand, we should allow taxpayers to raise objections to the information obtained as a result of the exchange.⁶⁹ Furthermore, means to invoke judicial review of information identification to determine the authenticity, legality, and relevance of the information should be made available. This is also the intention of the current tax judicial reform.

(e) Further Optimizing the Quality of Tax Services

While strengthening the exchange of tax information, due to the inconvenience it brings to taxpayers, tax authorities need to optimize tax services.⁷⁰ In this regard, the author proposes the following suggestions: first, we should pay attention to fostering social intermediaries. In the tax accountant reform that is recently completed, the original access examination for registered tax accountants has been converted to level examination, the purpose of which is to promote the tax accountant industry to further integrate with the market.⁷¹ As the legislation for tax account industry is imminent, the government can make stipulations on the functions, orientation, professional licenses and charging standards of tax-related intermediaries in the form of local regulations; and vigorously foster social intermediaries and their staff such as tax teachers, tax lawyers and certified public accountants. Through the policy of the government purchasing service, the social verification institutions can act as agents to review the daily tax returns of enterprises, work on the returns of settlement and loss assessment of the annual corporate income tax and individual income tax. At the same time, mutual recognition of qualifications can be implemented: those who have the qualifications of certified public accountant, tax accountant or lawyer can engage in relevant tax agent work (including litigation and non-litigation agents). This is in fact the mode adopted by major developed countries, which will help break the barriers of the industry, expand the range of choices for taxpayers and the government when purchasing services, and save labor and costs for tax collection.⁷² Second, under the implementation of "approval before review, independent approval and review, and one-stop service for examination and approval" reform, we can reconstruct tax-related processes, simplify the approval process and improve efficiency.⁷³ It is recommended to cancel the system of special administrators and establish network administration and strict tax inspection system; simplify tax returns and adopt online reporting, online review and online taxation methods; improve the level of invoice management; explore the tax collection and administration mechanism that is compatible with the classified regulation mode of cargo status; at the same time, further promote the paperless office which can be emulated from the "palm pass" mode of Fujian province to let tax administrative procedures including the delivery of tax documents be handled online in "one-stop" service. Third, we can establish an efficient and

⁶⁷ See Kechang Ge & Qingxiu Chen, *Tax Agency and Taxpayers' Rights*, Peking University Press, p.72 (2005).

⁶⁸ See supra note 65, at p.85.

⁶⁹ See Guo Li, *Information, Finance and Financial Law*, 6 Financial Law Forum 7, 11 (2003).

⁷⁰ Id.

⁷¹ See Zachary Nahass, *Codifying the Economic Substance Doctrine: A Proposal on the Doorstep of Usefulness*, 31 Administrative Law Review 120, 146 (2006).

⁷² See supra note 67, at p.72.

⁷³ See Kitano Hiroshi, *The Original Theory of Japanese Tax Law*, China Procurational Press, p.198 (2008).

convenient advance ruling system. The State Administration of Taxation may authorize the local tax bureau to make decisions on the advance ruling without reporting to the State Administration of Taxation for approval. When major transactions involving large enterprises and foreign-invested enterprises are conducted, the tax authorities should follow up in a timely manner to communicate with taxpayers and agree on the understanding and application of tax laws. Fourth, we can establish a tax reconciliation system. The premise of establishing this system is to amend China's *Administrative Litigation Law*, but judging from the current legislation trend, administrative reconciliation has gradually been supported by the legislative and judicial authorities.⁷⁴ Based on the revision of the law or the authorization of the National People's Congress, the government has the obligation and ability to conduct pilot tax reconciliation.⁷⁵ This will not only save the taxpayers' litigation costs, but also reduce the burden on the tax authorities. As is not a zero-sum game between the tax authorities and the taxpayers, there is no need to push the two to the opposite. The tax reconciliation can balance taxpayers' rights and treasury interests to the greatest extent.

5. Conclusion

Tax Information Exchange, especially an automatic exchange mechanism, is a general trend in tax cooperation among countries around the world and an inevitable result of the integration of world economy.⁷⁶ International organizations such as the European Union and the OECD, and developed countries like the United States are the main driving forces of this trend. As a developing country, China has gradually transformed from capital importing state to capital importing/exporting state in recent years. This requires China to adjust its tax policy in time and actively integrate into international rules. As we strengthen the right of international discourse, we also need to reform domestic tax laws to serve taxpayers and protect their rights and interests while protecting our tax base from erosions.

⁷⁴ For example, in March 2007, the Supreme People's Court issued *Several Opinions on Further Playing a Positive Role of Litigation and Mediation in Building a Harmonious Socialist Society*, which clearly states: "For administrative litigation cases, the people's court may refer to the principles and procedures of civil mediation according to the actual situation of the case, and try to promote the reconciliation of the concerned parties. The people's courts must continuously explore various ways of closing the case that contribute to the construction of a harmonious society through the practice of reconciliation of administrative litigation cases, create methods of litigation reconciliation, sum up work experience in a timely manner, and constantly improve the reconciliation mechanism of administrative litigation cases."

⁷⁵ See *supra* note 14, at p.52.

⁷⁶ See *supra* note 40, at p.178.

The Evaluation of Introducing Dual-class Share Structure in China

Le Fang¹

Abstract : The dual-class share structure is a double-edged sword. While stabilizing a company's control and obtaining financing for a company, it also increases a company's agency costs and poses risks to the rights and interests of minority shareholders. In 2019, due to practical needs and competitive pressure, the Shanghai Stock Exchange allowed for the application of a dual-class share structure in the Sci-Tech Innovation Board and established corresponding rules. Unlike the U.S., which has adopted a "light-touch" regulatory approach, China has adopted a "heavy-handed" regulatory approach consistent with Hong Kong and Singapore. This regulatory approach is in line with the development of China's securities market and securities laws, effectively reducing the negative effects of the dual-class share structure. However, in order to protect the rights and interests of minority shareholders better, regarding dual-class share structure, regulators should clarify the applicable conditions, strengthen the intensity of information disclosure and the internal supervision mechanism, and introduce a sunset clause.

Keywords: Dual-class Share Structure; Stock Exchange; Regulatory Approach; Minority Shareholders

1. Introduction

Share structures have always been a core issue of corporate governance and capital market development s it is related to the voting of company resolutions and the distribution of company profits. Generally speaking, the share structure could be divided into two types: the "one-share-one-vote" structure and the "dual-class share" ("DCS") structure. Among them, since the structure of "one-share-one-vote" can match the risks of decision-making and the profits of company in equal amounts for shareholders, which helps to maximize the democracy of the company, it is mandatory by many jurisdictions as a prerequisite for the company's listing.² However, with the increasing diversification of shareholder demands, more and more companies have abandoned the "one-share-one-vote" structure and turned to "DCS" structure. Under the dual pressures of practice and competition, the Singapore Exchange Limited ("SGX") and the Hong Kong Stock Exchanges and Clearing Limited ("HKEX") accepted "DCS" structure in 2018. Following the changes in the aforementioned jurisdictions, China (refers to Mainland China) has also begun to introduce "DCS" structure: In September 2018, the State Council issued a statement that science and technology enterprises could implement the governance structure of "same shares with different rights". With the implementation of the Sci-Tech Innovation Board rules in March 2019, China officially introduced "DCS", and then a company named Youked Technology Ltd became the first one applying "DCS" with the Sci-Tech Innovation Board. Despite "DCS" structure having taken root in China's securities market, what cannot be ignored is that "DCS" structure has been controversial: In theory, the adoption of "DCS" structure is a departure from the principle of "one-share-one-vote", which is a cornerstone of China's corporate rules. In other words,

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² See Frank H Easterbrook & Daniel R Fishel, *The Economic Structure of Corporate Law*, Harvard University Press, p.73 (1991).

the existing legal framework requires corresponding changes, such as adjusting the intensity of information disclosure and the company's internal monitoring mechanism.³ In practice, the introduction of "DCS" structure will create harmful institutional incentives. Those who own higher-class voting shares will be incentivized to seek disproportionate gains and the interests of lesser shareholders will be harmed.⁴ Particularly in China, limited by capacity, information and more, small and medium investors have faced serious difficulties in exercising and protecting shareholder's rights. "DCS" structure will undoubtedly place small and medium investors in a more vulnerable position. Therefore, a question arises: Is it a wise choice or a harmful experiment to adopt "DCS" structure for China's government? In order to answer this question, this article attempts to summarize the pros and cons of "DCS" structure at first, and then compares China's regulatory rules with other jurisdiction's regulatory approaches regarding "DCS" structure. On this basis, the fifth section makes a relatively rational evaluation of this bold attempt, and puts forward suggestions for resolving loopholes in the relevant rules as much as possible.

2. "DCS": A Double-edged Sword in Capital Market

(a) The Pros of "DCS"

For a long time, nearly all jurisdictions adhered to the "one-share-one-vote" principle.⁵ Because in business, the economic interests of shareholders are mainly represented by the residual claim rights with the distribution of surplus and the distribution of the company's residual property. Under normal circumstances, the economic interests that shareholders could obtain are directly proportional to the company's profitability. Shareholders with a higher share will be more enthusiastic to participate in reasonable corporate governance. Therefore, in order to ensure fairness, voting rights must properly reflect the interests of the voters. If not, the voting results will otherwise deviate from their interests. Within the structure of "one-share-one-vote", the interests of shareholders could be accurately measured through the shares they hold, and the voting rights they enjoy could be converted in equal proportion based on the shares they hold. The residual interests of shareholders and the voting weight of shareholders have achieved a good balance. Yet the design of "one-share-one-vote" is built on an ideal situation. There are at least two premises. First, it assumes that all shareholders have similar interests and motives. Second, it assumes that each shareholder has sufficient capacity to make rational decisions. However, with the development of the commercial field, these two premises have not necessarily been established. On the one hand, different shareholders often have different motives.⁶ For example, some shareholders expect to obtain short-term benefits through a company, while some shareholders expect to obtain long-term benefits through a company. Another example is that some shareholders only want to obtain economic benefits, and some shareholders pay more attention to the realization of the company's established goals. On the other hand, different shareholders

³ See Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 St. John's law review 863, 866 (1994).

⁴ See Raymond Siu Yeung Chan & John Kong Shan Ho, *Should Listed Companies Be Allowed to Adopt Dual-Class Share Structure in Hong Kong?*, 43 Common Law World Review 155, 179 (2014).

⁵ See Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholding Voting Rights*, 63 Washington and Lee Law Review 1347, 1354 (2006).

⁶ See Grant Hayden & Jordan M. Barry (ed.), *On Derivatives Markets and Social Welfare: A Theory of Empty Voting and Hidden Ownership*, 99 Virginia Law Review 1103, 1105 (2013).

often have different professional and information capabilities, especially in some fields of science and technology. The opinions of a few people are often more reasonable, which is conducive to the realization of a company's best interests. In addition, the "one-share-one-vote" structure will magnify the possibility of a company being acquired hostilely. Driven by interests, institutional investors with ample funds will play the role of barbarians, disrupting the order of the financial market and affecting the normal development scheme of the original industry. An clear example is the intense dispute between Vanke and Baoneng Group in China.

In this regard, "DCS" structure gives certain shareholders disproportionate voting power relative to their proportion of shares held.⁷ For example, Some shareholders have multiple voting rights per share while ordinary shareholders only have one voting rights attached to one share. Thus, the advantages of the "DCS" structure are clearly reflected in two aspects: Firstly, it helps to meet the different needs of different shareholders. On the one hand, "DCS" structure gives more voting rights to shareholders who are willing to participate in corporate governance, which is more conducive to achieving the purpose of operating companies. At the same time, the economic benefits of shareholders who are unwilling to participate in corporate governance have no direct influence. In fact, because they no longer need to pay for the cost (including time, energy, and money) of obtaining information and making decisions, these shareholders have received higher profits. More importantly, the realization of the company's business goals is not a profitable process from the beginning as the company's early development often requires large-scale costs. Shareholders whose primary objective is economic benefit tend to pay more attention to the company's short-term earnings comparatively.⁸ Under such interests, they will use their own voting rights to interfere with the normal management of listed companies, and then prompt them to make short-sighted decisions. By using "DCS" structure, managers of listed companies could get rid of the pressure from "short-sighted" shareholders and devote more energy to the long-term management policies of listed companies.

Secondly, it is conducive to the company's long-term stability. Generally speaking, the growth of a company is closely related to two factors: one is a capable management team, and the other is large-scale funding. However, as a company grows, whether it is seeking PE, VC, or funds from public investors through an IPO, the proportion of shares owned by the management group will be greatly diminished. Under the "one-share-one-vote" structure, once the share is substantially diluted, the management group's control of the company will be weakened accordingly. Therefore, a dilemma arises: raising money may lead to the loss of control;⁹ and if the control is retained, the scale of financing will have to be reduced. In fact, the direct consequence of losing control is that the company is likely to have no potential of development. For example, in media, technology, investment funds and other industries, companies are highly dependent on the personal experiences and value orientations of their managers. To illustrate this, a magazine needs a long-term stable editorial team to help it form a unique style and attract fixed readers. If the editorial team changes, the value of the company will be greatly reduced. In addition, as a rational economic person, the management team is not willing to bear the risk of being hitchhiked by institutional investors and other entities. If there is a possibility of the deprivation of control, management teams will not pay capable talent for the company's interest or accept financing from the capital market from the start. In this regard, the "DCS" allows the diluted management team to maintain control of the enterprise,¹⁰ and to a large extent, dispels the management team's concerns about listing, so that companies

⁷ See Leonard Ching & Alvin Zhuang (ed.), *Dual-class share structures—the Singaporean response*, 14 Capital Markets Law Journal 451, 452 (2019).

⁸ See Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 Capital Markets Law Journal 561, 579 (2006).

⁹ See *supra* note 3, at p.884.

¹⁰ See Ronald J. Gilson, *Evaluating Dual Class Common Stock: the Relevance of Substitutes*, 73 Virginia Law Review

with good growth have a stronger incentive to go public. It will ultimately benefit investors, especially public investors.

On the whole, the “DCS” structure is conducive to the enhancement of a company’s value. According to a research report released by MSCI, from 2007 to 2017, the annual earnings of the shares of listed companies with “DCS” in the North American market exceeded the traditional “one-share-one-vote” company by 4.5%.¹¹ Because of its unique advantages, the “DCS” structure is highly favored by listed companies. In America, a large number of companies have adopted “DCS” structure, especially technology companies. Almost all big tech IPOs, including Google, LinkedIn, Groupon, Yelp, Zynga, and Facebook, have adopted this share arrangement. Data shows that nearly 6% of companies in the U.S. have dual-class shares. In Canada, the proportion of listed companies with “DCS” structure was nearly 17%. Among the 5162 public companies in twelve EU countries, nearly 20% of the companies used “DCS” structure.¹² Even in Asia, Baidu, JD, Alibaba, 58 Tongcheng, Tuniu, Sina Weibo and other listed companies have also adopted “DCS” structure.

(b) The Cons of “DCS”

“DCS” structure is a double-edge sword however. Under “DCS” structure, the establishment of special voting rights results in the original company’s shareholders having higher voting rights with less shares. High voting power means that the group of founders could make almost any decision on the company without being influenced by the will of other shareholders. For example, Wang Xing, the founder of Meituan Dianping, owns 10.4% of the shares. According to this dual-class share structure, the 10.4% Class A shares held by Wang Xing have the power of 47.14% of the voting rights, which means that he can easily control the company. Hence, theoretically, the adoption of “DCS” structure can easily lead to insider control and weaker protection for minority shareholders.

(i) Insider control

First of all, there is the potential for the self-profiteering. With weak objections, the founder’s team could pay executives excessive salaries or take advantage of company resources to fund private interests or endeavors.¹³ The empirical analysis results have clearly shown that entrepreneurs have a tendency to sacrifice company interests to obtain private interests.¹⁴ Considering the separation of the company’s equity and control rights, even though directors and other persons need to bear the fiduciary duties, management teams have sufficient capabilities and advantages like information to deceive ordinary shareholders and then make profits for themselves. A typical example of this is Conrad Black, a media tycoon, who used the “DCS” structure to control 73% of the voting rights of a company called Hollinger International and served as the chairman of Hollinger. Later, he paid a high salary to the executives and

807, 812 (1987).

¹¹ See Dmitris Melas, *Putting the Spotlight on Spotify: Why have Stocks with Unequal Voting Right Outperformed?*, <https://www.msci.com/www/blog-posts/putting-the-spotlight-on/0898078592> (accessed on June 30, 2020).

¹² See Morten Bennesen & Kasper Meisner Nielsen, *The Impact of a Break - Through Rule on European Firms*, 17 *European Journal of Law and Economics* 259, 263 (2004).

¹³ See Ronald W Masulis & Cong Wang (ed.), *Agency Problems at Dual-Class Companies*, 64 *The Journal of Finance* 1697, 1722 (2009).

¹⁴ See Paul A. Gompers & Joy Ishii (ed.), *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 *The Review of Financial Studies* 1051, 1085 (2010).

implemented a series of transactions to transfer the company's assets to the insiders' pockets.¹⁵

Secondly, adverse incentives. The profits of the management team are not directly related to the company's profit.¹⁶ Ownership structure does not generate positive incentives for the founder team, and self-discipline is the only constraint on the behavior of the founders' team. Due to the lack of other shareholders' constraints, the founders' team may no longer be cautious in their decisions, and the company's success or failure is entirely controlled by founder's team. Even though the management's fraud and dishonesty may be dealt with through law, the law has difficulty regulating purely lazy or stupid managers, as it is difficult for judges to distinguish whether the company's management decisions are commercially good or bad due to the existence of business judgement rules. The only way to deal with such bad management is competition within the market, that is, to let good management replace bad management. However, the "DCS" structure restricts market competition and provides an umbrella for bad management. Management teams can insulate themselves from check mechanisms under "DCS" structure.¹⁷

Again, the path-dependence. The motivation for giving the management team high voting power is that shareholders believe that the management team has good market acumen and they can make company decisions that are more in line with market's needs. However, an overly stable management structure has little trouble solidifying the operator's ideas and thoughts. Under an almost eternal and continuous decision-making structure, it's not difficult to assume that they will be reluctant to change their original thoughts, and then cannot cater well to variable market demands.

Finally, fewer successful acquisitions. Acquisitions do not necessarily hinder industry development. The combination of resources in different industries may maximize the efficiency of utilizing resources and increase the company's development speed. For example, Alibaba acquired many companies such as Lazada, Youku, Tudou, Didi, Suning, etc., forming a complete industrial chain covering entertainment, e-commerce, travel and other fields, which has promoted the rapid development of related industries. To a certain extent, although the "DCS" structure prevents hostile acquisitions, it also hinders mergers and acquisitions among good companies and affects the efficiency of market to allocate resources.

(ii) Weaker protection for minority shareholders

Under a "DCS" structure, since management largely controls the company's decision-making mechanism by virtue of having multiple voting rights, it is likely to appear that the management acts deliberately or unintentionally not to take the company's interests as the goal, so that the company's interests are damaged, which in turn hurts the interests of minority shareholders.¹⁸ In practice, it is common for the interests of minority shareholders to be violated in a company. To protect the interests of minority shareholders, legislators have established an effective protection system. However, within the "DCS" structure, the above-mentioned measures of protection do not work well, and minority shareholders could only seek relief from the regulatory authority or the court when these measures failed.

¹⁵ See unknown from China Daily, *Conrad Black jailed 6 1/2 years*, http://www.chinadaily.com.cn/cndy/2007-12/12/content_6314885.htm (accessed on May 7, 2020).

¹⁶ See G.M. Hayden & M.T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 Cardozo Law Review 445, 482 (2008).

¹⁷ See Tian Wen, *You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies From Listing On the Securities Exchanges*, 162 University of Pennsylvania Law Review 1495, 1501 (2014).

¹⁸ See supra note 16, at p.471.

Firstly, information disclosure. Information asymmetry is very common in listed companies. There are distinct differences in the comprehensiveness of information, the source of information, and the time controlling information release. Due to the detailed provisions on content, time and others, the rights of minority shareholders to obtain information could be protected to a certain extent under the design of the “one-share-one-vote” structure. However, in the “DCS” structure, by design, multiple voting rights will make the problem of untimely and insufficient information disclosure more serious.¹⁹ The reason is that shareholders with high voting rights or special voting rights will use their monopoly on information resources to screen the content disclosed by listed companies, and the management who disclose information will not add additional risk warnings or reveal potential conflicts of interest between controlling shareholders and ordinary shareholders. Therefore, even though the information disclosure is required against company with “DCS” structure, the information obtained by the small and medium shareholders is still limited, making it impossible to make accurate investment decisions.

Secondly, the external supervision mechanism. The external supervision mechanism refers to a market mechanism. As mentioned before, under the structure of “one-share-one-vote”, if minority shareholders are not satisfied by the benefits they obtained from a company, they could choose to sell their shares. There is a possibility that the acquirer obtains equity from a large number of minority shareholders, and then obtains control of the target company. Due to this deterrent, management will actively protect the interests of minority shareholders. Yet under “DCS” structure, the founder owns shareholder power, precluding the potential threat. So, the existing market mechanism is difficult to exert ex-ante restraint on controlling shareholders.²⁰

Thirdly, the internal supervision mechanism. Under the structure of “one-share-one-vote”, the board of directors, independent directors and supervisory board are effective arrangements for protecting the interests of minority shareholders. Although the controlling shareholder has the right to nominate and control most of the directors through voting, the directors bear the fiduciary duty, they need to serve the best interests of the company and cannot fully obey the will of the controlling shareholder. Secondly, the independent directors on the board of directors and supervisory board assume the function of supervision. Even if executive directors violate their fiduciary duties, independent directors and the supervisory board could influence their decisions. However, within the “DCS” structure, executive directors and other senior executives jointly hold super voting rights. They are actually the controlling shareholder. Firstly, it is unclear whether the controlling shareholder has the fiduciary duty to the company and other minority shareholders in many jurisdictions. Secondly, in general, the power of appointment and removal of independent directors and supervisory board members are placed in the hands of controlling shareholders. Independent directors and the supervisory board will have weakened supervision over executive directors and other executives.

3. “Light-Touch” or “Heavy-Handed”: Different Regulatory Approaches for “DCS”

(a) An Example of “Light-Touch” Regulation: The U.S.

¹⁹ See Lucy Lim, *Dual-class versus single-class firms: information asymmetry*, 46 Review of Quantitative Finance and Accounting 763, 769 (2016).

²⁰ See Henrik Cronqvist & Mattias Nilsson, *Agency Costs of Controlling Minority Shareholders*, 38 The Journal of Financial and Quantitative Analysis 695, 715 (2003).

Faced with “DCS” structure that has both advantages and disadvantages, after long periods of debate, more jurisdictions have chosen to allow the application of the “DCS” structure. Reviewing the relevant rules of these jurisdictions, due to differences in market maturity, litigation culture, supporting measures and other conditions, regarding the “DCS” structure, these jurisdictions’ authorities have adopted two extremely different methods: “Light-touch” regulatory approach or “Heavy-handed” regulatory approach.²¹

A typical example of the former is the U.S. Because the federal securities law and the business laws of many states do not mandate the company’s shareholding structure, the “DCS” structure first appeared in the United States.²² In 1898, the international silver company issued 9 million shares of preferred stock and 11 million shares of non-voting common stock. In 1902, the company’s non-voting common shares were also granted voting rights, which are equivalent to one-half of the original shares.²³ Later, in the 1920s, the dual-class share structure began to be adopted by many American companies. According to statistics, by 1926, at least 184 companies in the United States had adopted a dual-class share structure to issue shares.²⁴ For example, Dodge Brothers issued 1.5 million Class A stocks, but it was controlled by investment banks who held 251,001 Class B stocks. While “DCS” structure is becoming more and more popular, opposition has begun to appear. Experts represented by William Ripley believed that the “DCS” structure will make the physical enterprises absolutely controlled by bankers.²⁵ Influenced by these doubts, the New York Stock Exchange (“NYSE”) officially announced its policy against non-voting ordinary shares on May 7, 1940, which affected the prevalence of the dual-class share structure over the next forty years. However, in the 1980s, the large-scale emergence of hostile acquisitions led many listed companies to implement “DCS” structure. Compared with other stock exchanges in the United States such as the Nasdaq Stock Exchange (“Nasdaq”) and the American Stock Exchange (“AMEX”), the “NYSE” is less attractive to listed companies because of its negative attitude to the “DCS” structure. Under the pressure of competition, the “NYSE” requested the Securities and Exchange Commission (“SEC”) to make amendments to the “DCS” structure.

After a period of discussion, the SEC established Rule 19-C in 1988. The rule restricted the implementation of “DCS” structure for companies that have already listed, but it exempted companies from having “DCS” structure during an IPO. Although the SEC has no regulatory authority over the inner governance of listed companies, the rule was invalidated by the court.²⁶ Through the efforts and coordination of the SEC, the “NYSE”, “AMEX” and “NASDAQ” still uniformly implemented rules similar to the Rule 19-C in 1994.²⁷ Why do regulators need to treat listed and unlisted companies differently? The reason is that in a fresh listing, investors are free to choose whether to buy stocks or not. At this point in time, the risk of the “DCS” structure has been reflected in the stock price. Purchasing means that investors agree to accept the risks of “DCS” structure. In contrast, if the company adopts a “DCS” structure after listing, the controlling shareholders will use the voting advantages to force the resolution to change the shareholding structure. Even though the unequal distribution of voting rights

²¹ See Longjie Liu, *The regulation of the dual-class share structure in China: a comparative perspective*, 15 Capital Markets Law Journal 224, 231 (2020).

²² See *supra* note 3, at p.470.

²³ See Author W. Howell, *The survival of the U.S. dual class share structure*, 44 Journal of Corporate Finance 440, 444 (2017).

²⁴ See Arthur Stone Dewing, *The Financial Policy of Corporations*, The Fronald Press, p.178 (1953).

²⁵ See Joel Seligman, *Equal protection in shareholder voting rights: The one common share, one vote controversy*, 54 George Washington Law Review 687, 694 (1986).

²⁶ See *The Business Roundtable v. Securities and Exchange Commission*, 284 U.S. App. D.C. 301 (1990).

²⁷ See *supra* note 16, at p.898.

is approved by minority shareholders, it is difficult to say that such consent is free. Because minority shareholders with scattered interests and insufficient professional capabilities are often reluctant to pay for time, energy and other costs to participate in making reasonable company decisions, they are more likely to vote with their feet and blindly support management's proposals. Hence, prohibiting listed companies from changing their shareholding structure to the "DCS" structure became the U.S.'s main restriction on the "DCS" structure. It can be seen that the United States has not adopted excessive regulatory requirements for companies having "DCS" structure. The use of "light-touch" to describe the U.S. regulatory approach is relatively appropriate.

But behind this "light-touch" regulatory approach, we should see that the U.S. securities market is relatively mature and the U.S. itself has relatively effective supervisory rules for listed companies. To illustrate this, firstly, in the U.S. securities market, institutional investors play an extremely important role. As of 2018, institutional investors hold almost 80% of the U.S. securities market.²⁸ Compared with retail investors, institutional investors not only have stronger professional capabilities, but also have a higher willingness to participate in company decision-making because of their high shareholding ratio which makes their equity highly correlated with company development. Therefore, even under "DCS" structure, minority shareholders with institutional investors as the main body still have the status of equals in negotiation with the controlling shareholders. In the U.S., the "DCS" structure does not blatantly trigger the possibility of infringement on the rights of small shareholders. Secondly, for the developed securities market, the U.S. has always adopted a regulatory model based on information disclosure. On the one hand, regulators do not emphasize the qualification constraints of listed companies, but rather the degree of information disclosure of listed companies. Regulators believe that investors can make reasonable decisions in a relatively transparent information environment. On the other hand, U.S. legislators provide investors with a powerful weapon of ex-post relief. On the legal basis, the U.S. has long established the fiduciary duty of the controlling shareholder to the company and minority shareholders.²⁹ Even under the "DCS" structure, it is necessary for the controlling shareholder to take the company's best interests as its behavioral goals. Any self-profit-making behavior at the expense of hurting the interests of investors constitutes a breach of fiduciary duty. In the litigation mechanism, the U.S. adopts securities class litigation. Because the U.S. allows lawyers to charge risk agency fees, in order to earn high lawyer fees, professional lawyers will actively explore the infringements of listed companies. Once the listed company's infringement is confirmed, the "opt-out" clause makes the listed company need to provide huge compensation for potential victims. Therefore, in the U.S., due to the existence of the above reasons, the potential harm of the "DCS" structure is not significant, and the exchange does not need to impose strict regulatory requirements on the "DCS" structure.

(b) Examples of "Heavy-Handed" Regulation: Hong Kong and Singapore

Unlike the U.S., the securities markets in jurisdictions such as Hong Kong and Singapore are full of individual investors. Low professional capabilities and information disadvantages make individual investors' rights and interests vulnerable to "DCS" structure. Besides, the lack of securities class litigation and the rule that the controlling shareholder does not perform fiduciary duties to minority

²⁸ Charles Mcgrath, *80% of Equity Market Cap Held by Institutions*, <https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions> (accessed on June 29, 2020).

²⁹ See *Southern Pacific Co. v. Bogert*, 250 U.S. 483 (1919).

shareholders amplify the risk of “DCS” structure. Hence, jurisdictions such as Hong Kong and Singapore have long held negative attitudes on whether to adopt “DCS” structure. Before 3 January 2016, Singapore’s company law clearly stipulated that all companies except newspaper companies must adhere to the principle of “one-share-one-vote”.³⁰ Although the company ordinance in Hong Kong does not prohibit “DCS” structure, “HKEX” has always focused on market integrity and has rejected listing requests from several companies with “DCS” structure on this ground. In 1987, “HKEX” rejected the Jardine Matheson Holding Limited’s request that this company proposed to change their share structure to “DCS” structure. In 2013, “HKEX” rejected Alibaba’s several listing proposals around “DCS” structure. Although Hong Kong and Singapore liberalized the ban on the “DCS” structure in 2018, regulators in both jurisdictions have been concerned about the risks of the “DCS” structure. This directly led to Hong Kong and Singapore applying a “heavy-handed” regulatory approach to the “DCS” structure.

To illustrate, in Hong Kong, the “HKEX” mainly restricts listed companies with “DCS” structure in terms of listing requirements, weighted voting stock restrictions, information disclosure requirements, corporate governance requirements, and termination clauses. Firstly, listing requirements. The “HKEX” also only allows unlisted companies to adopt “DCS” structure, and prohibits listed companies from changing to “DCS” structure. Compared with the U.S., the “HKEX” has imposed additional conditions on the applicants with “DCS” structure for listing. In terms of financial status, the company’s market capitalization must not be less than HK\$10 billion. If the company’s market capitalization is less than HK\$40 billion, the company needs to meet additional conditions: having revenue more than HK\$1 billion in the most recent audited financial year.³¹ In addition, applicants must also meet some subjective judgment standards set by the “HKEX”. For example, applicants need to have some characteristics in order to be recognized as an innovative company.³² Another example is that the applicant needs to obtain at least a large-scale investment from a sophisticated investor recognized by “HKEX”, and the investment needs to be retained by at least 50% within 6 months after the IPO.³³ Through these qualitative and quantitative conditions, the “HKEX” can screen out companies with higher security qualifications, reducing the risk of listed companies using the “DCS” structure to make illegal profits.

Secondly, limits on the weighted voting shares. In terms of subject, the shareholders holding weighted voting shares need to be directors who actively participate in the company’s management, and they should have an important role in the development of the company because of their own knowledge and skills.³⁴ In terms of quantity, with the purpose of avoiding excessive separation of decision-making power and ownership, “HKEX” stipulated that the economic benefits of high-voting shareholders in the company should not be less than 10%,³⁵ and the proportion of weighted shares cannot increase after listing.³⁶ In terms of power, the voting power of high-voting stocks shall not exceed 10 times of the voting power of low-voting stocks.³⁷ And, on some specific matters that are of great relevance to the company’s interests, special privileges for high-voting stocks should not be enjoyed. These matters include amending constitutional documents, changing shareholder rights, appointing and removing

³⁰ See Companies Act 2006, s.64(1).

³¹ See HKEX Mainboard Listing Rules 8A.06.

³² See HKEX, Guidance Letter: Suitability for Listing with a WVR Structure section 4.2.

³³ Id.

³⁴ Id.

³⁵ See HKEX Mainboard Listing Rules 8A.12.

³⁶ See HKEX Mainboard Listing Rules 8A.13.

³⁷ See HKEX Mainboard Listing Rules 8A.10.

independent non-executive directors and auditors, and winding up companies voluntarily.³⁸

Thirdly, requirements of information disclosure. The “HKEX” emphasized informing investors of the risks of “DCS” structure. On the one hand, it requires listed companies with “DCS” structure to have stock names ending with the marker “W”,³⁹ and on the front page of all listing documents, periodic financial reports, circulars, notifications and announcements that include warnings of “DCS” structure.⁴⁰ On the other hand, it requires that issuers describe the “DCS” structure, the associated risks for shareholders and introduce to the public why it has “DCS” structure.⁴¹

Fourthly, requirements of corporate governance. Companies with “DCS” structure are required by “HKEX” to hire a compliance adviser and establish a corporate governance committee. The former is to provide advice on issues related to “DCS” structure.⁴² The latter aims to supervise the company’s decision-making and publish a corporate governance report bi-annually.⁴³ The scope of supervision of the corporate governance committee covers almost all matters, including checking whether the issuer is operating for the benefit of all shareholders, whether the beneficiary who enjoys the weighted vote complies with the rules for exercising their rights, and whether “DCS” structure has risks, etc.⁴⁴ To ensure the supervisory effectiveness, the corporate governance committee must be comprised entirely of independent non-executive directors.⁴⁵

Fifthly, termination of “DCS” structure. In the U.S., regulators thought that the issue of when the “DCS” structure can end is a matter of corporate autonomy and it should be decided by all shareholders. So the U.S. has not clearly stipulated the termination guidelines of “DCS” structure. However, “HKEX” believed that the adoption of “DCS” structure is highly tied to the ability of the beneficiary, so it stipulated that if the beneficiary dies, ceases to serve as a director of the company, the Exchange determines that they do not have the ability to serve as a director, the Exchange recognizes their behavior as not meeting the requirements of a director, or the weighted shares have been transferred to another person, the weighted voting shares of the beneficiary shall be converted into ordinary shares.⁴⁶

For the “DCS” structure, the rules of “SGX” and “HKEX” are mostly the same, even though “SGX” did not introduce the “DCS” structure into the Catalist board, and this conservative approach has been questioned by some scholars.⁴⁷ The “SGX” also imposed restrictions on listed companies based on listing requirements, information disclosure, weighted voting shares, and termination clauses. For example, “SGX” also stipulates that the voting rights of weighted stocks cannot exceed 10 votes per share,⁴⁸ and cannot cover some resolutions including amendments to the articles of association.⁴⁹ However, compared to the “HKEX” rules, the design of “SGX” rules on certain terms makes it more subjective and flexible. Specifically reflected in: Firstly, listing requirements as the “SGX” sets neither financial requirements for applicants nor restricts applicants to innovative companies, but lists the considerations that influence whether the exchange accepts “DCS” structure. These elements include the applicant’s business model, track record, high-voting shareholders’ contribution to corporate governance, participation by sophisticated investors, suitability of the arrangement about holder groups and other relevant

³⁸ See HKEX Mainboard Listing Rules 8A.24.

³⁹ See HKEX Mainboard Listing Rules 8A.42.

⁴⁰ See HKEX Mainboard Listing Rules 8A.37.

⁴¹ Id.

⁴² See HKEX Mainboard Listing Rules 8A.34.

⁴³ See HKEX Mainboard Listing Rules 8A.32.

⁴⁴ See HKEX Mainboard Listing Rules 8A.30.

⁴⁵ See HKEX Mainboard Listing Rules 8A.31.

⁴⁶ See HKEX Mainboard Listing Rules 8A.17, 8A.18.

⁴⁷ See Lin Lin, *Venture Capital in Singapore: The Way Forward*, 5 *Journal of Business Law* 363, 384 (2017).

⁴⁸ See SGX Mainboard Rules, Rule 210(10)d.

⁴⁹ See SGX Mainboard Rules, Rule 730b.

features.⁵⁰ Secondly, regarding the limits on the weighted voting shares, “SGX” also requires high-voting shareholders to serve as directors, but it does not limit high-voting shareholders to individuals. It allows the entity or a group of people to become the holders of weighted voting shares as long as the issuer can determine the scope before listing, and one person can serve as a director.⁵¹ The “SGX” has stated that there is no need to exclude the group. Through a director, a group of people who jointly hold shares can jointly contribute to the development of the company.⁵² Thirdly, regarding requirements of corporate governance, “SGX” doesn’t require listed companies to set up an additional corporate governance committee. To ensure the independence of the board of directors, “SGX” requires issuers to ensure that the majority of the audit committee, nomination committee, and remuneration committee are independent directors, and the chairman of the committee is also an independent director.⁵³ Lastly, regarding the termination of “DCS” structure, “SGX” doesn’t consider the transfer of weighted voting shares as the cause of invalidation of weighted voting rights. If non-interested shareholders agree to the transfer of weighted shares through the enhanced voting process, the person to whom the weighted shares are to be transferred to can also enjoy the right of weighted voting.⁵⁴ Although compared with “HKEX” rules, flexible restrictions make SGX’s supervision more relaxed, though detailed requirements and comprehensive restrictions still indicate that Singapore has adopted a “heavy-handed” regulatory approach.⁵⁵

4. “Heavy-Handed” Regulation: China’s Choice on “DCS”

(a) The Reasons of Introducing “DCS” in China

In 2019, the Sci-Tech Innovation Board of the Shanghai Stock Exchange (“SSE” officially introduced “DCS” structure. Although the “DCS” structure has obviously unique advantages, taking its possible risks into consideration, the above-mentioned advantages cannot fully explain why the Sci-Tech Innovation Board introduced “DCS” structure. After all, compared to the United States, Hong Kong and Singapore, China’s securities market is less mature. In terms of market composition, China’s securities market is flooded with individual investors. Compared with institutional investors, individual investors have relatively low knowledge and information, and cannot make rational choices to sell or purchase stocks. Moreover, due to the relatively weak financial capacity, individual investors are more vulnerable to investment losses. The survey shows that among the individual investors interviewed, the average person invests in stocks accounting for 27.3% of the total current assets of the household. However, among them, 15.5% of individual investors have irrational investment tendencies such as short-term trading.⁵⁶ It can be seen that the protection needs of China’s individual investors are very strong. Based on this, the radical introduction of the “DCS” structure may not be a good choice as the risk of this tool may outweigh the benefits. However, China ultimately chose to introduce “DCS”

⁵⁰ See SGX, Responses to Comments on Consultation Paper: Proposed Listing Framework for Dual Class Share Structures, para.1.4.

⁵¹ See SGX Mainboard Rules, Rule 210(10)(e)(i).

⁵² See SGX, Responses to Comments on Consultation Paper: Proposed Listing Framework for Dual Class Share Structures, para.2.27.

⁵³ See SGX Mainboard Rules, Rule 210(10)(i).

⁵⁴ See SGX Mainboard Rules, Rule 210(10)(f).

⁵⁵ See *supra* note 7, at p.466.

⁵⁶ See Shenzhen Stock Exchange, *An Investigation into the Status of Individual Investors*, http://www.szse.cn/a_boutus/trends/news/t20200319_575272.html (accessed on June 04, 2020).

structure. Therefore, before introducing China's rules, it is necessary to explain the reasons why China needs to introduce the DCS structure urgently, in order to later rationally evaluate this attempt of China.

It should be acknowledged that the advantage of "DCS" structure is an important consideration for China to introduce the "DCS" structure, but the more important reason is to cater to the needs of commercial practice and regional competition. China has always had a culture of entrepreneurs who are attached to their companies.⁵⁷ With the purpose of holding a company, they prefer to raise funds through IPO and other means rather than through M&A. Especially now, there are a large number of high-tech companies, state-owned enterprises and family businesses in China. The "DCS" structure could perfectly meet the special needs of the above-mentioned enterprises. Taking high-tech companies as an example, the founders have a strong need to use "DCS" structure as they hope to achieve financing for the company while retaining control. Before the "DCS" structure was allowed by the Sci-Tech Innovation Board, well-known companies including Alibaba, JD.com, Baidu, Pinduoduo chose to list overseas because of the dual-class share structure. As of December 10, 2018, 208 companies in China have gone public in the United States. Among them, 61 companies have adopted dual-class share structure.⁵⁸ Since a considerable number of companies choose to go overseas for a listing, the Chinese stock market has lost some IPO applicants with high development potential. On the one hand, domestic exchanges have lost opportunities for development. On the other hand, domestic investors missed profitable opportunities as they had difficulty investing in these fast-growing companies. As the "HKEX" and the "SGX" have officially adopted the "DCS" structure in 2018, it is foreseeable that rejection of the "DCS" structure will make domestic exchanges less attractive to listed companies, which will affect the overall development of the securities market.

In fact, the original legislation does not prohibit dual-class share structure but facilitated the introduction of "DCS" structure in China. Pursuant to Art 126 and Art 131 of China's company law, although the legislator established the principle of "one-share-one-vote" for a joint stock company, this principle only applies to the same type of shares, and different types of shares can be set up with different rights. In addition, the State Council may formulate additional rules regarding the shareholding structure. These rules leave room for the application of "DCS" structure.

(b) China's Measures to Prevent Risks Brought by "DCS"

Taking into account the risks of the "DCS" structure, the "SSE" has also issued a series of rules to prevent potential risks. Regarding the "DCS" structure, the regulatory rules of the "SSE" have inherited the "heavy-handed" regulatory approach of the "HKEX". Similarly, "SSE" restricts listed companies with "DCS" structure in terms of listing requirements, weighted voting stock restrictions, information disclosure requirements, and termination clauses.

In terms of listing requirements, it is mainly reflected in three points: Firstly, applicants with "DCS" structure for listing on the Sci-Tech Innovation Board need to be deemed suitable by the regulator.⁵⁹ Not all companies that meet the hard conditions could be successfully listed. China's Securities Regulatory Commission plays the role of substantial reviewer. According to the published regulations, regulators prefer companies listed on the Sci-Tech Innovation Board with the following characteristics:

⁵⁷ See Lin Lin, *Venture Capital Exits and the Structure of Stock Markets: Lessons from China*, 12 Asian Journal of Comparative Law 1, 13 (2017).

⁵⁸ See Shenzhen stock exchange, *Analysis of the feasibility of different voting stocks in the A-share market*, <http://www.szse.cn/aboutus/research/research/report/P020190114352235851173.pdf> (accessed on June 04, 2020).

⁵⁹ See STAR Market Rules, Rule 1.3.

in line with national strategies, possess key core technologies, have outstanding technological innovation capabilities, mainly rely on core technologies for production and operation, and have a stable business model, highly recognized by the market, has a good social image, and has strong growth.⁶⁰ Secondly, applicants need to meet specific capital requirements to reduce the investment risk of small and medium investors. In order to have “DCS” structure, the applicant's estimated market capitalization should no less than RMB 10 billion or the revenue in the most recent audited financial year should be no less than RMB 500 million when the applicant's market capitalization value is not less than RMB 5 billion.⁶¹ Thirdly, applicants with “DCS” structure for listing on the Sci-Tech Innovation Board could only be new applicants, and the change to the “DCS” structure is not allowed after the listing.⁶² Similar to “NYSE”, “HKEX” and “SGX”, the “SSE” denied the change in the shareholding structure post listing, protecting minority shareholders who are easily to fall into the dilemma of collective action.

In terms of limits on the weighted voting shares. Firstly, the rules require that holders of weighted voting rights should make a significant contribution to the listed company and be a director or similar person in the listed company⁶³, so that the behavior of holders could be bound by fiduciary duties even though China has not yet officially confirmed that the controlling shareholder has a fiduciary duty to minority shareholders. Secondly, due to the separation of control rights and ownership, excessively high voting weights will produce reverse incentives for management. The rules require that the voting power of high-voting stocks should not exceed 10 times of the voting power of low-voting stocks,⁶⁴ and that the proportion of voting rights of holders of high-voting stocks should not be increased after listing.⁶⁵ Thirdly, in order to avoid excessive agency costs caused by excessive separation of economic benefits and control in differential voting rights arrangements,⁶⁶ high-voting shareholders themselves should also bear the risks of company operations and decision-making. Therefore, the rules stipulate that the total shares held by high-voting shareholders at the time of listing should reach more than 10% of the company's total issued voting shares.⁶⁷ Fourthly, the listed company should not adopt a differentiated voting rights mechanism for any matters of the company, otherwise the management will grasp the decision-making power of all matters. In this regard, the rules stipulate some equal voting matters. These equal voting matters include amending the company's articles of association, changing the number of voting rights enjoyed by weighted voting shares, hiring or firing independent directors, hiring or firing accounting firms that issue audit opinions for listed companies' periodic reports, and changing the company's form.⁶⁸

In terms of requirements about information disclosure. Transparent information has at least two functions: on the one hand, it deters insiders and reduces the possibility of insiders of committing violations. On the other hand, it transmits signals of safety and gives investors confidence in the securities market. With the support of sufficient information, investors could make a timely decision to exit from the company. In this regard, the rules stipulate that listed companies should make sufficient risk warnings in the listing documents, including emphasizing the adoption and reasonable

⁶⁰ See Administrative Measures for the Initial Public Offering of Stocks of Sci-Tech Innovation Board (pilot edition), Article 3.

⁶¹ See STAR Market Rules, Rule 2.1.4.

⁶² See STAR Market Rules, Rule 4.5.2.

⁶³ See STAR Market Rules, Rule 4.5.3.

⁶⁴ See STAR Market Rules, Rule 4.5.4.

⁶⁵ See STAR Market Rules, Rule 4.5.6.

⁶⁶ See Adolf A Berle, Non-Voting Stock and Bankers Control, 39 Harvard Law Review 673, 675 (1926).

⁶⁷ See Supra note 63.

⁶⁸ See STAR Market Rules, Rule 4.5.10.

basis of the “DCS” structure, revealing the specific information of the controlling shareholder, disclosing the status of corporate governance, and reporting on the implementation of relevant measures about investor’s protection.⁶⁹ Secondly, the rules require listed companies to disclose all changes to matters concerning the “DCS” structure annually. Among them, the company and relevant obligors of information disclosure should disclose the major changes in a timely manner.⁷⁰ In addition, the rules require the board of supervisors to issue special opinions on whether the company continues to comply with rules and whether the interests of shareholder have been protected in the annual report.⁷¹

In terms of termination of “DCS” structure. Weighted shares should not continue for no reason, otherwise the reverse incentives of controlling shareholders will become more and more apparent. Empirical analysis shows that the effect of the differential voting rights structure on corporate development is diminishing.⁷² Under the arrangement of differential voting rights, when the controlling shareholder has no special value to the company or ordinary shareholders have no trust to them, the basis for granting additional voting rights to the controlling shareholder no longer exists. In this regard, the rules provide a conversion mechanism for weighted shares. In some circumstances, special voting shares should be converted into ordinary shares at a 1: 1 ratio. These circumstances include weighted voting shareholder’s death, departure, loss of exercise ability, violation of exercise rules, loss of control of weighted voting shares, etc.⁷³ It is worth noting that, unlike the “SGX”, “SSE” stipulates that if shareholders transfer or entrust weighted voting shares to others, the weighted voting shares should be converted into ordinary shares.⁷⁴

5. Future: The Perfection of Relevant Rules about “DCS” in China

(a) Overall Evaluation

Admittedly, in China’s immature securities market, “DCS” structure will bring high agency costs and hurt the rights of minority shareholders. However, China had to drink this glass of poisonous wine. On the one side, just like Frank Easterbrook and Daniel Fischel have mentioned, “the best structure must be developed through experience.”⁷⁵ We cannot find a more perfect structure to meet the actual needs of management in practice. As far as China is concerned, there are a large number of high-tech companies, state-owned enterprises and family enterprises. In order to achieve better development, these types of companies do need to introduce “DCS” structure. If legislators and regulators have always been cautious about the “DCS” structure, more and more companies will be forced to go overseas for listing because they choose the “DCS” structure. This is not only the loss for domestic exchanges and investors, but also the loss for the Chinese stock market. On the other side, whether to choose a “DCS” structure belongs to the company’s own internal governance, and whether to buy stocks of companies with “DCS” structure belongs to the freedom of investors. Both the regulator sets rules to prohibit the “DCS” structure, and

⁶⁹ See Guidelines for Contents and Formats of Information Disclosure about Offering Securities to the Public No. 41-Prospectus in Tech Innovation Board, Rule 57.

⁷⁰ See STAR Market Rules, Rule 4.5.11.

⁷¹ See STAR Market Rules, Rule 4.5.12.

⁷² See Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Virginia Law Review 585, 629 (2017).

⁷³ See STAR Market Rules, Rule 4.5.9.

⁷⁴ Id.

⁷⁵ See supra note 2, at p.5.

the regulator puts pressure on the exchange to set constraints on the “DCS” structure, constituting a “one size fits all” inhibition of financial innovation. Therefore, introducing “DCS” structure is an inevitable choice for China. The core of evaluating China’s introduction of “DCS” structure lies in the effectiveness of the risk prevention rules established by China around the “DCS” structure.

Looking at other jurisdictions, we can see that : whether it is the U.S., which has adopted a “light-touch” regulatory approach, or Hong Kong and Singapore, which have adopted a “heavy-handed” regulatory approach, the regulatory approach adopted is a response to the securities market and existing legal rules in this jurisdiction. It is conceivable that if the U.S. does not have sufficient institutional investors and a highly developed litigation market, “light-touch” regulatory approach will inevitably cause investors to be out of control of the risk of infringement. Based on this, the “heavy-handed” regulatory approach adopted by the “SSE” is appropriate. In detail, on the one hand, considering the high degree of similarity in market and culture between China and Hong Kong, the rules of the “SSE” draw heavily on the rules of the “HKEX”, and impose strict requirements on listed companies on the matter of listing requirements, weighted voting stock restrictions, information disclosure requirements, and termination clauses. On the other hand, compared with the “HKEX”, the Shanghai Stock Exchange's practice of placing listed companies with “DCS” structure on the Sci-Tech Innovation Board further reduces the potential risks of “DCS” structure. There is a big difference between the Sci-Tech Innovation Board and the Mainboard. The Sci-Tech Innovation Board mainly serves companies with high potential in new industries such as cutting-edge technology, and it is more possible for these companies to adapt to new rules, while the Mainboard serves mature, large-scale companies. In other words, the Sci-Tech Innovation Board has higher fault tolerance and it is more suitable to be used as a sandbox for adjusting regulatory rules. In addition, compared with the Sci-Tech Innovation Board, the threshold for investors in the Mainboard market is lower. To a certain extent, excluding individual investors with poor financial capacity is also a way to protect investors. Even though it’s inevitable for the China’s Mainboard to introduce “DCS” structure in the future, limiting listed companies with “DCS” structure to the Sci-Tech Innovation Board is a more rational choice. In summary, the rules of the “SSE” on the construction of “DCS” structure are in line with the development of the Chinese stock market, and it can basically achieve the target of reducing the negative impact of the “DCS” structure.

(b) Specific Suggestions

The rules formulated by “SSE” for the “DCS” structure are worthy of recognition. However, it should be noted that with reference to the rules of the U.S., Hong Kong, Singapore and other jurisdictions, the existing rules still have room for further discussion and improvement.

(i) Clarify the applicable conditions of the dual-class share structure

Firstly, whether the company with “DCS” structure could be listed on the Sci-Tech Innovation Board is still controlled by China’s Securities Regulatory Commission. In other words, the listing conditions are not clear, and the results of listing are not transparent. As a result, applicants do not have stable expectations about listing or not, and listed companies will have the appearance of endorsement by the government, which in turn encourages listed companies to gain blind trust from investors. These results are not conducive to the long-term development of the securities market. In this regard, the applicable conditions of the “DCS” structure should be clarified by “SSE” instead of China’s Securities

Regulatory Commission. Some Chinese scholars suggest that companies should be limited to family businesses, public welfare state-owned enterprises, and other enterprise types.⁷⁶ However, if the scope of application of the “DCS” structure is limited to certain types of companies, it will undoubtedly limit the effectiveness of dual equity institutions in financing. Rather than emphasizing characteristics of company, emphasizing whether management plays a significant role in enterprise development should be clearly defined as the applicable premise of “DCS” structure. In fact, both Hong Kong and Singapore regard the role and contribution of super-voting shareholders as an important consideration for allowing listed companies to adopt “DCS” structure.

(ii) Strengthen the intensity of information disclosure

The existing rules have already set high requirements on listed companies in terms of information disclosure. However, due to the overlapping identity of the controlling shareholder and the management, the subject of information disclosure may deliberately disclose incomplete and untimely information. Moreover, even if the information disclosed by a listed company is complete and timely, abstract information disclosure and risk warnings have no practical value. Retail investors who lack professional skills will still use market prices as the basis for trading, and will not reduce the motivation for trading with simple risk warnings.⁷⁷ Therefore, the regulatory rules should propose more specific requirements about information disclosure for every important issue. For example, for each major transaction, the company should disclose the basis for the decision, the possible risks of the decision, the content of the transaction, and whether the controlling shareholder and the ordinary shareholder have a conflict of interest in the decision to the public.

(iii) Strengthen internal supervision mechanism

Should China follow Hong Kong’s mandatory rule that listed companies with “DCS” structure must set up Corporate governance committees? The answer from “SSE” is no. It is not difficult to understand that China’s legal rules have already mandated that listed companies must establish a board of supervisors, and there is no need to waste resources on setting up institutions with the same functions. However, since most members of the board of supervisors are elected by the shareholders’ meeting, the effectiveness of the board of supervisors in overseeing company decisions has always been questioned.⁷⁸ In fact, under the “DCS” structure, the board of supervisors is more likely to be controlled by high-voting shareholders. Therefore, without considering the introduction of the corporate governance committee, the independence of the board of directors and the board of supervisors should be further enhanced to ensure that the board of directors can make rational decisions that maximize the interests of the company. The ways to enhance the independence of the board of directors and the board of supervisors are at least the following: Firstly, shareholders with high-voting rights are prohibited from exercising high-voting rights with regard to the selection of the board of supervisors, independent directors, and other similar personnel. Secondly, the chairman of the board of directors should serve as

⁷⁶ See Li Li, *Research on the Potential Risk and Prevention System of the Localization of the Dual-Class Share Structure—Comment on the Special Voting Rules of the Technology Board*, 8 Financial Supervision Research 19, 23 (2019).

⁷⁷ See Wei Zhang, *The Overseas Experience of Dual-class Share Structure and China’s Response*, 1 Financial Law 64, 79 (2020).

⁷⁸ Jay Dahya & Yusuf Karbhari (ed.), *The Supervisory Board in Chinese Listed Companies: Problems, Causes, Consequences and Remedies*, 9 Asia Pacific Business Review 118, 124 (2002).

an independent director. Thirdly, the company is required to establish a nomination committee, an audit committee, and a remuneration committee with independent directors as the majority. In addition, because the identities of directors and controlling shareholders often overlap, China's legislators may consider introducing the fiduciary duty of controlling shareholders to ordinary shareholders. For example, the applicable conditions and performance standards for controlling shareholders' fiduciary duties could be specified through judicial interpretation and guiding cases. As a result, the relative independence of the listed company's daily decision-making agencies and supervisory agencies is guaranteed. Even if the relative independence is undermined by the intervention of controlling shareholders, the infringed person can still obtain relief through lawsuits regarding fiduciary duties.

(iv) Introduce sunset clause triggered by a fixed period

The existing rules of the Sci-Tech Innovation Board have already stipulated the sunset clause be triggered by specific events and by the ratio of shareholding for the "DCS" structure. It can be seen that the rules of "SSE" are the same as those of the "HKEX" and the "SGX", and they have not established a sunset clause triggered by a fixed period. The reason that none of the above exchanges have established this type of sunset clause may be that public shareholders have the tendencies to end "DCS" structure, and changing the company's control at an arbitrary time is not in the best interests of all shareholders.⁷⁹ However, the lack of this clause makes the listed company unable to cope with the cost of agent capacity caused by the lapse of time and the risk of the decline of the founder's ability, nor can it solve the diminishing governance advantages of the "DCS" structure over time. The inefficiency of corporate governance may become the final result of applying "DCS" structure.⁸⁰ After all, it is hard to believe that every successful entrepreneur will take the initiative to give up the dominance of the company. Hence, it is necessary to force the sunset clause triggered by a fixed period in the rules. As for how to determine a reasonable time limit, there are already many research teams using market data to analyze the optimal duration of "DCS" structure. For example, the Canadian Coalition for Good Governance pointed out that 5 years is more appropriate.⁸¹ The designers of these relevant rules may determine a reasonable value based on the above results and allow listed companies have the freedom to adjust the duration with the approval of the exchange. After the expiration, considering that the sunset clause may aggravate the short-sightedness of controlling shareholders and general shareholders' aversion to "DCS" structure, all shareholders should have the right to vote equally on whether to extend the length, although, shareholders who do not vote should be defaulted to support the use of "DCS" structure. The reason is that the inference that the advantages of "DCS" structure outweigh the disadvantages has been tested in practice. This inference can only be overturned when most shareholders express their opposition to the "DCS" structure.

6. Conclusion

While the "DCS" structure avoids the dilution of the shares of shareholders who actually help the

⁷⁹ See Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 Boston University Law Review 1057, 1057 (2019) .

⁸⁰ See Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Virginia Law Review 585, 586 (2017).

⁸¹ See Canadian Coalition for Good Governance, *Dual Class Share Policy* , <https://ccgg.ca/wp-content/uploads/2019/03/Dual-Class-Share-Policy-2013.pdf> (accessed on July 03, 2020).

company's development, it also causes problems such as insider control and the violation of the rights of minority shareholders. So, whether to adopt a "DCS" structure is not a simple matter. However, as major exchanges around the world have accepted the "DCS" structure, due to practical needs and competitive pressures, accepting the "DCS" structure has become an inevitable choice. The acceptance by "SSE" regarding "DCS" structure is a stark example. Therefore, each exchange should consider how to set rules to reduce the risks of "DCS" structure. With a global vision, the U.S., Hong Kong and Singapore provide two distinct regulatory approaches for other jurisdictions. Although the rules set by the "SSE" are still inadequate in terms of application conditions, information disclosure, internal supervision mechanisms, sunset clauses, etc., it upholds the "heavy-handed" regulatory approach of "HKEX" and "SGX", effectively eliminating structural costs such as insider controlling. In fact, the rules of "SSE" are also a product of responding to China's national conditions. Summing up the experience of the above-mentioned exchange in formulating rules about "DCS" structure, it can be found that good risk prevention rules must be based on the maturity of the securities market in this jurisdiction and the enhancement of existing legal systems. In the future, China still needs to uphold this logic to improve its rules. Correspondingly, jurisdictions wishing to build rules around "DCS" structure should also regard this experience as customary to avoid unnecessary reform costs.

The CJEU Judgements: Exploring the Luxemburg Legislation on State Financial Aid to Higher Education Studies?

-- A Case Note on the CJEU Case C-20/12, C-238/15 and C-410/18 between Children of the Frontier Workers and the Luxemburg Government

Jiayi He¹

Abstract: In principle, migrant workers and frontier workers shall be treated the same as national workers in the context of the EU. However, a series of cases, namely *Giersch* (2013), *Bragança* (2016) and *Aubriet* (2019) concerning Luxemburg state financial aid on higher studies shows that the principle is not applied to the practice. The Luxemburg national law on study financing has been undergone several major changes since its adoption in 2000. The latest amendment was made in 2019 following the CJEU's judgement in the *Aubriet* case. Under the new rules, in order to apply for the study aid, the frontier workers need to be employed for at least five years in Luxemburg during a ten years reference period preceding the date of application. The same requirement is not applied to migrant workers or national workers. Even though the CJEU has constantly made decisions favoring frontier workers and the Luxemburg Government has been loosening the criteria under which the children of frontier workers can apply for the study subsidy, the different treatment between migrant workers and frontiers workers is still existing. It can be expected that the challenge on the Luxemburg national legislation will not stop until the CJEU gives a clear guideline on whether certain minimum working period can be the sole element that the Member State should take account when deciding its connection with the frontier worker.

Key words: Free Movement of People; Frontier Workers; Migrant Workers

1. Introduction

The European Union (EU) was formally established in 1992 by the Maastricht Treaty,² before which the EU was called the European Community. It was in the same treaty that the concept of the 'citizenship of the Union' was introduced for the first time.³ After the Maastricht Treaty, people who are born in any EU Member State, are not only the nationals of the Member State, but also citizens of the Union. The Maastricht Treaty further explained and characterized the European Internal Market, as it was to abolish the obstacles to the free movement of goods, persons, services and capital ('four free movements').⁴ As Union citizens, people are able to freely move, reside and work in any other Member States of which they are not nationals. The rights of the Union citizens are enshrined in both EU primary legislations, including Treaty on the European Union (TEU)⁵ and Treaty on the Functioning of the European Union (TFEU),⁶ and secondary legislations, such as the Directive 2004/38/EC⁷ and the

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² The Maastricht Treaty refers to the Treaty on European Union (1992), as it was signed in the Maastricht Netherlands, on February 7 1992.

³ See Article B of the Maastricht Treaty.

⁴ See Article G(B)(2) of the Maastricht Treaty.

⁵ Treaty on European Union (consolidated version), OJ 2016 C 202/13.

⁶ Treaty on the Functioning of the European Union (consolidated version), OJ 2016 C 202/47.

Regulation No 492/2011.⁸

The free movement of workers is one of the most important perspectives of the European Internal Market. All Member States of the EU are obliged to abolish ‘any discrimination based on nationality between workers’,⁹ including direct and indirect discriminations. Workers, who are nationals of an EU Member States, but work and reside in another Member State, are usually referred as migrant workers. Different from migrant workers, frontier workers or cross-border workers are referred to people who work in a Member state but don’t have a residence in the same country.¹⁰

Generally, migrant workers and frontier workers shall be treated the same as national works¹¹ regarding ‘employment, remuneration and other conditions of work and employment’.¹² This non-discriminatory requirement is implemented by the EU Regulation No 492/2011, which requires EU Member States to provide the same social and tax advantages to workers from other Member States.¹³ According to the former judgements of the Court of Justice of the European Union (CJEU), study subsidies granted to the children of migrant workers constitute part of the workers’ social benefits, where the workers continue to support their children.¹⁴ When it comes to that of frontier workers, however, issues are much more unsettled.

In this regard, the Luxemburg legislation on state financial aid to higher education studies has caused debates and undergone several major changes in the last two decades. In compliance with the CJEU’s judgements, especially in the case of *Giersch* (2013),¹⁵ *Bragança* (2016)¹⁶ and the latest case of *Aubriet* (2019),¹⁷ the initial legislation, the Law of 22 June 2000 (the Law of 2000)¹⁸ has been amended tremendously by the Law of 26 July 2010 (the Law of 2010),¹⁹ the Law of 19 July 2013 (the Law of 2013),²⁰ the Law of 24 July 2014 (the Law of 2014)²¹ and the latest Law of 26 October 2019 (the

⁷ Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC, OJ 2004 L 158/77.

⁸ Regulation No 492/2011 of the European Parliament and of the Council of 5 April 2011 on freedom of movement for workers within the Union, OJ 2011 L 141/1.

⁹ See Article 45 of the TFEU.

¹⁰ See Article 1(f) of the Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, OJ 2004 L 166/12. Frontier worker refers to ‘any person pursuing an activity as an employed or self-employed person in a Member State and who resides in another Member State to which he returns as a rule daily or at least once a week.’

¹¹ See Recital 5 of the Regulation No 492/2011.

¹² See Article 45 of the TFEU.

¹³ See Article 7(2) of the Regulation No 492/2011.

¹⁴ See CJEU Case C-337/97 *C.P.M. Meeusen v Hoofddirectie van de Informatie Beheer Groep*, ECLI:EU:C:1999:284, at 19.

¹⁵ See CJEU Case C-20/12 *Elodie Giersch and Others v État du Grand-Duché de Luxembourg*, ECLI:EU:C:2013:411. (*Giersch*)

¹⁶ See CJEU Case C-238/15 *Maria do Céu Bragança Linares Verruga and Others v Ministre de l'Enseignement Supérieur et de la Recherche*, ECLI:EU:C:2016:949. (*Bragança*)

¹⁷ See CJEU Case C-410/18 *Nicolas Aubriet v Ministre de l'Enseignement supérieur et de la Recherche*, ECLI:EU:C:2019:582. (*Aubriet*)

¹⁸ See Journal officiel du Grand-Duché de Luxembourg (Official Newspaper of the Grand Duchy from Luxembourg), the Law of 2000, at <http://legilux.public.lu/eli/etat/leg/loi/2000/06/22/n1/jo>, (accessed July 2, 2020).

¹⁹ See Official Newspaper of the Grand Duchy from Luxembourg, the Law of 2010, at <http://legilux.public.lu/eli/etat/leg/loi/2010/07/26/n1/jo>, (accessed on July 2, 2020).

²⁰ See Official Newspaper of the Grand Duchy from Luxembourg, the Law of 2013, at <http://legilux.public.lu/eli/etat/leg/loi/2013/07/19/n1/jo>, (accessed on July 2, 2020).

²¹ See Official Newspaper of the Grand Duchy from Luxembourg, the Law of 2014, at <http://legilux.public.lu/eli/etat/leg/loi/2014/07/24/n1/jo>, (accessed on July 2, 2020).

Law of 2019).²² A detailed comparison between those legislations has been made in the Table 1 below.

Table 1: Development of the Luxembourg Legislation on State Financial Aid to Higher Education Studies*

Legislation	Content	Requirement	Relevant Case
Law of 22 June 2000	Article 2: A student admitted to higher education studies shall be entitled to receive financial aid from the State for higher education studies where he or she satisfies one of the following conditions: (a) he or she is a Luxembourg national, or (b) he or she is a national of another Member State of the European Union, is domiciled in the Grand Duchy of Luxembourg and falls within the scope of the provisions of Articles 7 and 12 of Regulation No 1612/68 (now Regulation No 2011/492) ...	The family members of the frontier workers are not entitled to Luxembourg national study grant.	
Law of 26 July 2010	Article 2: (a) He or she is a Luxembourg national or a member of the family of a Luxembourg national and is domiciled in the Grand Duchy of Luxembourg, or (b) he or she is a national of another Member State of the European Union [...], and resides in the Grand Duchy of Luxembourg as an employed person, a self-employed person, a person who retains that status, or a family member of one of the categories of persons above, or as a person who has acquired the right of permanent residence.	The family members of the frontier workers are entitled to the study grant if they have a residence in the Luxembourg.	C-20/12 <i>Giersch</i>
Law of 19 July 2013	Article 2bis: <u>'A student not residing</u> in the Grand Duchy of Luxembourg may also receive financial aid for higher education studies <u>where that student is the child of an employed or self-employed person who is a Luxembourg national or a national of the European Union or [...], is employed or pursuing an activity in Luxembourg, and has been employed or has pursued an activity in Luxembourg for a continuous period of at least five years</u> at the time the student makes the application for financial aid for higher education studies.	The family members of the frontier workers are entitled to the study grant if the workers have continuously employed in the Luxembourg for 5 years.	C-238/15 <i>Bragança</i>
Law of 24	Article 3(5): A student not resident in the	The family	C-410/18

²² See Official Newspaper of the Grand Duchy from Luxembourg, the Law of 2019, at <http://legilux.public.lu/eli/etat/leg/loi/2019/10/26/a732/jo>, (accessed July 2, 2020).

July 2014	Grand Duchy of Luxemburg who: (a) is a worker and a Luxemburg national or a national of the European Union ..., employed or pursuing an activity in the Grand Duchy of Luxemburg at the time when the application for financial aid for higher education studies is made; or (b) is the child of a worker who is a Luxemburg national or a national of the European Union ... employed or pursuing an activity in the Grand Duchy of Luxemburg at the time when the student's application for financial aid for higher education studies is made, provided that the worker is continuing to contribute to the maintenance of the student and the worker has been employed or has pursued an activity in the Grand Duchy of Luxemburg for at least five years at the time of the student's application for financial aid for higher education studies, in the course of a reference period of seven years counting back from the date of the application for financial aid for higher education or, by way of derogation, the person retaining worker status met the aforementioned criterion of five years out of seven when he or she finished work.	members of the frontier workers are entitled to the study grant if the workers have satisfied the 'five out of seven rule'.	<i>Aubriet</i>
Law of 26 October 2019	Article 3(5) A student not resident in the Grand Duchy of Luxemburg who: (a) [...] (b) "For a cumulative period of at least five years at the time of application by the student for financial assistance for graduate studies during a ten-year reference period retroactive to the date of the application for the obtaining financial assistance for graduate studies.	The family members of the frontier workers are entitled to the study grant if the workers have satisfied the 'five out of ten rule'.	

*Compiled by the author.

In a series of cases between the children of the frontier workers in Luxemburg and the Luxemburg Minister for Higher Education and Research dating back to 2013, the different treatment between migrant workers and frontier workers is still existing, even though the rulings of the CJEU were constantly favoring the migrant workers and their family members. Since the very first case of *Giersch*, after which children of frontier workers could be entitled to study financial grant, Luxemburg has been loosening the criteria with regard to the entitlements of financial grant to the children of frontier workers. Allowing students, not residing in the Luxemburg, to have an access to the national study subsidy could

be referred as ‘portability’ or ‘exportability’ of the benefits in the EU context.²³

Unlike the situation of migrant workers where a genuine link between the worker and the working state is presumably existent, there is a need for frontier workers to prove such existence. ‘Five years’ has been an important time period, so as to establish a sufficient link between the frontier workers and the host state. However, as the CJEU has ruled in the case *Bragança*, ‘a continuous five years’ is not an appropriate criterion to determine the existence of a genuine link. Later the Luxembourg state financial aid law made a change by applying the ‘five year’ criterion to a seven-year reference period. The rule was challenged again in the present *Aubriet* case. The most recent development of the study finance law was made to extend the reference period from 7 years to 10 years.²⁴ The development of the CJEU’s case laws can be seen in the Table 2 below.

Table 2: Cases of the CJEU between Children of the Frontier Workers and Luxembourg Authority Concerning the Entitlements of National Study Aid *

Case Number	Parties	The Law at Issue	CJEU’s Decision
C-20/12, ECLI:EU:C:2013:411	Elodie Giersch etc. v Luxembourg Minister for Higher Education and Research (‘ <i>Giersch</i> ’)	Law of 26 July 2010	The national at issue which makes the grant of financial aid for higher education studies conditional upon residence by the student in that Member State is not compatible with EU legislations on freedom of movement for workers. The objective of increasing the proportion of residents with a higher education degree in order to promote the development of the economy of that Member State is a legitimate objective.
C-238/15, ECLI:EU:C:2016:949	Maria Do Céu Bragança Linares Verruga etc. v Luxembourg Minister for Higher Education and Research (‘ <i>Bragança</i> ’)	Law of 19 July 2013	The national law at issue which makes the grant of financial aid for higher education studies to a non-resident student conditional on at least one of that student’s parents having worked in that Member State for a minimum and continuous period of five years at the time of application is not compatible with EU legislations on freedom of movement for workers.
C-410/18, ECLI:EU:C:2019:582	Nicolas Aubriet v Luxembourg	Law of 24 July 2014	The national law at issue which makes the grant of financial aid

²³ See Janine Silga, ‘Luxembourg Financial Aid for Higher Studies and Children of Frontier Workers: Evolution and Challenges in Light of the Case-Law of the Court of Justice’, 25 European Public Law 13 (2019), at 13.

²⁴ See Article 3 (5) (b) the Law of 2019.

	Minister for Higher Education and Research (<i>'Aubriet'</i>)		for higher education studies to non-resident students subject to the condition that, at the date of the application, one of the parents of the student has been employed or carried on an activity in that Member State for a period of at least five years in the course of a reference period of seven years calculated retroactively from the date of that application is not compatible with EU legislation on freedom of movement for workers, because it does not permit the existence of any connection with the labor market of that Member State to be understood in a sufficiently broad manner.
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*Compiled by the author.

However, where do the series of decisions made by the CJEU actually lead to? Is the newest legislation in Luxemburg compatible with free movement of workers? If not, where further improvements are needed? With those questions, this article will be focusing on the set of cases between frontier workers together with their family members and Luxemburg Government, namely the case of *Giersch* (2013), *Bragança* (2016) and *Aubriet* (2019). The facts and legal background of those cases will be discussed in the second section, followed by an analysis on the CJEU's judgements in the third section. The comments of the case will be given in the fourth section, mainly concerning three issues. Firstly, whether the different treatment between migrant workers and frontier workers is compatible with EU regulations. Secondly, whether the CJEU has assessed the legitimacy and proportionality of national measures correctly. Thirdly, an estimation will be made with regard to the end of the changes of Luxemburg state financial aid law. Finally, reflections on the migrant workers and frontier workers in China will be given in the last part of the section 4.

2. Factual Background and Legal Issues

The defendant to the three disputes was actually the same, namely the ministre de l'Enseignement supérieur et de la Recherche luxembourgeois (Luxembourg Minister for Higher Education and Research), the claimants to the disputes were children of different frontier workers in the Luxemburg, including *Elodie Giersch*, *Maria Do Céu Bragança Linares Verruga* and *Nicolas Aubriet*. The scenarios in all three cases were quite similar. Those children of the frontier workers, were students not residing in the Luxemburg, but they applied for Luxemburg national study aid on the ground that at least one of their parents had been employed in the country as frontier workers. Their applications were turned down by the defendant for the reason that they could not satisfy the requirements stated in the law in force at

the time. For example, in the latest case of *Aubriet* between Mr. Nicolas Aubriet (referring as Mr. Aubriet junior) and the Luxembourg Government. Mr. Aubriet junior applied for Luxembourg state financial aid for his study in France on the ground that Mr. Aubriet senior, his father, was a frontier worker in Luxembourg and had been working in the country for a long period of time. The application was turned down by the Luxembourg authority for the reason that Mr. Aubriet junior did not satisfy the requirements listed in the Law of 2014, more specifically for the reason that, in the course of a reference period of seven years counting back from the date of the application, Mr. Aubriet senior had not been employed for at least 5 years cumulatively.

The Luxembourg legislation has undergone several changes before the Law of 2014. Originally, in the Law of 2000, the Luxembourg financial aid on higher education would only be granted to its nationals, or other European citizens who were domiciled in Luxembourg. This requirement could be referred as a ‘residence condition’. Later in the Law of 2010, the scope of the beneficiary was extended to the family members of workers residing in the Luxembourg. However, the frontier workers and their family members still were excluded from the scope because they don’t have a residence in the country. The Law of 2010 was challenged by some children of frontier workers in the case *Giersch* before the CJEU on the ground that the Luxembourg legislation was against the Article 7(2) of the Regulation No 1612/68, now Article 7(2) of the Regulation No 492/2011,²⁵ and was further against the free movement of workers. The Luxembourg Government amended its domestic legislation after losing the case for the first time, by replacing the ‘residence condition’ with the requirement of a genuine link between frontier workers and the state.

Under the new amendments, students, not residing in Luxembourg, are entitled to study financial aid, if a genuine link can be found between their frontier worker parents and the Luxembourg. Since then, the Luxembourg Government has been trying to establish a bright-line rule to distinguish the frontier workers who have a sufficient link with the state from those who don’t. However, the bright-line rules were kept being challenged before the CJEU.

After the *Giersch* case, the Luxembourg legislation for the first time had included the children of the frontier workers into the scope of beneficiaries of the state study aid. The Luxembourg Government subscribed in the Law of 2013 that students whose parents have been employed in Luxembourg for ‘a continuous period of at least 5 years’, are entitled to state financial aids on higher education. In other words, a minimum five-year working period can prove that there was a genuine link between the worker and the state. The ‘continuous 5-year period’ was later challenged in the case *Bragança* where the Luxembourg Government lost the case for the second time.

In *Bragança*, the CJEU indicated that the imposition of a minimum working period requirement on the frontier workers constituted an indirect discrimination,²⁶ which was against the principle of free movement of workers. Because the same requirement was not placed on the Luxembourg national workers or migrant workers. Nevertheless, the CJEU pointed it out that the indirect discrimination could be justified if the national legislation was legitimate and appropriate.²⁷ The CJEU found that by requiring the ‘continuity’, the national measure had failed to take into consideration that short breaks during the employment of a five-year period would not impede the connection between the frontier worker and the state.²⁸ Therefore, the requirement subscribed in the Law of 2013 was not necessary to reach its objective. Had been confirmed in its legislative documents and several related cases, the objective

²⁵ Article 7(2) of the Regulation No 492/2011: A worker who is a national of a Member State, in the territory of another Member State, shall enjoy the same social and tax advantages as national workers.

²⁶ See supra note 16, at 44.

²⁷ See supra note 16, at 44.

²⁸ See supra note 16, at 69.

of the Luxemburg national study financial aid was aimed at increasing the proportion of people with higher education degree.²⁹

In order to comply with the EU legislations and the *Bragança* judgement, another bright-line rule was introduced by the Luxemburg Government later in the Law of 2014. Article 3(5)(b) of the Law of 2014 stated that the child of a frontier worker who has been employed in Luxemburg for at least 5 years in the course of a 7-year reference period preceding the application ('five out of seven rule') can be entitled to the study financial aid in the child's own capacity.

Despite the fact that Mr. Aubriet senior, had been working in Luxemburg as a frontier worker for a significant period of time, Mr. Aubriet junior's application was rejected by authorities in Luxemburg on the ground that in the past 7 years dating from the date of the submission of application, his father had failed to work cumulatively at least 5 years in the Luxemburg. Unsatisfied with the result, Mr. Aubriet junior brought an action before the Administrative Court in Luxemburg, challenging the legitimacy of the refusal decision and the compatibility of the 'five out of seven rule' with the free movement of workers. Receiving the filing, the national court decided to suspend the case and made a preliminary reference from the CJEU. The same happened in the two earlier cases as well.

In the preliminary questions, the national court of the Luxemburg essentially asked whether the law in force at the time was against Article 7(2) of the Regulation 492/2011,³⁰ and in the two later disputes asked, whether the condition imposed in the Law of 2013 and the Law of 2014, which did not consider other connecting factors apart from the minimum working period, was necessary to attain the objective of the Luxemburg legislation.³¹ One thing worth noticing is that, in the *Bragança* case, while the national court expressly mentioned that the Law of 2013 did not take into account any other connecting factor apart from the minimum time of employment, the CJEU did answer this question throughout the whole judgement. It remains unclear whether the national legislation shall consider other valid factors besides the minimum working period.

There are mainly two legal issues that the CJEU needs to solve in response to the preliminary questions of each dispute, firstly, whether the national law in force at that time constituted a discrimination. If so, the CJEU would need to further analyze whether the discrimination could be justified. In order to justify the national law, there should be a legitimate objective pursued by the law (legitimacy), and the law should not go beyond the necessity to achieve the goal (necessity).

As for the first issue, the CJEU found it without difficulty that the national measures in all three disputes constituted indirect discriminations,³² on the ground that the same requirement was not imposed on the children of the national workers or students who had a residence in the territory of the Luxemburg.

In terms of the second issue, the objective of the Luxemburg state aid legislations was the same, namely to increase the proportion of the residents with a higher education degree.³³ The Luxemburg Government believed that, compared with students who reside in the country, children of the frontier workers having no residence, have less attachment to the country. Therefore, additional requirements are needed for them to have access to the national study aid.

In the *Bragança* case, the Luxemburg Government provided that the minimum and continuous period of work in the country represented an actual degree of attachment to the society of the Luxemburg, so as to ensure that children of frontier workers would go back to Luxemburg after finishing their studies in other countries, and further could increase the proportion of Luxemburg

²⁹ See the Opinion of the Council of State of 21 Mar. 2000 on draft legislation no. 4562, leading to the adoption of the Loi du 22 Juin 2000 concernant l'aide financière de l'Etat pour études supérieures (the Law of 2000).

³⁰ See supra note 15, at 32-33; see supra note 16, at 31.

³¹ See supra note 16, at 30; supra note 17, at 19.

³² See supra note 15, at 46; supra note 16, at 34; supra note 17, at 28.

³³ See supra note 15, at 48; supra note 16, at 45; supra note 17, at 30.

residents with a higher education degree.

Later in the *Aubriet* case, the Luxembourg Government argued that following the CJEU's judgment in *Bragança*, the legislator had already taken into account the minor breaks in the employment of the frontier worker.³⁴ The new legislation (the Law of 2014) had already allowed a cumulative 2 years break during a reference period of 7 years. The Luxembourg Government believed that any longer break than that would sever the connection between frontier workers and the host Member State and further remove the interest of the Luxembourg in granting aid to those students, not residing in its territory.³⁵ Secondly, the Luxembourg Government argued that excluding other connecting factors into consideration made it possible for the authority which was responsible for processing the application to apply a 'standardized mass procedure'.³⁶ With the standardized procedure, the assessment on the establishment of a genuine link would be more neutral and objective.³⁷ Otherwise, without the minimum employment period, the competent authority would have to process the application on a case-by-case basis, relying on a subjective standard, namely the 'sufficient connection with Luxembourg society',³⁸ which is more time- and cost- consuming.

3. The Judgments and Reasoning of the CJEU

The decisions of the CJEU concerning this set of cases are largely similar, if not the same. The CJEU kept giving rulings that were in favor of the frontier workers and their familiar member.

In the *Giersch*, the CJEU for the first time ruled that the 'residence condition' required by the Luxembourg state financial aid law constituted an indirect discrimination and it could not be justified by the social and budgetary considerations. The *Giersch* judgement made an extension to the scope of the beneficiary of the study aid, after which children of frontier workers were able to apply for such social benefit in Luxembourg.

In terms of *Bragança* case, the CJEU gave a more precise answer on the scope of the beneficiary,³⁹ and the condition of the entitlements. The CJEU confirmed its ruling in the *Giersch* that the national legislation imposing different requirements on children of frontier workers and national workers constituted an indirect discrimination. The justification of such discrimination was divided into two parts, namely the legitimacy and necessity of the national legislation. The CJEU accepted the argument provided by the Luxembourg Government concerning the legitimacy, but rejected the arguments about the necessity. However, it remains questionable whether it is appropriate to make certain minimum period of working time the sole factor to assess the degree of attachment between the frontier worker and Luxembourg society.

In the latest judgment of *Aubriet*, the CJEU essentially cited, relied on, and confirmed its reasonings in the previous case law, including, *Giersch*, *Bragança*, *Commission v. Netherlands*⁴⁰ and some early cases concerning the grant of social benefits to cross-border workers.⁴¹ Following its approach in the well-settled case law, the CJEU had no difficulty in concluding that assistance granted for maintenance

³⁴ See supra note 17, at 40.

³⁵ Ibid.

³⁶ See supra note 17, at 41.

³⁷ See supra note 17, at 41.

³⁸ See supra note 17, at 42.

³⁹ See supra note 23, at 19.

⁴⁰ See CJEU Case C-542/09 *European Commission v Kingdom of the Netherlands*, ECLI:EU:C:2012:346 ('*Commission v Netherlands*').

⁴¹ For example, the CJEU also relied on, Case C—57/96 between *H. Meints and Minister van Landbouw, Natuurbeheer en Visserij*, ECLI:EU:C:1997:564 and Case C—73/08 *Nicolas Bressol and Others and Céline Chaverot and Others and Gouvernement de la Communauté française*, ECLI:EU:C:2010:181.

and education, including for the children of frontier workers, constituted a social benefit within the meaning of Article 7(2) of the Regulation No 492/2011,⁴² as social benefits should be interpreted broadly in order to make the whole system effective.⁴³ Further, the CJEU found it with ease that by placing a different requirement on the students who don't reside in the territory, the national legislation of the Luxembourg constitutes an indirect discrimination,⁴⁴ as the 'five out of seven rule' would be liable to operate mainly to the detriment of nationals of other Member States.

The most difficult parts of the decision lay on the whether the 'five out seven rule' could be justified, for which the Luxembourg Government needed to prove that the rule presented a legitimate objective, and it was appropriate and necessary to realize the primary objective of Luxembourg's financial aid system for higher studies.

As for the legitimacy, the CJEU kept its particularly undemanding attitude towards the assessment of the public interest justification put forward by the Luxembourg Government.⁴⁵ Regardless of the long period of time between the three judgments and excepted developments in the society of Luxembourg, the CJEU repeated its reasoning in the case *Giersch* and *Bragança* and decided that increasing proportion of people with higher education was an legitimate objective of general interest. No evidence was required for the Luxembourg Government to prove that whether there was still a need to improve the number of residents with a higher education degree. No statistics or figures were presented by the Luxembourg Government to show the effect of the undergoing study finance aid in the country.

With regard to the proportionality of the national legislation, in the wording of the present judgment, it seemed that the CJEU drew the conclusion that provisions of legislation in Luxembourg did not pass the necessity test because those provisions were unable to accommodate the circumstance of Mr. Aubriet junior. From the perspective of the CJEU, Mr. Aubriet senior, being a 'tax payer in Luxembourg and making contribution to the social security scheme of the State for more than 17 years during the 23 years' before his son's application, had established a genuine link with the Luxembourg.⁴⁶ However, the 'five out of seven rule' failed to include such situation. The CJEU found that the national rule was incompatible with EU laws on the ground of the unfairness shown in this single case.

In the two later case *Bragança* and *Aubriet*, the Luxembourg national court referred to the CJEU, asking what kind of other factors apart from the minimum working period should be considered by the Member State when deciding the connection between frontier workers and the country. In the *Bragança* case, the CJEU simply ignored the question and did not provide any valid answer or guideline.

In the closing remarks of the *Aubriet* judgment, the CJEU finally came to the core of the preliminary question that whether provisions of both EU primary and secondary legislation at Union level preclude a Member State to exclude taking into account of any other connecting factors except for certain minimum period of time when deciding the grant of financial aid for higher studies to the children of frontier workers. Carefully constructing its wording, the CJEU only provided that merely taking into consideration of the activity carried out in Luxembourg in the course of a reference period of 7 years was not enough to make the full assessment of sufficient connection.⁴⁷ The CJEU did not give a general answer on whether other elements need to be considered, and if so what are the relevant elements. The CJEU stepped a little bit further in the last paragraph of the judgment by saying that

⁴² See supra note 17, at 25.

⁴³ See CJEU Case C-67/14 *Jobcenter Berlin Neukölln v Nazifa Alimanovic and Others*, ECLI:EU:C:2015:597, at 44.

⁴⁴ See supra note 17, at 28.

⁴⁵ See Siofra O'Leary, 'The Curious Case of Frontier Workers and Study Finance: *Giersch*', 51 Common Market Law Review 601 (2014), at 612.

⁴⁶ See supra note 17, at 43.

⁴⁷ See supra note 17, at 45

national legislation making the grant of study finance subject to the ‘five out seven rule’ was not complied with EU rules, because it did not permit the existence of any connection with the labor market of that Member State to be understood in ‘a sufficiently broad way’.⁴⁸ However, there is no further clarification about what is ‘sufficiently broad way’.

4. Lessons and Reflections on the Cases

The *Aubriet* decision contains the typical a ‘discrimination-justification’ approach that the CJEU usually adopts when it addresses cases concerning free movements. At first, the CJEU would decide whether the national measure at issue constitutes a direct or indirect discrimination. If so, it would further decide whether the national measure could be justified.

In this set of cases, the CJEU concluded that the national measure at issue constituted an indirect discriminatory restriction on the ground of nationality. Later, the remaining parts of judgment focused on the justification of the national measure, namely whether there was a legitimate objective and if so, whether the national legislation was necessary to reach that goal. While the CJEU tried to compete the final piece of the series cases, by answering whether certain minimum period of working time can be the only factor that the host Member State takes account when deciding the genuine connection, its implicit wording caused more problems than it answered. Moreover, migrant workers and frontier workers are not unique in the EU, there is a great number of migrant workers in China. Lessons learned from this series of cases can be useful to the Chinese society as well.

(a) Different Treatments between Migrant Workers and Frontier Workers

Pursuant to the preamble the Regulation No 492/2011 the right of free movement must be enjoyed by workers ‘without discrimination by permanent, seasonal and frontier workers and by those who pursue their activity for the purpose of providing services’.⁴⁹

In the case of *Commission v Netherlands* in 2012, the CJEU stuck to the non-discriminatory treatment between migrant workers and frontier workers by reiterating the normative assumption⁵⁰ that in principle, the fact that migrant and frontier workers had participated in the labor market of a Member State, created a sufficient link of integration with the society.⁵¹ The genuine integration can be reinforced by the mere fact that those migrant workers and frontier workers, pay tax to the host Member State and make social contributions to its industries. There is no need to prove the establishment of a sufficient connection by frontier workers who are economically active.

However, the CJEU adopted a slightly different approach later in the case *Giersch and Bragança*. In the *Giersch* judgment, the CJEU expressly stated that ‘it must be noted that the frontier worker is not always integrated in the Member State of employment in the same way as a worker who is resident in that State.’⁵² The same reasoning was followed in the *Bragança* judgment. Therefore, the CJEU seems to accept that in the case of frontier workers, the indirect discriminatory restriction could be justified when a sufficient connection to the society of the host Member State is not presented.⁵³ The CJEU appears to adopt an opposite assumption that unlike a typical migrant worker who is employed and resided in the

⁴⁸ See supra note 17, at 47.

⁴⁹ See Recital 5 of the Regulation No 492/2011.

⁵⁰ See Floris de Witte, ‘Who funds the mobile student? Shedding some light on the normative assumptions underlying EU free movement law: *Commission v. Netherlands*’, 50 Common Market Law Review 203 (2013), at 203.

⁵¹ See supra note 15, at 65.

⁵² See supra note 15, at 65.

⁵³ See supra note 17, at 34.

hose Member State, a frontier worker is not always integrated in the Member State through employment.⁵⁴ The standard of proof on the establishment of a sufficient link is imposed more heavily on the frontier workers than that on the migrant workers. Therefore, it is hard to say that both migrant workers and frontier workers are equally protected, by both EU primary law⁵⁵ and secondary law.⁵⁶

The EU legislations do not incorporate a clear definition of ‘workers’. The CJEU establishes the concept in its famous case of *Lawrie Blum*,⁵⁷ under which both migrant workers and frontier workers could be perfectly defined as ‘workers’. Additionally, the right of free movement of workers does not specifically refer to a certain type of workers. However, in the series cases concerning Luxembourg, the CJEU created a distinction on the basis of ‘an integration condition’⁵⁸ between migrant workers and frontier workers. In doing so, the unified concept of ‘worker’ at the Union level might be fragmented.⁵⁹

However, the distinction between migrant workers and frontier workers might be reasonable from the logic of strict financial reciprocity.⁶⁰ Firstly, compared with migrant workers, who live in the state of employment, frontier workers pay less income tax to the state as the income tax is usually levied in the state of residence instead of place of employment. Frontier workers make less contribution than migrant workers in terms of taxation. Thus, it might be reasonable for the state to apply different integration condition on migrant and frontier workers. Second, pursuant to the preamble of Directive No 2004/38,⁶¹ ‘persons exercising their right of residence should not become an unreasonable burden on the social assistance system of the host Member State’. The Luxembourg could well justify the discriminatory measure imposed on the frontier workers, if it can prove that without the measure, the study aids granted to the children of frontier workers will constitute unreasonable burden on its social system. In *Giersch* case, the Luxembourg Government put forward an argument on the second ground, saying that it ‘cannot be more generous towards non-resident students’ without damaging the financial system.⁶² However, the argument was not accepted by the CJEU.

(b) Legitimacy and Proportionality of the National Legislation

In the context of the free movement of workers, a national measure restricting the right of movement will only be found incompatible with EU rules, if it constitutes a discrimination without a proper justification. Usually, a national measure can be justified if it has legitimate objective and it does not go beyond the necessity to reach the goal.

(i) The legitimacy of national legislation in the context of internal market

In *Giersch*, Luxembourg Government contended that the law establishing study finance was aimed at increasing the proportion of residents with a higher education degree. The specific goal was set that by the year of 2020, more than 40% of the residents in Luxembourg would hold a higher education

⁵⁴ See CJEU Case 66/85 *Deborah Lawrie-Blum v Land Baden-Württemberg*, ECLI:EU:C:1986:284, at 19.

⁵⁵ See Article 45 of the TFEU.

⁵⁶ See Article 7(2) of the Regulation No 492/2011.

⁵⁷ See *supra* note 54, at 22.

⁵⁸ See *supra* note 23, at 22.

⁵⁹ *Ibid.*

⁶⁰ See *supra* note 15, at 209.

⁶¹ See Recital 10 of Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the Right of Citizens of the Union and Their Family Members to Move and Reside Freely within the Territory of the Member States OJ 2004 L158/81 (‘Directive 2004/38/EC’).

⁶² See *supra* note 15, at 50.

degree.⁶³ Luxemburg Government believed that the study aid at issue would help to achieve its primary goal by increasing the number of students who would return to the granting Member State after finishing their studies. This was confirmed by the CJEU that national measure had a legitimate objective, as it was adopted to ensure the well-education of the resident population, which was compatible with headline targets agreed at an European level.⁶⁴ Later in both *Bragança* and *Aubriet* cases, the CJEU came to the conclusion that increase the percentage of well-educated population was of overriding public interest, by merely citing its ruling in *Giersch* without any further assessment.⁶⁵

Although the two documents cited by the CJEU in the case *Giersch*, namely the COM (2010) 2020 final⁶⁶ and the ET 2020,⁶⁷ encourage Member State to adopt specific measures implementing those shared objective objectives at the national level, those policy documents should be understood in a broader manner, in the context of the EU internal market. The two official documents generally speak of the higher education of young people without any reference to national or geographic scope.⁶⁸ The Luxemburg measures in the cases of *Giersch*, *Bragança* and *Aubriet*, making the grant of study aid subject to a minimum period of working time, will increase the number of students who would go to the Luxemburg after their study. Those students may go back for two reasons. Firstly, their studies are financed by Luxemburg Government. Secondly, their parents have a closer relationship with the country.

However, more students returning to the granting Member State means that less students will be able to fully enjoy the right of free movement within the whole Union, which actually hinders free movement of persons in the internal market as a whole. The reasoning in the *Aubriet* judgment is contradict to the traditional rationale of the fundamental rights protected by the Union law.⁶⁹

(ii) The proportionality of a 7-year reference period

The heart of the *Aubriet* judgment lies on whether the ‘five out of seven rules’ could pass the test of proportionality. In *Bragança*, the CJEU had accepted that the condition of a minimum period of five years of employment was necessary as to establish a connection between the frontier worker and the society of the Member State.⁷⁰ Therefore, there is little dispute about the cumulative 5-year working time, but the 7-year reference period has caused more concerns.

The 7-years reference period was introduced into the legislation in Luxemburg in order to comply with the CJEU’s judgment of *Bragança*, in which the CJEU concluded that a minimum and continuous period of five years without taking the short breaks into consideration went beyond necessity to achieve the objective of the law. In the *Aubriet* case, Luxemburg Government argued that the introduction of a 7-year reference period made it possible to take account the short breaks. Further, it believed that any break longer than 2 years would not be ‘minor’ and could damage the connection between the frontier worker and the state.

The CJEU was not convinced by the argument and turned it down from another perspective. Firstly, the CJEU assessed the situation of Mr. Aubriet senior and found out that he had been making contributions to the Luxemburg social security scheme for ‘more than 17 years during the 23 years proceeding his son’s application’.⁷¹ In the CJEU’s eyes, Mr. Aubriet senior had established a genuine link with the society by making such great contributions. However, the ‘five out seven rule’ excluded

⁶³ Id., at 20.

⁶⁴ Communication from the European Commission: Europe 2020, A Strategy for Smart, Sustainable and Inclusive Growth, COM (2010) 2020 final, at 5.

⁶⁵ See *Bragança*, supra note 16, at 35 and *Aubriet*, supra note 17, at 31.

⁶⁶ See supra note 78.

⁶⁷ Conclusions of 12 May 2009 on a Strategic Framework for European Cooperation in Education and Training (‘ET 2020’), OJ 2009, C 119/2.

⁶⁸ See supra note 57, at 614.

⁶⁹ Ibid.

⁷⁰ See supra note 16, at 58.

⁷¹ See supra note 17, at 43.

him and his family from the scope of beneficiary. In this sense, the Law of 2014, failing to accommodate the situation of the Aubriet's, was not broad enough. Although the CJEU again protected frontier workers' right of free movement, it appeared to draw the conclusion on a case-by-case basis, which was against the argument of the Luxemburg that a 'standardized mass procedure' was needed.

However, the CJEU neither explicitly rejected the application of a standardized mass procedure nor confirmed its application. Throughout the whole judgement, it did not mention any other factors except for the certain period time of employment, that the Member State should take into consideration, but merely indicates that the only consideration of a 7-year reference period was not broad enough. For the compliance with the CJEU's ruling in *Aubriet*, the most recent change of Luxemburg legislation on study aid was made to replace the 7-year reference period by a longer, 10-year reference period. It is also worth noticing that, except for the extended reference period, the current legislation does not introduce any new element that may affect the sufficient link between frontier workers and the host Member State. However, it remains unclear that when deciding the genuine link between the frontier workers and the Member State, whether any other factors should be taken in to consideration, such as the amount of taxation paid by the frontier worker and their contributions to the social security scheme.

(c) Possible Developments of Luxemburg Legislation on Study Financial Aid

Since its adoption, the compatibility of the Law on State financial assistance for higher studies has been constantly challenged before the CJEU. Having been amended tremendously for at least three times to comply with the judgments of the CJEU, the latest legislation has extended the previous 7-year reference period to a decade long period. Currently, under the Law of 2019, the children of frontier workers will be entitled to study grant if one of their parents has been employed in Luxemburg for a cumulative 5 years in the course of a decade reference period preceding the date of application. The frontier workers will be able to enjoy at most a cumulatively 5 years' break during their employment, which is half of the total reference period of time.

The CJEU has held in case of *Bragança* that a minimum 5-years' working time, which is the same the period of the permitted break in the latest national legislation, can establish a sufficient link between frontier workers and the host Member State.⁷² Purely looking at the logic corollary of the reasoning of the CJEU's judgements, if a period of 5 years could establish a genuine link between concerned parties, the same period of 5 years should be able to sever the established connection in the same way.

Frontier workers whose sufficient link with the society of the Member State has been severely affected, could not be able to claim social benefits, the same principle applies to their family members. From this point of view, the latest legislation in Luxemburg has reached a balanced point. However, in *Aubriet*, the CJEU ruled that the existence of any connection with the labor market should be understood in 'a sufficiently broad manner',⁷³ indicating that apart from a certain minimum period of working time, Member State should take more relevant elements into consideration when it comes the establishment of sufficient connection to its society.

From the judgments of the CJEU concerning Luxemburg state study aid, it appears that, migrant workers and frontier workers in principle will find it easy to create a close connection to the Member State if they work in Luxemburg for a significant period of time. On the contrary, the Luxemburg, as the host Member State will find it quite difficult to stop the connection with the frontier workers, even when those workers are no longer working in its territory after sometime of working. The lack of 'exit mechanism' for Member State may bring about practical budgetary problems and further may cause unreasonable burden to the host Member State.

(d) Reflections on the Migrant Workers in China

⁷² See supra note 16, at 58.

⁷³ See supra note 17, at 47.

Generally, it is easy to conclude that, within the EU, children of the migrant workers or frontier workers, are able to establish a connection with a Member State through their parents' employment in that Member State. With this close connection, those children will be able to enjoy the social benefits of the Member States where they are not nationals. However, the same is not happening in China, while there is also a large number of migrant workers. In the past year of the 2019, there are around 174,250,000 migrant workers.⁷⁴ Most of them come from comparatively undeveloped area, work and reside in the capital cities or other big cities of China. The concept of 'free movement of workers' is unique in the context of the EU and it is hard to find a counterpart term in the Chinese legislation. Moreover, with the household registration system (hukou system), migrant workers might find it harder to move and reside in a different city or province in China.

The education of the children of those migrant workers also have caused concerns. More than a half of the migrant workers found it hard for their children to go to school at their place of working, especially in those big cities whose population is larger than 5,000,000.⁷⁵ There two main concerns of those migrant workers and parents. Firstly, the cost of the education is hard to afford in big cities, especially the cost of private schools. Secondly, children of the migrant workers will not be able to attend the college entrance examinations at the place of their parents' employment, if they don't have a registered residence at the same place.⁷⁶

To address those concerns, the State Council of the People's Republic of China has issued an Opinion in 2014, the third and fourth part of which are to ensure the rights and interests of the migrant workers.⁷⁷ More specially, the Opinion mentioned that children of the migrant workers who move with their parents to the place of employment, shall have the access to public school to take compulsory education.⁷⁸ Additionally, the Opinion urged the local government to facilitate policy and provide convenience for the children of migrant workers to take entrance exams to high school or college in their parents' working place instead of their registered place.⁷⁹

However, there are two indications of the Opinion. Firstly, in the third and fourth section of the Opinion, it is only mentioned that children who move with their parents can have access to compulsory education in their parents' work place. The children who do not move with their parents will not be able to enjoy any educational resources or benefits in the work place of their parents. Those so-called left-behind children will not be able to establish an attachment to the society which is generally more advanced than the city where they were born, through their parent's employment. Secondly, the right of migrating children to attend public school is only extended to compulsory education. After the middle school, it depends on the local policies and regulations to determine whether those children will have to take entrance exams and further their education back in their registered place.

In the context of the EU, the children of migrant or frontier workers, as EU citizens, are able to freely move and reside in any European Member States. Therefore, there is no concern about whether they can attend school in a different country or not. The problem is more on whether they can enjoy the social benefits in a different Member States. Differently in China, whether children of migrant workers can attend school in the same way as local children remains a question. As for the social benefits, more

⁷⁴ See the Report of the National Bureau of Statistics, at http://www.stats.gov.cn/tjsj/zxfb/202004/t20200430_1742724.html, (accessed on July 27, 2020).

⁷⁵ Ibid.

⁷⁶ Ibid.

⁷⁷ See the opinion of the State Council of the People's Republic of China, at http://www.gov.cn/zhengce/content/2014-09/30/content_9105.htm, (accessed on August 18, 2020).

⁷⁸ Id., at Point 14.

⁷⁹ Ibid.

differences can be found between the EU and the China. In the EU, the study aid granted to the kids of the worker, constitutes part of the worker's social benefit.⁸⁰ Contrarily, the social benefits enjoyed by the migrant workers in China are more limited, which are mainly extended to basic medical insurance.

Movement of workers in China might not be as free as that in the EU, however, it becomes increasingly popular and common. With the movement of labor force, the poverty problem in the undeveloped areas could be mitigated, at the same time economy in the developed areas might be further strengthen. If a better guarantee on the education can be provided to the children of the migrant worker, the movement of labor force can be better reinforced. In this sense, the concept of free movement of workers and a large scope of the social benefits enjoyed by the migrant workers could be learned by the local and central government in China.

5. Conclusion

The current balance achieved in the newest Luxemburg legislation between the time of employment and the time of break, a five-to-five distinction, is based on strict mathematics. Yet, situations in real life are always more complicated than pure math problem. Without an explicit answer from the CJEU in the neither Bragança nor Aubriet case, we still do not know whether it is appropriate for a Member State to exclude other related factors from consideration when considering its relationship with frontier workers. It leaves only for the time to tell whether the Law of 2019 on state financial assistance for higher studies in Luxemburg will be challenged again and whether the new provisions of national legislation goes beyond its necessity by excluding other relevant factors.

In Aubriet, the last piece of entitlement to social benefits for frontier workers and their family has not been completed firmly. The CJEU still insists on a sufficient link test instead of a normative presumption in the cases of frontier workers. The different treatment between migrant workers and frontier workers is not eliminated, but contrarily enhanced by the CJEU. The legitimacy and proportionality of the national measure should be equally important when assessing the possible justification of the national measure. The CJEU is really undemanding in the legitimacy test, coming to the conclusion in favor of Luxemburg without requiring any further evidence. However, it becomes quite strict and sets a high threshold in the proportionality test by adopting a case-by-case approach without thinking about the arguments put forward by the Luxemburg Government.

Encouragement on the free movement of students, requires the exportability of study finance. The series of cases in Luxemburg also contains a hint that despite the possible study forum shopping problem and practical budgetary obstacles that may occur in the Member States, the CJEU tries to fully guarantee the free movement of persons and protect the interest of frontier workers and their family members. Even though, the series of cases is brought before the CJEU in the context of the free movement of workers, it concerns the right of education and the human rights of the frontier workers as well. The protection on migrant workers and frontier workers is further enhanced by the series of cases. Lessons should also be learned from the judgement of the CJEU by other societies, including China.

⁸⁰ See *supra* note 15.

Enlightenment of Japan's Private International Law Legislation to China

Guangjie Zhang¹

Abstract: From Horei to Act on the General Rules of Application of Laws, the revision of Japan's private international law fully reflects the fact that Japan's private international law legislation draws on the concept of extraterritorial legislation based on its own national conditions taking into account the characteristics of internationalization and localization. By analyzing and sorting out the internationalization and localization of Japanese private international law legislation, insight into the coordination of internationalization and localization has promoted the development of Japanese private international law, such as: stipulating norms of interpersonal conflicts; introducing mandatory norms; recognizing the effectiveness of the compulsory norms of the host country in the most closely connected places, which leaves room for the introduction of the compulsory norms of the affiliated country of the foreign applicable law and the compulsory norms of the third country; and pursuing the flexibility of the closest relationship principle. This modern legislative process can provide useful experience and reference for the improvement of China's private international law legislation.²

Key words: Japan's Private International Law Legislation; Horei; Act on the General Rules of Application of Laws; Localization; Internationalization; Norms of Interpersonal Conflict.

Since 1980, with the economic globalization and the increase of international civil and commercial exchanges, international civil and commercial rules have shown a trend of unification and international private laws of various countries in the world have been integrated in many aspects, such as their manifestations and legislative methods.³ As the mutual influence among the legal systems of various countries deepen, each country's private international law legislation will take into account its own national conditions, reasonably draw on and absorb the experience of other countries' legal systems, and reflect the characteristics of internationalization and localization of private international law legislation. As we all know, Japan is good at learning from the strengths of other countries. During the Meiji Restoration period, under the guidance of the idea of "departing from Asia for Europe," Japan fully inherited German law and French law in the legal field. After World War II, Japan inherited American law in the Constitution and other branches of laws. Since modern times, Japanese law has largely inherited the laws of European and American countries, forming a unique modern legal system⁴ which can be affirmed by the path taken by Japan's private international law legislation.⁵ This unique form of legislation is what we have to learn and learn from, which has enlightening significance for the legislative improvement and judicial practice of private international law in China.

1. The Internationalization of Japan's Private International Law Legislation

Japanese academic and practical circles have been studying, absorbing, and transforming

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² Japan has undergone seven major revisions during the modernization of private international law, including the Act on the General Rules of Application of Laws.

³ See Xiaohong Liu, *Forty years of China's private international law legislation: system, concept and direction*, 43 Legal Science 3, 10-1 (2018).

⁴ See Xia Hua & Lixin Zhao, *Legal succession and legal cultural changes in Japan*, China University of Political Science and Law Press, pp.163-200 (2005).

⁵ Japanese private international law legislation refers to seven revisions from Japan's Horei to Act on the General Rules of Application of Laws.

advanced theories and systems of foreign private international law, which manifests the internationalization of Japanese private international law legislation. In addition, the broad discussions caused by controversies over “universalism”⁶ and “particularism”,⁷ “justice conflict” and “substantive justice” in the academic development of private international law in Japan have also profoundly affected the process of internationalization of Japanese private international law legislation.

(a) The Influence of Particularism and Universalism on Japanese Private International Law

In the 19th century, the European and American scholars of private international law developed two schools of thoughts: particularism and universalism. Supporters of particularism believe that private international law belongs to domestic law, and the rules of private international law of each country can be determined independently according to the principle of state sovereignty, and an unequal attitude shall be taken towards the application of domestic law and foreign law.⁸ The supporters of universalism use the transcendental theory of private international law to solve legal conflicts, deduce the principles of private international law from natural law, and hold that there is a system of private international law that is uniformly applicable to all countries in the world.⁹ Supporters of universalism believe that the rule of law should reflect the spirit of universalism, and countries can apply uniform conflict norms. However, in the process of its development, the conflict of laws of each country provides different or even contradictory rules, which affects the function of conflict law to solve the civil and commercial legal conflicts of each country. Therefore, some scholars believe that we should strive for the highest value of conflict law,¹⁰ which can only be realized by adhering to the universalist theory.¹¹ Under the initiative of moncini and others, the movement of unifying conflict laws arose in Europe. There are obvious differences and conflicts between particularism and universalism, but the supporters of the two theories keep seeking balance through the process of mutual compromise. While supporters of particularism hold that private international law is only domestic law, they also see that without proper coordination, legal conflicts will never be truly resolved. Therefore, many of them believe that the task of private international law should be to coordinate the legal systems of different countries and the basis of such coordination is that when each country determines its own jurisdiction, it should take the jurisdiction and laws of other countries into consideration. In this way, particularism also has the element of universalism.¹² The supporters of universalism find their views inconsistent with the practice of international exchanges and it is impossible to solve all conflicts of law universally and consistently. They also believe that states have the right to

⁶Universalism, also called internationalism, and the scholars who hold this view are called “universalism-internationalism school”. Representatives of this school include Savigny and Von Bar from Germany, Weiss from France, Mancini from Italy and Jitta from the Netherlands. See Shuangyuan Li, *Private International Law*, Peking University Press, pp.25-6 (2006).

⁷Particularism, also known as nationalism, and the scholars who hold this view are called “particularism - nationalism school”. The representatives of this school include Franz Kahn, Wolff, Bartin, Niboyet, Dicey, Cheshire, Cook and Lorenzen. See supra note 6, at p.26.

⁸See Shuangyuan Li, *Direction of Research on China's Private International Law*, 2 Law and Social Development 58, 61 (1996).

⁹See supra note 8, at p.60.

¹⁰The initial highest value of conflict of laws is the balance between predictability and operability. The earliest conflict of laws pursued predictability and operability, enabling all countries to resolve foreign-related legal disputes by a common conflict rule. Now it pays more attention to fairness, making the highest value a balance between the fair value of operability and predictability.

¹¹See Juan Shen, *Conflict of Laws and its Value Orientation (revised)*, China University of Political Science and Law Press, p.78 (2002).

¹²See Donggen Xu, *Trend of Private International Law*, Peking University press, pp.284-5 (2005).

exclude, laws that should have been applied under the rules of conflict. In this way, universalism has the element of particularism.¹³

The theory of particularism and universalism also influenced the legislation of Japanese private international law. The majority of scholars in Japanese private international law agree that Japanese private international law should take universalism as its basic concept and emphasize that the significance of private international law is to satisfy and promote the development of international civil and commercial exchanges.¹⁴ Under the guidance of this academic trend, the legislation of Japan's private international law has been adjusted accordingly. For example, the Act on the General Rules of Application of Laws can better demonstrate than Horei (Japanese Law and Regulation the private international law concept of equality between domestic and foreign laws. Paragraph 2 of Article 3 of Horei is a unilateral transaction protection clause, which is limited to transactions carried out in Japan.¹⁵ This provision that only protects domestic transactions is inconsistent with the private international law concept of equality between domestic and foreign laws. By contrast, the Act on the General Rules for the Application of Laws prescribed in Paragraph 2 of Article 4: "When the parties to a legal act in accordance with its domestic law are of limited capacity for conduct, but in accordance with *lex loci actus* shall have full capacity for conduct, if all the parties to the legal act are in the same place of law, the parties shall not be restricted by the aforesaid provisions, and shall be deemed to have full capacity for conduct."¹⁶ Therefore, the Act on the General Rules of Application of Laws changes it into a bilateral transaction protection clause, that is, no matter where the Act is, as long as the parties are in the same country or region when the relevant legal act is implemented, and the party is a person with full capacity in accordance with *lex loci actus*, then the party shall be deemed to have full capacity for conduct. These provisions not only protect minors, excluding online transactions from the scope of Paragraph 2 of Article 4 of the Act on the General Rules of Application of Laws,¹⁷ but also protect the transaction act from the subjective influence of the transaction subject. The bilateral transaction protection clause can better reflect the equality between domestic and foreign laws and conform to the basic concept of foreign private international law, which is the theoretical premise of the modernization of Japanese private international law.

(b) The Impact of Controversy between Justice Conflict and Substantive Justice on Japanese Legislation

As the types of international civil and commercial disputes become more complicated and diversified, the trend of flexible conflict norms has become the consensus of the international private law academic circle and the practical circle. Flexibility is a feature of the transition from tradition to modernity.¹⁸ The traditional theory of private international law focuses on the realization of "justice conflict", that is, the equal application of domestic and foreign laws. Its characteristic is that the court directly applies the laws of a certain country to international civil and commercial disputes in accordance with the guidance of domestic conflict norms, and does not consider the specific contents of the applicable law. It can be seen that conflict norms in this way choose not the law, but the jurisdiction

¹³ See Shuangyuan Li, *The Process of the Unification of China and Private International Law*, Wuhan University Press, p.148 (1993).

¹⁴ See Keisuke Takeshita & Sadajiro Atobe (ed.), *The Universal Private International Law School of Thought in Japan*, Japanese Yearbook of International Law, p.238 (2013).

¹⁵ Article 3, Paragraph 2 of Horei: "Notwithstanding the provisions of the previous paragraph, a foreign person who would be a person of full capacity under the Japanese law shall be considered as such when performing a juristic act, even if he/she has only limited capacity under the law of his/her home country."

¹⁶ See Yoshiaki Sakurada & Masato Dougauchi, *100 Private International Law Cases*, Yuhikaku, p.252 (2012).

¹⁷ See Sada Kanzaki, *Interpretation: Act on General Rules for Application of Laws - a new private international law*, Koubundou, p.32 (2006).

¹⁸ Professor Chongli Xu formalizes modern flexible legal conflict resolution methods and summarizes some relatively fixed legal choice rules, which are called "modern conflict norms". See Chongli Xu, *The Return of Conflict Norms: A*

(state). Therefore, this kind of “justice conflict” cannot guarantee the fair and reasonable settlement of the case. However, modern conflict law theory focuses on “substantive justice” and emphasizes the setting of flexible conflict norms, which makes up for the rigid and mechanical traditional conflict norms and can better realize individual case justice.

It is under the influence of the modern conflict law theory which pays attention to flexibility and individual case justice that the legislation of Japan’s private international law has been innovated again and again. It does not exaggerate to say that the Act on the General Rules of Application of Laws was the latest contemporary private international law legislation enacted in Japan in the background of legal modernization and internationalization.¹⁹ The Act on the General Rules of Application of Laws builds the legal application system based on the bilateral conflict norms, injects more flexibility into the conflict norms and “softens” them, thus gaining greater development potential and vitality, and unleashing great vitality of legal adaptability. In particular, it demonstrates the adoption of selective link points and link points “softening”.

(i) Selective link points

According to the content of private international law, American professor Simonides divided the change of private international law into two generations: that of civil law system before it was influenced by the American “conflict law revolution” was the first generation and the revised private international law influenced by it was the second.²⁰ The first generation was characterized by an excessive reliance on a single link point, such as the place where the contract was entered into or where the tort was committed, so that judges had no discretion in determining the applicable law. The first step towards the second generation was the adoption of selective link points, in which judges could consider multiple link points in a particular case.²¹ According to this norm, as to the way of entering into a contract, the application of law is not only based on the law of the place where the contract is entered into, but the judge can also choose the applicable law according to the law of the mutual residence, mutual habitual residence or business place of the parties in a larger scope, thus improving the possibility of entering into contract and protecting the interests of the parties. For international tort disputes, *lex loci delicti* is no longer the only link point. In order to protect the interests of the victim, the judge can choose to apply *lex loci delicti* or the law of the place where the damage results occur. Thus, selective linkage is not only conducive to the establishment of a certain legal relationship, but can also protect the interests of the parties.

The 1961 Convention on Conflict of Laws relating to the form of testamentary dispositions uses selective link points,²² to which Japan participated and ratified its application in its own country. Since then, the law application of testament in domestic law adopts the conflict norm of selective link, that is, the laws pertaining to the testamentary place, the nationality, domicile and habitual residence of the testator at the time of making testament or the death of the testator are all valid. When the Act on the General Rules of Application of Laws was enacted in Japan, selective link points were widely used in legal relationships other than testament, including capacity for conduct, legitimation, formation of

Developing Trend of Modern Conflict of Laws Theory and Practice in the United States, 21 Law Review 101, 109 (2000).

¹⁹ See Wang Li, *Legislation on Japan’s New Private International Law - A Review of Japan’s Act on General Rules for Application of Laws*, 29 *Global Law Review* 122, 123-5 (2007).

²⁰ See Symeon C. Symeonides, *Codification and flexibility in private international law*, General Reports of the XVIIIth Congress of the International Academy of Comparative Law, p.167 (2012).

²¹ See *supra* note 20, at p.174.

²² The 1961 Convention on the Conflict of Laws on the Method of Disposal of Wills adopts selective link points, i.e. the laws pertaining to the testamentary place, the nationality, domicile and habitual residence of the testator at the time of making testament or the death of the testator are all valid.

parent-child relationship, adoption, marriage, etc. For example, Article 30 of the Act on the General Rules of Application of Laws provides for the application of legitimation: “when the child is ready for legitimation, he or she obtains the status of legitimate child pursuant to *lex patriae* of his or her father or mother or the child.”²³ Some Japanese scholars believe that this is a revolutionary trend of conflict norms reform.²⁴ This shows that Japan’s private international law legislation conforms to the main trend of the world and embodies the latest achievements of the internationalization of Japan’s private international law.

(ii) Link points “softening”

Traditional conflict norms often provide only one link point for a certain kind of legal relationship (such as tort, and determining the applicable law with this single and rigid link point can no longer meet the needs of the increasingly complex legal relationship. Therefore, there is a tendency to “soften” the link points of traditional conflict norms, meaning to make them more flexible. For example, by increasing the number of link points and the type of complex link points in the conflict norm, a conflict specification can have many link points, and a legal relationship can be divided into different parts, with different link points applicable to different parts.

“Most significant relationship principle” and “party autonomy principle” are the main methods used to soften the conflict norms. They turn link points from rigid to flexible breaking the traditional application of law based on a fixed link point; such as place of act, place of injury, nationality and domicile; into more flexible and appropriate choices that become available when solving cases. “Most significant relationship principle”, based on the connection between the constituent factors in the legal relationship and such legal relationship, gives judges the freedom to choose laws. It “requires them to abandon the original single and mechanical connection factor when deciding the application of laws in the trial of international civil and commercial cases, considers and weighs various factors related to the parties involved in the case, comprehensively analyzes various factors related to the legal relationship, measures the subjective and objective connection factors in terms of quality and quantity, and seeks and determines the most direct, essential and substantive connection between a country or jurisdiction and the facts and parties of the case.”²⁵ “Party autonomy principle” gives the parties freedom to choose applicable law of the legal relationship, paying more attention to the will and substantive justice of the parties, which greatly improves the flexibility of choosing applicable law in the international civil relationship.

The softening of link points has been described as “a major feature of the development of contemporary private international law”.²⁶ The Act on the General Rules of Application of Laws retains Article 16 of Horei on the law application of divorce in 1999,²⁷ which not only reflects the concept of gender equality in modern foreign private international law, but also enhances the flexibility of the law application through the progressive connection method, which is more consistent with the practice of international civil and commercial relations. The adoption of the habitual residence law and most significant relationship rules in conflict norms conforms to the general trend of the development of modern

²³ See *supra* note 16, at p.255.

²⁴ See Hiroshi Taki, *A Trend of German Private International Law Theory: From the Theory of Value Neutrality to the Theory of Value Promotion*, 10 *Journal of Legal Theory* 148, 177 (1977).

²⁵ See Xinli Du, *From Domicile, Nationality to Habitual Residence: Research on Legislative Reform of Personal Law in China*, 29 *Tribune of Political Science and Law* 28, 32 (2011).

²⁶ See Kahn-Freund, *General problems of Private International Law*, III, *Recueil des cours*, p.140 (1974).

²⁷ Article 16 of the 1999 Horei provides: “The provisions of Article 14 shall apply *mutatis mutandis* to divorce. However, if the husband or the wife is a Japanese having a permanent residence in Japan, the divorce shall be governed by the Japanese law”.

private international law. The Act on the General Rules of Application of Laws gives up the rigid objective link point of “place of act” and introduces most significant relationship principle and the characteristic performance theory to coordinate the flexibility and predictability of the application of contract law. The Act on the General Rules for the Application of Laws introduces most significant relationship principle and party autonomy principle into the law application of tort, especially negotiorum gestio and unjust enrichment, and softens the objective link point of law application of tort. As to the value orientation, it not only pursues the objective effect of protecting the victims, but also takes into account the balance of interests between the tortfeasors and the victim. It can be seen that Japan's private international law has absorbed the experience of other countries' private international law legislation in softening the link points, which reflects the convergence of the rules of private international law legislation.

To sum up, the academic and practical circles of Japan's private international law have always attached great importance to absorbing the latest research achievements of foreign academic and legislation. In other words, Japan's private international law is always in the process of “internationalization”. Through internationalization, Japan's private international law theory research and legislation technology can line up with international standards, keeping pace with the times, and ensure that the Act on the General Rules for the Application of Laws has a high legislative level and can well protect the international civil and commercial exchanges of Japan through learning from, absorbing and applying the latest research achievements to guide the domestic legislation.

2. The Localization of Japan's Private International Law Legislation

Law is an important part of a nation's culture. The laws of different countries have different characteristics. From the awareness of law to the system of law, all of them are characterized by the nation and show various distinct characteristics, which is the localization of law.²⁸ The rule of law of later countries followed the path of law transplantation, extensively absorbed the advanced systems and theories of other countries, and localized them based on their own national conditions, thus creating a unique rule of law path.²⁹ The localization of Japan's private international law legislation fully embodies this development track. In comparing the legislation and practice of private international law in western developed countries, Japanese jurists combined the national conditions and customs of their own countries to form a combination of law transplantation and local law, incorporating Japanese elements, making Japan's private international law not only have its own characteristics, but also reflect the development trend of contemporary private international law.

(a) Theory First and Tested by Practice

The study of Japan's private international law began in the Meiji, and has been enriched, improved, systematized and refined through the Taisho, Showa and Heisei. With the development and change of the international and domestic situations, Japan's private international law learned from the legislative model and experience of the developed countries, and continuously improved its rules of private

²⁸ See Liuyu Chen, *On the Native Nature of Law*, 19 Politics Science and Law 15, 18 (2000).

²⁹ See Qingkun Xu, *The Localization of American Traditional Conflicts Law and its Implications for China*, 56 Journal of Shandong University (Philosophy and Social Sciences) 99, 100-5 (2007).

international law to guide the judicial practice.

(i) Theory first

During the Meiji, Japan relaxed the restrictions on the activities and trade of foreigners, which increased the number of international legal disputes, so it was necessary to regulate the private legal relationship centered on trade or identity relationship. The early studies of private international law scholars in Japan were deeply influenced by the theories of private international law in Italy, France, Germany and other civil law countries. For example, the German scholar Savigny's universalism theory³⁰ and the Dutch scholar Jitta's thought.³¹ In addition, the study of private international law in Japan during this period was closely related to the study of domestic civil law. Due to the controversy between the natural law school and the historical law school in Japan, the famous "civil code debate" in Japanese history was aroused, which led to the delay of implementation of Horei and other codes.³² Generally speaking, Japan's private international law in the Meiji is still in its beginning stage despite some development.

Private international law research in Japan developed rapidly in Taisho, showa and heisei. Different from the Meiji period, the research goal of the scholars of private international law in Taisho was to establish a system of private international law that was adapted to Japan's national conditions centered on the enacted Horei. Therefore, the research of Japanese private international law scholars must take the old Horei as the object and mainly develop their own theories, referring to the private international law theories of Italy, France, Germany and other European civil law countries and paying little attention to the British and American private international law theories. Before World War II, almost all Japanese scholars of private international law inherited the theories of particularism and universalism of the previous period, and they were deeply influenced by the comparative law research methods advocated by German scholars.³³ For example, Japanese scholar Professor Saburo Yamada, by comparing law in different countries, puts forward the academic point of view that sovereignty is the core element of private international law research and we should handle international civil and commercial disputes from a flexible and unbiased perspective, integrating theories of Professor Von Baer, his teacher during his study in Europe, Professor Weis, a famous French scholar of private international law, and Daisy, a law professor at Oxford University.³⁴

After World War II, the study of private international law in Japan gained new development. The research of private international law overcame the negative influence of pre-war nationalism and

³⁰ The universalism-internationalism school was founded by f. k. savigny of Germany and prevailed in the private international law school in Europe and the United States in the 19th century. The scholars of this school believe that some principles of private international law can be deduced from the international law or natural law beyond the state, and these principles can constitute a system of universal conflict norms, which can be used to make clear the legislative jurisdiction of states and have general binding force on states.

³¹ Jitta holds that private international law is common law of mankind, he replaces savigny's "international legal community" with "community of human common law", trying to put forward some generally applicable conflict norms which can adjust conflict of laws, as well as a set of substantive norms to satisfy the needs of the human community and human life internationalization. See Shoichi Kidana & Hiroshi Matsuoka, *An Introduction to Communication Private Law*, Yuhikaku, pp.17-8 (2005).

³² See supra note 16, at p.62.

³³ See supra note 16, at p.288.

³⁴ See supra note 16, at p.63.

began to become a scientific and reasonable legal discipline. Japanese scholars have analyzed and studied the theories of European and American private international law, and Japanese private international law scholars have also made many important achievements in comparative law. Such advanced private international law theories as Currie's "analysis of government interests", Francesca's "directly applicable law" and Kegel's interest jurisprudence have exerted a great influence on the study of Japanese private international law. The unification movement of private international law from the end of 19th century to the 20th century also had a great influence on the modernization of private international law legislation in Japan. During the Heisei period, Japanese scholars made a comparative study on the legislation of Japan's private international law, and that of other countries and international organizations, which made a significant contribution to the improvement of Japan's private international law legislation.³⁵

(ii) Tested by practice

With the deepening of economic globalization, the rapid development of Japanese enterprises around the world has also intensified the internationalization of Japanese national life. The study of private international law in Japan flourishes with the diversification of social demands, and Japanese courts also encounter many complicated international civil and commercial cases. On the one hand, the Japanese scholars of private international law actively absorb the latest experience of the development of European and American private international law, and on the other, they also make empirical analysis on their domestic international civil and commercial disputes. Therefore, the study of Japan's private international law after the second world war generally attach great importance to empirical inductive research based on domestic and foreign precedents.

Before World War II, there were only a few cases of private international law in Japan, thus not many achievements in the study of private international law through cases. After World War II, U.S. armies occupied Japan as North Korea and Taiwan withdrew from Japanese colonial rule. The co-complicated political and economic relations between the United States, North Korea and Taiwan made Japan's civil and commercial disputes very complex. In the legislative and judicial practice of private international law, both the ministry of foreign affairs and the ministry of justice have issued many ambiguous regulations and orders, and courts have also made many contradictory precedents. With the rapid increase in the number of cases of Japan's post-war private international law, scholars of private international law are confronted with a large number of legal issues that need to be explained and clarified, which strongly promoted case study by the post-war Japanese private international law scholars.³⁶ With the deepening of case studies, the practical needs of Japan's international civil and commercial exchanges become more explicit and Japanese scholars have more comprehensive thoughts on the legislative concepts and causes of conflict norms in Horei. Case studies have promoted the improvement of Japanese conflict norms and also made up for many shortcomings in the theories and legislation of private international law.

³⁵ See Guangjie Zhang, *A Probe into the Evolution of Japanese Private International Law —on the Perspective of Historical Dimension*, 19 Journal of Southwest Jiaotong University (Social Science) 133, 140 (2018).

³⁶ In 1957, the Japan international legal case study institute was established with professor Hidebumi Egawa (1898-1960) of Tokyo University as the core, and published the Case Review of Private International Law Relationship (I, II) (1958), and the Precedent of International Identity Relationship (1959), etc. Then, many scholars of private international law launched many case sets of private international law in their own names. Into the 1980s, Japan's private international law case study became more active, and published a number of additions to the case sets, such as ichirou shimadu, case Kommentar 7, 8, 9 - civil law V, succession law, foreign family law (the supplement edition, sanseido, 1983); Ikehara Sueo and yoshiro souda, 100 International Legal Cases (2000, third edition, Yuhikaku).

Japan also demonstrates the dialectical relationship between theory and practice in the formulation of tort conflict norms. The application of *lex loci delicti* is the traditional conflict norm of tort, but when the place of the act and the place of the injury are in different jurisdictions, the place of tort will be unclear and its connotation is constantly argued over. Horei did not make a clear definition on this, and there were many disputes in practice. A typical case is an international patent infringement case brought by the Supreme Court of Japan on September 26, 2002 (heisei 14).³⁷ In this regard, Article 17 of the Act on the General Rules of Application of Laws makes the determination of the place of tort more explicit, and takes “the law of the place where the consequence of the tort occurs” as the principle. If the parties to the tort cannot foresee the aforesaid place, the law of the place of the act shall prevail.³⁸ It can be seen that the conflict norm of tort in the Act on the General Rules of Application of Laws is a useful attempt for legislators to solve the long-term theoretical disputes in domestic private international law according to years of judicial practice.

(b) Taking National Conditions and Traditions into Account

After the Meiji restoration, Japan carried out the reform of the legal system and learned much from the western developed countries. In the process of establishing its own system and theory of private international law, Japan adopted the “takism” -- not copied it, but combined it with its own national conditions.

(i) National conditions

In this era of globalization, national conditions are very important because it represents the national and public interest, and we have specifically set up “evasion of law”, “public order reservation” and “directly applicable law” in private international law, all of which are designed to ensure the national interests.

The unification of private law among countries is ideal, but cannot be achieved. National conditions are important, so the private law cannot be fully internationalized. The foreign-related judgment may not be recognized and enforced without considering the national conditions.

The enactment of the Act on the General Rules of Application of Laws takes into account the national conditions, mainly reflected in the fact that the setting of link points is compatible with the provisions of the substantive law. For example, the term “domicile” is used in Article 6, paragraph 1 of the Act on the General Rules of Application of Laws, rather than “habitual residence”, because it is used in existing legislation such as the relevant civil procedure law.³⁹

Besides, in terms of the formality of marriage, Article 24 (3) of the Act on the General Rules of Application of Laws still retains the “Japanese exception clause”, that is, “the marriage in Japan with one of the parties Japanese is not subject to this limitation”. This has something to do with Japan’s special household registration management system. If the Japanese and foreigners get married in Japan, and according to *lex patriae* of the foreigner, as long as no marriage registration was proposed, such marriage can not enter the Japanese household registration, then the Japanese identity relationship cannot be

³⁷ See *supra* note 16, at p.151.

³⁸ See *supra* note 16, at p.254.

³⁹ See Kunio Koide, Interpretation: Act on General Rules for Application of Laws, Shoji Homu, p.64 (2009).

correctly reflected in the household registration, which is clearly different from the system in Japan.

What's more, Japan enacted the Product Liability Law in 1994, so the application of that law was not stipulated when Horei was enacted. With the increase in international product liability cases, in order to better solve the product liability compensation disputes with other countries, as well as protect the rights and interests of the consumers and the states, when enacting Act on the General Rules for the Application of Laws, Japan referred to the private international law rules of other countries, combining it with its national conditions, and added special provisions of the applicable law of product liability. This not only improves the legal provisions, but also fully reflects the development trend of private international law.

Finally, the reservation of the rule of double action ability is a conservative aspect of Japanese private international law, but it is also an example of its being based on national conditions. The "old Horei" enacted in 1890 had no similar provisions, and in 1898, when the "old Horei" was amended, it set up "overlapping application of Japanese law within a certain scope". The Japanese legislators referred to the Anglo-American legal system⁴⁰ and the provisions of the German civil law enforcement.⁴¹ The overlapping application of Japanese law is for the protection of Japanese nationals.

(ii) Traditions

When the Act on the General Rules of Application of Laws was enacted in Japan, many legal terms were involved, some of which were easily confused and some were inconsistent with the modern context. However, the legislative review council of Japan did not adopt the principle of total abolishment and reform, but carried out modification while preserving traditional habits. In preserving traditional terminology, the term "legal act" is typically retained. Both the Act on the General Rules of Application of Laws and Section 7 of Horei use the concept of "legal act".⁴² Because the concept of "legal act" is easily confused, some scholars in the Japanese law academia have advocated that the expression of "legal act" should be changed into "agreement".⁴³ During Horei's revision, the council also discussed whether to change the "legal act" in Article 7 of Horei into "contract". However, the intermediate draft continues to use the expression "legal act" in Horei. After discussion, the council held that if the concept of "agreement" is adopted, the unilateral legal act and contract act⁴⁴ contained in "legal act" need to be stipulated separately, which is widely disputed.⁴⁵ For example, in substantive law, some countries identify the gift as a unilateral civil legal act, while some countries identify it as a contract. The intermediate draft maintains the "legal act" in Article 7 of Horei, which is the result of multiple consultations between the academic and practical circles, and the decision made by the council after an opinion poll. Moreover, the continued use of the term "legal act" in Japanese legal practice has not created any special obstacles to the application of law.⁴⁶

⁴⁰ The common law system adopts the parallel of *lex loci actus* and *lex fori*.

⁴¹ Article 12 of the *German Civil Law Enforcement* (Einführungsgesetz zum Bürgerlichen Gesetzbuch) provides that *lex loci actus* shall be limited by *lex fori*.

⁴² See *supra* note 16, at p.257.

⁴³ The term "contract" is also used in modern legislation, led by the *Rome Convention*, refer to the Research institute of Horei for details. *Issues Relating to the Amendment of Horei (1) -- applicable law of agreements, assignment of rights, etc.* See Junichiro Nakano, *status quo and legislative subject relating to the interpretation of article 7 of Horei*, Yuhikaku, p.36 (1998).

⁴⁴ "Agreement act" refers to the act that the parties agree on "Contract act" is formed by substantial agreement on the same content, which is different from the agreement of different and opposite minds.

⁴⁵ See *Creation of Act on General Rules for Application of Laws*, Yuhikaku, pp.13-4 (2006).

In addition to retaining traditional terms, Japan's private international law legislation has inherited much from tradition. For example, Paragraph 1 of Article 3 of Horei stipulates that the law application of natural person's capacity adopts the *lex patriae*, and the Act on the General Rules of Application of Laws maintains that. This is because in the law application of civil capacity, nationality is more specific and stable than habitual residence as a link point, and the "capacity" in Article 3(1) of Horei can be interpreted as having civil capacity, so it is more suitable to adopt the *lex patriae* rather than the habitual residence. In addition, many countries adopt *lex personalis* to legislate on civil capacity.⁴⁷ Besides, Article 4(3) of the Act on the General Rules of Application of Laws inherits Horei's Article 3(3), which states that "the preceding paragraph shall not apply to legal act under the law of domestic relation or the law of inheritance, nor to legal act in relation to real property in a different jurisdiction from the place of the act".⁴⁸ In Japan, capacity is divided into property capacity and civil capacity. Neither Horei nor the Act on the General Rules of Application of Laws excludes the law application of civil capacity. Therefore, it is reasonable to retain that the transaction protection provisions of Paragraph 2 are not applicable under the law of domestic relation or the law of inheritance. The reason why the preceding paragraph does not apply to the relevant legal relationship of real estate is that normally, the sale of real estate is carried out in the country where the real estate is located. If a party conducts a transaction in a country other than the location of the real estate, the real estate transaction cannot be carried out if the law of the country where the real estate is located determines that the party has no capacity, even if the law of the country where the real estate is located applies to guarantee the validity of the transaction. In this case, the law of one country to guarantee the validity of the transaction and the law of the country where the real estate is located will fiercely conflict, which is not conducive to the effective conduct of the transaction. What's more, as mentioned above, in terms of the formality of marriage, Article 24 (3) of the Act on the General Rules of Application of Laws still retains the "Japanese exception clause", which is based on the consideration of Japanese national conditions. The Act on the General Rules of Application of Laws retains Article 16 of Horei on the law application of divorce, which not only reflects the concept of gender equality in modern private international law, but also enhances the flexibility of the law application through the progressive connection method, which is more consistent with the practice of international civil and commercial relations. In addition, the Act on the General Rules of Application of Laws retains Article

⁴⁶ See NBL editorial, *Information and Interpretation on the Act on General Rules for Application of Laws*, Shoji Homu, p.135 (2006).

⁴⁷ For example, Article 7, Paragraph 1 of the German Civil Law Enforcement (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*) stipulates that the law of the country to which a natural person belongs shall apply to his capacity for rights and conduct. This provision also applies when capacity is extended by the marriage. Zou Guoyong, *Selection of Foreign Private International Law Legislation*, China University of Political Science and Law Press, p. 5 (2011). The first sentence of Article 23, Paragraph 1 of the Italian Private International Law stipulates that the capacity of a natural person is pursuant to the law of his country. Research institute of Horei. *Issues Relating to the Amendment of Horei* (3) -- applicable law of capacity, legal person, succession, etc., Shoji Homu, 2004. Article 7 of the Greek civil law stipulates that capacity is pursuant to the law of the country to which the person belongs. Research institute of Horei. *Issues Relating to the Amendment of Horei* (3) -- applicable law of capacity, legal person, succession, etc., Shoji Homu, 2004. Article 9, Paragraph 1 of the Polish private international law stipulates that the law of the country to which a natural person belongs shall apply to his capacity for rights and conduct. Research institute of Horei. *Issues Relating to the Amendment of Horei* (3) -- applicable law of capacity, legal person, succession, etc. Shoji Homu, 2004. Article 13, Paragraph 1 of the Korean Private International Law stipulates that the capacity of a natural person is in accordance with the law of his country. This provision shall also apply when the capacity for conduct is extended by the marriage. Research institute of Horei. *Issues Relating to the Amendment of Horei* (3) -- applicable law of capacity, legal person, succession, etc., Shoji Homu, p.31 (2004).

⁴⁸ See *supra* note 16, at p.252.

31 of Horei on interpersonal conflict norms.⁴⁹

To sum up, Japan's private international law legislation actively absorbs the latest foreign research achievements while moderately reforming traditional legal rules based on its national conditions. This is not only beneficial to maintaining the stability of Japan's legal system, but also maintain the continuity of the applicable law, helping people and judges adapt to the new law, and ensuring the quality and efficiency of Japanese courts' dealing with international civil and commercial disputes.

3. Enlightenment of the Act on the General Rules of Application of Laws to China

Through the analysis above, it can be seen that Japan always considers the dialectical relations such as internationalization and localization, convergence and characteristics, justice conflict and substantive justice, flexibility and certainty in the legislation of private international law, and it is necessary to properly handle these relations in the legislation of private international law in China. This paper proposes the following suggestions from the enlightenment.

(a) Focusing on National Conditions -- International Integration with Chinese Characteristics

Japan has absorbed much foreign experience in the private international law legislation. Instead of copying, it pays attention to the implementation effect of foreign experience in the country and absorbs it on the basis of selecting fittest. The introduction of interpersonal conflict in the Act on the General Rules of Application of Laws in Japan is a typical example.

In terms of the private international law, there are only a few countries that have special regulations on interpersonal legal conflict. Interpersonal legal conflict refers to the conflict among civil and commercial laws applicable to different races, religions and classes within a country.⁵⁰ Japan is one of those countries that sets interpersonal conflict norms. Before 1989, due to the lack of explicit provisions on the interpersonal legal conflict norms, Japanese courts mostly judged household registration-related international disputes based on *lex patriae*.⁵¹ There are also rare cases where the analogy is applied as to Paragraph 3 of Article 27, of the old Horei (Horei of Meiji 23 (1890) concerning the application of the laws of different jurisdictions, i.e., "if the laws of the parties in different parts of the country are different, then the local laws to which they belong shall be applied".⁵²

⁴⁹ Article 31 of Horei: " (1) In the case that a party has a citizenship of a country having different laws applying to different persons, the law of the home country of such party shall be the law specified by the regulation of that country or, if there is no such regulation, the law most closely related to him/her. (2) The provisions of the previous paragraph shall apply mutatis mutandis to the law of the jurisdiction where the party has permanent residence if that jurisdiction has different laws applying to different persons, and to the law of the jurisdiction most closely related to the husband and the wife if that jurisdiction has different laws applying to different persons."

⁵⁰ An important condition for the occurrence of interpersonal legal conflict is that different legal systems are applicable to different groups of people in a country. The chief characteristic of this system of laws applicable to different groups of people is that it is of human nature, that is, closely related to a particular group of people, and it does not matter whether they are related to a specific region. See Jin Huang, *Interregional Conflict of Laws*, Yongran Culture Press co., p.106 (1996).

⁵¹ For example: Tokyo Family Court Showa 49· 12 · 27, *Monthly Bulletin on Family Court* 27 · 10 · 71 (Malaysia); Yokohama District Court Showa 58 · 11 · 30, *Hanreijiho* 1117 · 154 (Indonesia); Urawa District Court Showa 49 · 12 · 27, *Monthly Bulletin on Family Court* 37·2·156 (Pakistan).

⁵² For example: Tokyo Family Court Showa 50· 3 · 13, *Monthly Bulletin on Family Court* 28 · 4 · 121 (India); Tokyo

However, some scholars questioned this, believing that Paragraph 3 of Article 27 of old Horei was a provision for the resolution of international legal conflicts, and that there was no basis for the presumption to solve interpersonal legal conflicts of different nature. When Japan revised Horei in 1989, legislators proposed the addition of rules on interpersonal conflict, added Article 31 of Horei by imitating Article 7 of the applicable law of supporting obligations⁵³ “1. Where the state of nationality of the parties provides that the law varies from person to person, party’s *lex patriae* is specified by the rules of that state. In the absence of such rules, the law most closely related to the parties shall be their *lex patriae*. 2. The preceding paragraph is applicable to the law of habitual residence if such law varies from person to person, and the law most closely related to husband and wife if such law varies from person to person.”⁵⁴ Subsequently, when the Act on the General Rules of Application of Laws was amended, both the academic and practical circles believed that it was necessary to retain the norms of interpersonal conflict, so they followed the Article 31 of Horei and changed it into a modern language expression, i.e., “1. Where the state of nationality of a party implements private interpersonal law, the law specified in the conflict norm of that country (or, if there are no such norms, the law of the region with which the party has the most significant relationship) is the party’s *lex patriae*. 2. In accordance with Article 25 (including quasi occasions specified in Paragraph 1 of Article 26 and Article 27), Paragraph 2(2) of Article 26 or Paragraph 2 of Article 38, preceding paragraph shall apply to the law of habitual residence if the party’s habitual residence belongs to regions or countries implementing private interpersonal law, as well as the law of the place with which husband and wife has the most significant relationship if such place belongs to countries implementing private interpersonal law.”⁵⁵

Both Horei and the Act on the General Rules of Application of Laws provide that interpersonal conflict norm reflects the legislative concept of Japan’s private international law based on its national conditions, which is consistent with the historical background of Japan’s vigorous development of export-oriented economy and active integration into the world trading system since 1980. During this period, a huge number of immigrants went to live or work in Japan, which increased the complexity of the international civil and commercial disputes. Multinational people, stateless people, long-term sojourn people make the law application based on nationality stiff, and the result of law application is difficult to take the ethnic tradition and religious belief of the parties into account. By contrast, the interpersonal conflict norms soften the link points and add the place of the most significant relationship, so that the court can take into account the ethnic traditions and religious beliefs of the parties in dealing with international civil and commercial disputes, which is of positive significance for safeguarding the reasonable expectations of the parties. If people of different religious beliefs have lawsuits due to inheritance and other legal relations, the court can determine applicable law by applying the corresponding interpersonal conflict norm, respecting religion and folk custom so as to better solve civil disputes between different ethnic groups and religions, maintain social stability and protect personal interests.

Family Court Showa 58· 4 · 25, Hanreijiho 1123 · 105 (Malaysia).

⁵³ In 1964, Japan ratified the Convention on Conflicts of Laws Relating to the Form of Testamentary Dispositions formulated by the international conference of the Hague in 1961, and incorporated its main contents into the domestic legislation -- the Applicable Law Relating to the Form of Testamentary Dispositions (law 100 of showa 39), which only stipulated the different legal areas of the country that the legal system does not unify. Then, in 1986, when Japan ratified the Convention on the Applicable Law of Supporting obligations (1973) and in accordance with article 16 of this convention, the Japanese government enacted the applicable law of supporting obligations law (law 84 of showa 61), which explicitly stipulated for the first time the provisions in countries where the interpersonal legal system was not unified. See Zyunichi Akiba, *The Enactment of Relevant Laws on the Applicable Law of Supporting Obligation and Future Issues*, Jury, Shoji Homu, p.83 (1986); Takao Sawaki, *The Enactment of Relevant Laws on the Applicable Law of Supporting Obligation*, Hougakukyoushitsu, Yuhikaku, p.133 (1986).

⁵⁴ See supra note 16, at p.258.

⁵⁵ See supra note 39, at p.57 (2009).

China is also a multi-ethnic and multi-religious country. With the continuous promotion of the “Belt and Road” initiative, the level of China’s opening to the outside world has been deepened, and the number of foreigners working and living in China has also increased substantially. China is also facing increasingly complex interpersonal legal conflicts. When making the Law on Application of Law, we absorb the foreign advanced experience and use “habitual residence” instead of nationality or domicile as a basic link point of *lex personalis*. This considers the significant relationship between the residence and the parties, to some extent compensating for the lack of flexibility in settling interpersonal legal conflict under the law of place of nationality. However, the establishment of the habitual residence has not fully considered the basic national conditions of multi-ethnic and multi-religious countries and the increasing number of foreigners settling in China and it is difficult to take into account the influence of religious belief and ethnic customs on the legal act of the parties concerned. Ignoring the influence of religion and folk custom on the parties’ legal act is likely to lead to unreasonable or unfair judgement, which not only affects the foreigners’ acceptance of and identity with Chinese international trial, but also increases the difficulty of the cross-border recognition and enforcement, bringing negative effect to the open policy under B&R initiative .

To sum up, it is suggested that the revision of the law on the application of law should be based on the national conditions, and try to reflect the latest national policies and concepts in the legislation of international civil and commercial affairs in a timely manner so as to highlight Chinese characteristics. In addition, consideration should be given to the fact that our country is faced with the increasingly complex interpersonal legal conflict, and influence of religion and folk custom in this diversified society is still huge. When revising the law on the application of law, we should introduce the interpersonal conflict law norms in an appropriate way, or further soften the link points of *lex personalis* by adopting the most significant relationship principle. Following Japan, we should determine the applicable law from the perspective of respect for religious and folk so as to better resolve civil disputes between different ethnic groups and religions and maintain social stability and safeguard the legitimate interests of the citizens.

(b) The Pursuit of Justice -- Justice Conflict and Substantive Justice

Justice conflict and substantive justice come from the differences in system and concept under different legal traditions. With the mutual learning and integration of laws, the conflict justice and substantive justice also learn from each other on their respective basis, and co-exist.⁵⁶ Justice conflict is mainly reflected in upholding the correct concept of justice and interests. First, upholding the correct concept of justice and interests requires equal application of domestic and foreign laws. Due to its abstractness, justice has different connotation and extension in different legal areas, so it is difficult to have a unified standard. With the convergence of private international law, the understanding of justice in the world will gradually converge and be reflected in the specific conflict norms. Second, adhering to the correct concept of justice and interests requires the unification of standards rather than double standards. Professor Symeon c. Symeonides, an American conflict jurist, said that substantive justice refers to the transcending of conflict of laws in order to achieve the justice of the substantive results of individual cases, so that such cases can get the same result of justice as the purely domestic and conflict-

⁵⁶ See Lizhen Zhang, *A Multidimensional View on the Evolution of Conflict Justice and Substantive Justice in Private International Law*, 33 Social Science Review 39, 46 (2018).

free cases.⁵⁷ To give consideration to justice conflict and substantive justice is to realize the justice of the substantive results of individual cases when the law is applied equally. Specifically, according to the conflict norms, private law of different countries can be equally applied. Besides, extraterritorial effect is given to other countries' law in pursuit of fairness and justice in individual cases, which means courts apply mandatory norms of the country to which the foreign applicable law belongs and of a third country when handling international civil and commercial disputes, so as to achieve individual justice and substantive justice.

For example, Article 4 of China's law on the application of law clearly states: "if the law of the People's Republic of China has mandatory provisions on international civil relations, such mandatory provisions shall be directly applied." This is the first time for China's private international law legislation to make explicit provisions on mandatory norms, marking the mandatory norms into China's private international law system of multiple law selection.⁵⁸ The introduction of mandatory norms provides a convenient way for China to safeguard its own interests in international civil and commercial disputes. However, in the judicial practice a number of problems were exposed in the application of the Article.

First, the concept of "mandatory provisions" is not consistent with the mandatory norms in private international law. In China, the definition of "mandatory provisions" has long existed in the legal theory and the actual law. Article 4 of the law on the application of law and Article 10 of the Interpretation of the Supreme People's Court on several issues concerning the application of the law of the People's Republic of China on the application of international civil laws (a)(2012)(hereinafter referred to as the "judicial interpretation (a)") can be easily confused. The vagueness will lead to misuse or confusion in the judicial field. Excessive expansion of the direct application scope of mandatory norms will also compress the adjustment space of conflict norms and aggravate the "Homeward Trend" of domestic courts in the application of laws,⁵⁹ undermining the justice conflict pursued by the system of private international law.

Second, the mandatory provisions in the law on the application of law only refer to the provisions of China's laws, which cannot include the legal system of mandatory norms. A complete legal system of mandatory norms includes the application of the mandatory norms in the country where the court is located, the application of the mandatory norms in the country to which the foreign applicable law belongs and in a third country. However, the judicial interpretation (a), when defining the mandatory norms, is only limited to the mandatory norms mentioned in Article 4 of the law on the application of law, and fails to define the mandatory norms from the perspective of private international law. From the perspective of legislative technology, Article 4 of the law on the application of law does not leave any space for the application of mandatory norms of third countries in our country. The judicial practice of various countries has proved that, under certain conditions, the validity of mandatory norms of third countries can be recognized, and mutual benefit and win-win results can be achieved in the fields of cultural relics protection, environmental protection and foreign exchange control through handling international civil and commercial disputes.

⁵⁷ See Symeon C. Symeonides, *The American Choice-of-Law Revolution: Past, Present and Future*, Martinus Nijhoff Publishers, p.404 (2006).

⁵⁸ See Yongping Xiao & Weidi Long, *On the International Mandatory Rules in the Private International Law of China*, 32 China Social Sciences in China 107, 109 (2012).

⁵⁹ Also, some scholars translate "Homeward Trend" into "trend of going home", in German Private International Law published in 1932, Arthur Nussbaum for the first time put forward "the trend of going home", which means in some conflict of laws rules or principles emerges a tendency for lex fori to prevail, thus affecting court's choice of law. See

Similar to the law on application of law, the Act on the General Rules of Application of Laws in Japan also introduced the concept of mandatory norms. For example, Paragraph 1 of Article 11 provides that “with regard to the establishment and validity of a consumer contract, if the party has not chosen the consumer’s habitual residence law as the applicable law, the mandatory norm shall apply as long as the consumer has indicated to the enterprise that the mandatory norm in the habitual residence law shall apply.”⁶⁰ Paragraph 3 of Article 11 provides that “as to the establishment of the consumer contract, when choosing law other than that of consumers’ habitual residence in accordance with Article 7 of this law, if the consumer indicates to the operator that mandatory provisions of its habitual residence law shall be applied to the formality of the consumer contract, then without subject to Paragraph 1, 2 and 4 of Article 10, the mandatory provisions of its habitual residence law(if any) shall be applied to the formality of the consumer contract.”⁶¹ Paragraph 1 of Article 12 of the Act on the General Rules of Application of Laws provides that “as to the establishment of the labor contract, when choosing or changing applicable law other than that of the place of most significant relationship with the contract in accordance with Article 7 or Article 9 of this law, if the laborer indicates to the employer that mandatory provisions of the law of the place of most significant relationship with the contract shall be applied to the establishment and validity of the labor contract, then such mandatory provisions (if any) shall be applied to the establishment and validity of the labor contract.”⁶² It can be seen that the expression of the Act on the General Rules of Application of Laws in Japan fully reflects the concept of mandatory norms in private international law. In addition, different from China’s legislation pattern which uniformly stipulates mandatory norm in Article 4 of the law on applicable law, the Act on the General Rules for the Application of Laws introduces mandatory norm in Article 11 on the consumer protection and Article 12 on the protection of laborers in the form of special terms or exception terms. These recognized the effectiveness of mandatory norm of the country to which the place of the most significant relationship belongs. This leaves space for mandatory norms in the country to which the foreign applicable law belongs and in a third country. The mode of separate legislation also effectively limits the scope of application of mandatory norms and guarantees the stability of the system of multiple law selection.

To sum up, the openness of the Act on the General Rules of Application of Laws in Japan towards mandatory norms is worth learning from for China. With the continuous advancement of economic globalization, the common interests among countries are increasing, not only in the traditional civil and commercial areas, but also in some public law areas that are subject to mandatory regulation. Under certain conditions, it is helpful for foreign courts to protect China’s public interests based on the principle of mutual benefit to apply the foreign mandatory norms and recognize the foreign public interests protected by them, so as to achieve mutual benefit and win-win situations between the two countries. Conversely, if the court rigidly refuses to apply the mandatory norm of the foreign relics protection law when dealing with international business contract dispute of cultural relics, this may encourage the illegal purchase and sales of foreign cultural relics, which conflicts with the legislative concept to crack down on illegal trade of cultural relics and will reduce the enthusiasm of the foreign court to protect the cultural relics in China. It can be seen that denying the effect of foreign mandatory norms is likely to bring “lose-lose” situations in many fields such as cultural relics protection. From the

Qisheng He & Wei Xu, A Brief Analysis of the “trend of going home” in the Application of Foreign Civil Law in China, 64 Wuhan University Journal (Philosophy & Social Sciences) 5, 7-9 (2011).

⁶⁰ See supra note 16, at p.253.

⁶¹ Id.

⁶² Id.

perspective of building a community with a shared future for mankind, such “lose-lose” situations should also be avoided. Therefore, it is suggested that when revising the law on the application of law, China should further clarify the concept of mandatory norms, specify the scope of direct application, and leave certain space for the application of foreign mandatory norms, especially the one of the third country.

(c) Focusing on Flexibility -- Limiting the Discretion in Judicial Practice

The flexibility and certainty of conflict norms are a pair of eternal contradictions and all countries are trying to balance them in the legislation of private international law. When Japan introduced the principle of the most significant relationship in the legislation of private international law, it attached great importance to the limitation of its flexibility. The greatest advantage of the principle of the most significant relationship is that it can change the mechanical and rigid nature of the traditional conflict rules, realize the flexibility of the law application, and satisfy people’s requirements for the fairness of the case trial. However, with the popularization of that principle in various fields, people find it difficult to unify the scale and control the discretion of judges, which will make the flexible rule be out of control. Individual cases are different, and it is difficult to achieve substantive justice.

As we know, the principle of the most significant relationship is also a very important principle in the law on the application of laws in China. It is not only applicable to the specific adjustment of inter-regional conflicts, creditor’s rights, as well as securities and other international civil and commercial legal disputes, but also set as the basic rule of the whole law.⁶³ Specifically, Paragraph 2 of Article 2, of the law on the application of laws provides that: “Where this law or any other law does not provide for the application of laws concerning international civil relations, the law of the most significant relationship with the international civil relations shall apply.” The most significant relationship principle is set as the “basic clause”, which can effectively enhance the flexibility of the whole law, fill the blind spot of the adjustment of conflict norms, and provide a great space for the settlement of international civil and commercial disputes. However, the principle of the most significant relationship not only gives judges flexibility, but also makes more demands on them. If judges have prejudice or misunderstanding on the definition of the “most significant relationship”, it is easy to cause the abuse of the principle of the most significant relationship in practice. China’s judicial practice shows that there is a common phenomenon when the judge apply this principle to determine the applicable law, that is, “in the judicial practice, Chinese courts generally determine the place of most significant relationship by calculating the number of link points, and the judge determines whether the case has the most significant relationship with China in the first place, which is quite different from the American model that seeks the most closely related state. As a result, Chinese courts generally only list links to China and do not compare it with the number of links to other countries, let alone measure the importance of each link.”⁶⁴ If only emphasizing that international civil and commercial disputes have the most significant relationship with China, it will undoubtedly greatly expand the application scope of Chinese law, and will undermine the system of multiple selection of law and the values of fairness and justice established in the law on application of law.

⁶³ See Jie Weng, *The Judicial Application of the Principle of the most Significant Relationship -- Centering on Article 2 of the Application Law of Foreign Civil Relations Law*, 34 Science of Law 194, 196 (2017).

⁶⁴ See Yongping Xiao, *Conflict of Laws From the Perspective of Jurisprudence*, Higher Education Press, p.466 (2008).

By contrast, the Act on the General Rules of Application of Laws in Japan does not set the most significant relationship principle as the basic principle of the law, but we can find it in Article 8 (the parties do not choose the applicable law), ⁶⁵ Article 12 (the exception of labor contract), ⁶⁶ Article 15 (the exception that there is obviously a more significantly related place in the law application of negotiorum gestio and unjust enrichment), ⁶⁷ Article 20 (the exception that there is obviously a more significantly related place in the law application of tort), ⁶⁸ Article 25 (validity of marriage), ⁶⁹ Article 27 (divorce), ⁷⁰ Article 38 (lex patriae), ⁷¹ and Article 40 (countries or regions implementing interpersonal private law) of the Act on the General Rules of Application of Laws. From the perspective of terms design, the Act on the General Rules of Application of Laws attaches great importance to the control of “flexibility” of the most significant relationship principle. First, the general expression “place of the most significant relationship” is rarely used directly, but the place of the most significant relationship is directly presumed according to the nature of international civil and commercial disputes. For example, Paragraph 2 and 3 of Article 12 of of the Act on the General Rules of Application of Laws both use presumptions, that is, “2. When the preceding paragraph is applied, the

⁶⁵ Article 8 of the Act on General Rules for Application of Laws is as follows:

(1) Where there is no choice under the preceding Article, the formation and effect of a juristic act shall be governed by the law of the place with which the act is most closely connected at the time of the act.

(2) For the purpose of the preceding paragraph, where only one party is to effect the characteristic performance of the juristic act, it shall be presumed that the juristic act is most closely connected with the law of his or her habitual residence (i.e., the law of his or her place of business where that place of business is related to the act, or the law of his or her principal place of business where he or she has two or more places of business related to the act and where those laws differ).

(3) For the purpose of the first paragraph of this Article, where the subject matter of the juristic act is immovables, notwithstanding the preceding paragraph, it shall be presumed that the act is most closely connected with the law of the place where the immovables are situated.

⁶⁶ Article 12 of the Act on General Rules for Application of Laws is as follows:(1) Even where by choice under Article 7 or variation under Article 9, the applicable law to the formation and effect of a labor contract is a law other than the law with which the contract is most closely connected, when the employee indicates to the employer his or her intention that a particular mandatory rule from within the law of the place with which the employee is most closely connected should apply, this mandatory rule shall also apply to the matters covered by the rule concerning the labor contract’s formation and effect.(2) For the purpose of the preceding paragraph, it shall be presumed that a labor contract is most closely connected with the law of the place where the work should be carried out under the contract (i.e., the law of the place of business through which the employee was engaged, where the work is not to be carried out in a particular place. The same applies for the next paragraph).(3)Notwithstanding Article 8, paragraph 2, where no choice under the provision of Article 7 has been made with regards to the formation and effect of a labor contract, it shall be presumed that regarding its formation and effect the contract is most closely connected with the law of the place where the work should be carried out under the contract.

⁶⁷ Article 15 of the Act on General Rules for Application of Laws is as follows:Notwithstanding the preceding Article, the formation and effect of claims arising from agency by necessity (negotiorum gestio) or unjust enrichment shall be governed by the law of the place with which they are clearly more closely connected in light of circumstances such as where at the time of the occurrence of events causing the claims both of the parties had their habitual residence in a place with the same law, or where the agency by necessity (negotiorum gestio) or unjust enrichment arose relating to a contract between the parties.

⁶⁸ Article 20 of the Act on General Rules for Application of Laws is as follows: Notwithstanding Articles 17, 18, and 19, the formation and effect of claims arising from tort shall be governed by the law of the place with which they are clearly more closely connected in light of the circumstances such as where at the time of the tort both of the parties had their habitual residence in a place under the same law, or where the tort occurred by breaching obligations in a contract between the parties.

⁶⁹ Article 25 of the Act on General Rules for Application of Laws is as follows:The effect of a marriage shall be governed by the spouses’ national law when it is the same,xiii or where that is not the case, by the law of the spouses’ habitual residence when that is the same, or where neither of these is the case, by the law of the place with which the spouses are most closely connected.

⁷⁰ Article 27 of the Act on General Rules for Application of Laws is as follows: Article 25 shall apply mutatis mutandis to divorce. However, divorce shall be governed by Japanese law where one of the spouses is a Japanese national with

law of the place of labor services stipulated in the labor contract (if it is difficult to determine such place, the law of the place of business office where the laborer is employed shall apply, the same hereinafter) shall be presumed to be the law of the place most significantly related to the labor contract. 3. If the establishment and validity of a labor contract is not selected in accordance with Article 7 of this law, it shall be presumed that the law of the place of labor services in the labor contract has the most significant relationship, without subject to Paragraph 2 of Article 8 of this law.”⁷³ Second, put the place of the most significant relationship in the exception clause. For example, Article 20 of the Act on the General Rules of Application of Laws stipulates that “Despite regulations in the 3 preceding articles, as to the establishment and the effectiveness of the creditor’s right caused by the tort, the tortfeasor has habitual residence in the same jurisdiction when committing tort, or commits tort in breach of the obligations under the contract between the parties, if there was a place more significantly related than the place provided in the 3 preceding Articles, the law of the place of the most significant relationship shall apply”.⁷⁴ Through which, the Act on the General Rules of Application of Laws limits the discretion of judges in the application of the most significant relationship principle, provides clear guidelines for judges to determine the place of most significant relationship, and reduces the possibility that Japanese judges abuse and apply such principle to *lex patriae*. It is noteworthy that in addition to the introduction of the most significant relationship principle, we can also find the flexibility of the Act on the General Rules of Application of Laws in the clever combination of bilateral conflict norms, will autonomy and the most significant relationship principle. As to the protection of the consumer, the Act on the General Rules of Application of Laws is more flexible and effective than the law on application of law.

What’s more, Article 42 of the law on application of law provides that: “Law of the habitual residence of consumers shall apply to consumer contracts; Where a consumer chooses to apply the laws of the place where the goods or services are provided, or the operator does not engage in relevant business activities at the habitual residence of the consumer, the laws of the place where the goods or services are provided shall apply.” The above provision provides unilateral autonomy in the legislation, endows consumers who are obviously in a weak position with right to legal selection, and makes the balance of justice moderately tilt to consumers. However, such right has certain limitations. With respect to the provisions, the right to legal selection that Article 42 directly endows consumers is just “the law of the place where goods and services are provided”, even if the law elsewhere related to consumer contracts is more favourable to protect rights and interests of consumers, consumers can’t choose the applicable law, which seems to deprive them of the opportunity to obtain the optimal protection. In addition, online cross-border transactions is so advanced that at the same time the service may involve multiple places which provide services, Article 42 only provides that the law of the consumer’s habitual residence or the place where goods and services are provided are applied to deal with international consumer contracts, which no doubt increased the unpredictability of the applicable law and deprive the operators of reasonable expectation. Unfair treatment of business operators will also inhibit the development of cross-border trade and will bring negative effects to China’s economic development.

habitual residence in Japan.

⁷¹ Article 38 of the Act on General Rules for Application of Laws is as follows: (1) Where a person has two or more nationalities, his or her national law shall be the law of the country in which the person has habitual residence from among those states of which he or she has nationality. Where there is no such country, the person’s national law shall be the law of the state with which he or she is most closely connected. However, where one of those nationalities is Japanese, Japanese law shall be that person’s national law. (2) In the case where a person’s national law shall govern but the person has no nationality, the law of that person’s habitual residence shall govern. However, this shall not apply to cases where Article 25 (including its application *mutatis mutandis* under Article 26, paragraph 1 and Article 27) or

By contrast, the Act on the General Rules of Application of Laws provides detailed provisions on consumer contracts. Article 11 has six parts.⁷⁵ Specifically, Paragraph 1, 2 and 3 reflect the respect of the Act on the General Rules of Application of Laws for the will autonomy between operators and consumers, and effectively guarantee the reasonable expectation of the parties as to the application of law by introducing the party's will autonomy. Besides, out of concern about the weak position of the consumer, the Act on the General Rules of Application of Laws specifically sets an exception clause for the application of will autonomy, providing consumers the right to safeguard their legitimate rights and interests according to the mandatory norms in the consumer protection legislation of their habitual residence. This reflects the humanistic care and real protection of Japan's private international law for consumers and other vulnerable groups. In order to improve the predictability of the application of the law, Paragraphs 4 and 5 of Article 11 set up consumers' habitual residence as an objective link point for the establishment of the contract. In addition, to respect the operator's reasonable expectation, Paragraph 6 of Article 11 sets up exceptions of the application of law of consumer's habitual residence: when consumer signs a contract at operator's place of business, or the operator's place of business is the place both for contract establishment and performance, or the operator does not know consumer's habitual residence, the court can deal with foreign-related contract dispute without applying the law of consumer's habitual residence. It can be seen that the Act on the General Rules of Application of Laws not only provides protection for consumers, but also gives consideration to operators' reasonable expectations. Interests of both sides of the transaction is rebalanced through will autonomy principle, consumer habitual residence and mandatory norms.

Article 32 is applicable. (3) Where a person has nationality in a state where the law differs by region, that person's national law shall be the law designated by the rules of that state (or the law of the region with which that person is most closely connected in the case where such rules do not exist).

⁷³ See supra note 16, at p.253.

⁷⁴ See supra note 16, at p.254.

⁷⁵ Article 11 of the Act on General Rules for Application of Laws is as follows: 1. As to the establishment and effectiveness of contracts (except the labor contract, in this Article all referred to as "consumer contracts") between Individual consumers (except enterprises or contract parties representing enterprises, the same below) and operators (individuals as legal persons and other social groups, financial groups, enterprises or contract parties representing enterprises, the same below), even if in accordance with the provisions of Article 7 and Article 9 of this law, choosing or changing the applicable law into the law other than that of consumer habitual residence, if the consumer declares to the operator that the mandatory provisions of its habitual residence law shall be applied, then the mandatory provisions shall be applicable for the establishment and effectiveness of consumer contracts. 2. If not choosing in accordance with Article 7 of this law, the mandatory provisions shall be applicable for the establishment and effectiveness of consumer contracts, without subject to Article 8. 3. Even if in accordance with the provisions of article 7 of this law, choosing the law other than that of consumer habitual residence, if the consumer declares to the operator that the mandatory provisions of its habitual residence law shall be applied to formality of consumer contract, then the mandatory provisions shall be applicable for the formality, without subject to Paragraph 1, 2 and 4 of Article 10. 4. The establishment of consumer contract, in accordance with the provisions of Article 7 of this law choosing the consumer habitual residence law, if the consumer declares to the operator that habitual residence law shall be applied to formality of consumer contract, then the habitual residence law shall be applicable for the formality, without subject to the provisions of Paragraph 1 and Paragraph 4 of Article 10 of this law. 5. If not choosing in accordance with Article 7 of this law, the habitual residence law shall be applicable for the establishment of consumer contracts, without subject to Paragraph 1, 2 and 4 of Article 10. 6. The provisions of this article shall not be applicable under any of the following circumstances. (1) the consumer contract is signed in the business office of the operator, and the jurisdiction of the business office of the operator is different from that of the consumer habitual residence, and the consumer went to the same jurisdiction as the business office to sign the consumer contract. Except where a consumer receives an offer from a business operator at his habitual residence, and signs the consumer contract in the same jurisdiction as the business office. (2) the consumer contract is signed in the business office of the operator, and the jurisdiction of the business office of the operator is different from that of the consumer habitual residence, and the consumer accepts or is considered to have accepted the settlement of all debt in the consumer contract in the same jurisdiction as the business

4. Conclusion

The accurate expression and legislative process of Japanese law are worth learning. China is in a new period of reform and opening up. The high-level opening to the outside world is bound to bring more investment, trade and services, as well as more international civil and commercial disputes. This requires us to constantly improve the foreign legal system, especially the system of private international law with Chinese characteristics. The law on the application of laws which is being revised should, referring to the experience of Japan, not only reflect Chinese characteristics, but also adapt to the development of private international law.

office. Except where a consumer receives an offer from a business operator at his habitual residence and accepts the settlement of all debt in the consumer contract in the same jurisdiction as the business office. (3) When signing a consumer contract, the operator does not know and has full reason to prove that it does not know the consumer's habitual residence. (4) When signing a consumer contract, the operator mistakes and has full reason to prove that it mistakes the other party for not being the consumer.

A Pioneer Lawyer and China's Early Consular Court

Xin Zeng¹

Abstract: The study of lawyers and their legal activities figures prominently in the study of modern Chinese legal history. However, when and how those earliest lawyers of port cities started to plead in court and the details of the trials have rarely been explored. Published in August 1861 by the North China Herald (an early English newspaper published in China at that time), a detailed report focused on the trial process and the performance of the lawyers acting in the case. This case was the epitome of the situation of the first courts and lawyers in China's foreign Concessions. This study provides an overview of the primary sources surrounding this trial and the lawyers, illuminating their importance to the study of the early Chinese legal system and colonial experience.

Key Words: The Earliest Lawyers in China; North China Herald; Lawyer System; Consular Court; History of Chinese Legal System

1. Introduction

Professional lawyers appeared as early as in ancient Rome when the legal system became too complicated for common people to handle, which had been considered as a significant advance in the realization of legal justice. However, it was in the late Nineteenth Century that Chinese people started to regard lawyers as decent professionals and accept their legal assistance, owing to the contact with foreigners in treaty port cities. Despite the consensus among Chinese legal history researchers that lawyers in the modern sense appeared in China in the Concessions of the Qing Dynasty, as a product of Western powers' forceful transplantation of their legal system into China after the Opium War, the lives of lawyers who pioneered first in China's foreign Concessions and the cases they represented remain seldom explored. To shed light on this almost untouched field, we turn to case announcements published in English newspapers and magazines in Hong Kong, Guangzhou and Shanghai, the first port cities opened to the West, which regularly reported hot up-to-date social issues, including legal ones. For the study of the modern Chinese judicial system, these English newspapers and magazines published more than 100 years ago can serve as the most valuable and reliable historical data and reference bases. However, possibly due to the difficulty in tracking down the relevant materials, considering their age, few Chinese scholars in modern China have systematically studied the contents of judicial activities recorded in these early English newspapers and magazines so far.

The field of modern Chinese legal history reveals little research on the problem of "the first case in China where an advocate appeared in court". The author's extensive search shows that it is only Chen Tong who has systematically discussed the legal activities of foreign lawyers in modern Shanghai in his works. He cautiously remarked: "Judging from the materials available now, in the early 1860s, if not earlier, foreign lawyers began to practice law in the Concessions. To the author's knowledge, appearance of the first case in the North China Herald where a foreign lawyer pleaded in a Concession court took place in February 1862, and the activities of foreign lawyers must have started before that."²

It is safe now to conclude that foreign lawyers began to practice law in the Concessions in the late 1850s. The first sentence in an article published in the North China Herald in 1856 reads: "We hear the

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² Tong Chen, *On the Legal Activities and Influence of Foreign Lawyers in Modern Shanghai*, 3 Historical Review 20, 21 (2005).

question of Barristers and Solicitors pleading in the Consular Courts is finally settled in the affirmative”,³ clearly indicating that there had been a debate on this question, but from then on, the Common Law would take the place of Common Sense, where the Consuls would confront the Bar. That was 13 years after the British established their Consular Court in China in 1843, and lawyers should have been an indispensable part of the British Court. Then why did it take so many years for them to plead in the British Consular Courts in China? The answer can partly be found in the same article. Calling the Consular Court without lawyers a “legal Utopia”, the author was reluctant to see “a cheap and simple form of justice” to be replaced by “a dearer and more complicated one”.⁴ This attitude was possibly shared by many residents in those Concessions of Chinese port cities; otherwise, the North China Herald would not publish such an article that implied the struggle of lawyers with those who preferred a primitive legal system and the common sense over a civilized one and the Common Law.

The question of the time when lawyers started to plead in courts of Chinese Concessions is thus settled, after being admitted into the Consular Courts. How the pioneer lawyers performed became the next focus. As far as the specific case in which a lawyer appeared for his clients in Consular Courts for the first time, according to Chentong’s findings, a case in 1862 is considered to be the first one when a foreign lawyer represented his client. Moreover, he assumed a case in 1866, the first one in which a British lawyer pleaded in court for a Chinese client in Shanghai.⁵ However, the author’s systematic study and analysis of a large number of the earliest English newspapers and magazines in China collected in a multitude of archives, libraries and various electronic databases----also the earliest newspapers and magazines in China, as Chinese newspapers and other foreign newspapers and magazines did not appear until later has discovered that as early as 1861, a case was reported in minute details where a British Solicitor appeared in court for his Chinese client in Shanghai.

On August 17, 1861, in the form of a long report, a whole page of the North China Herald was devoted to a full coverage of a case in which a British lawyer, G. J. W. Cowie, appeared in Court, defending the Superintendent of Shanghai Customs.⁶ The failure to find any earlier like cases, despite an extensive study of a wide range of historical materials, convinces the author that the 1861 case was most likely the first, or at least one of the first, of its kind in China where a Chinese client was defended by a solicitor. It should be beyond people’s imagination about the “concession court” and “extraterritoriality” in modern Chinese history that the first client “foreign lawyers” in China represented was the Chinese Customs. The case therefore deserves elaborate presentation, discussion and analysis, the court hearing and characteristics of the case, the lawyer’s activities in China and his court performance in the case combined with other related historical materials, and will also provide a new perspective for the study of the Consular Court and the legal history in Shanghai Concessions.

2. The Case where Mr. Cowie Appeared in Court as Solicitor

The plaintiff of this case was the Superintendent of Customs, Mr. Woo, and the defendant was the owner of the British ship Rose. The H.B.M. British Consular Court in Shanghai served as the trial court. The claim by Mr. Cowie on behalf of the plaintiff was that the defendant, in violation of the Sino-British treaties, illegally traded outside the designated ports, and therefore the Rose and its illegal trading income shall be confiscated. The main phases of the trial were as follows:

(a) Speeches by the Consul and the Solicitor before Trial

³ See *Article 3-No Title*, The North China Herald, April 26, 1856.

⁴ Ibid, at p.154.

⁵ See supra note 2, at p.26.

⁶ See *H.B.M. Consular It Court, Shanghai: Before W.H.Medhurst, Esp.*, The North China Herald, August 17, 1861.

Before entering the formal trial procedure, the British Consul presiding over the trial, Sir Walter Henry Medhurst, addressed the court and wished to call to the attention of the two gentlemen assessors that they were not to try the defendants on a criminal charge. Mr. Cowie interrupted and remarked that it was a criminal charge, inasmuch as it was for a breach of treaty. However, Sir W. H. Medhurst went on to address the two assessors, stating that they were there at the requisition of the Chinese Authorities to decide whether the defendants had broken the solemn engagements made by the Queen on their behalf with the Emperor of China, and whether they were liable for the penalties imposed under those engagements. Thus, they must not allow their feelings for their fellow countrymen to militate against their sense of justice and their duty to maintain inviolate the promises of Her Majesty to the Chinese Government, but they also must keep in mind that the property of British merchants was at stake, and that the owners of the said property had no advocate but themselves to defend their rights and privileges under treaty. They must therefore endeavour as far as they could to pursue that middle course. The defendants were charged with breach of treaty, but that treaty was a favorable one in many points to Chinese interests, and it was for them to protect British interests to the utmost of their power, consistent with other obligations which were laid upon them.⁷

(b) Trial Process

As required by the Court, Mr. Cowie presented his qualification as defending lawyer before reading out the indictment, accusing the defendant of violating the Treaty of Tianjin (Tientsin) and the Regulations On Trade at the Yangtze and requesting that, under Paragraph 47 of the Treaty, the defendant's ship be confiscated, given its involvement in illegal commercial activities in some places between Shanghai and Zhenjiang (ChinKiang). Cowie also stated that Shanghai Customs officials were lenient toward the Rose and that the lawsuit was brought to the Consular Court only after the patrol boats of customs caught it engaging in illegal transactions many times. Two foreign customs patrolmen appeared in court as witnesses for the plaintiff.⁸

The testimony under oath of the first witness, Henry Wakeman, Master of the Plato, a Custom House cruiser, reads roughly as follows: "The first time the Rose came up the Sin-Yu-Miou Creek about the June 10, Mr. Wakeman boarded her and asked for her name and all papers, which are all right. The Master then was told to go out of the creek as he was not allowed there, but he insisted to go despite Mr. Wakeman's notice that the boat might be seized. Mr. Wakeman sent his First Mate and 6 men to see what he discharged and took in, and tried to induce him to come back. The boat returned after being there for a short time and discharged no cargo, so Mr. Wakeman allowed it to return to Shanghai. But the Rose arrived on July 10 again in ballast from Shanghai, and remained at the entrance of San-yu-miou Creek until the 23. At half past 10 that day, a Chinese boat came down the creek and refused to stop at the Custom House, so Mr. Wakeman had to chase her. While passing the Rose, a man looked like a shroff on it bowed and nodded to Captain Matthews, the latter answered it. The Chinese boat got outside and the Rose commenced sailing too. Mr. Wakeman sent his First Mate on board to go to Shanghai in the Rose, but Captain Matthews stated that his destination was Ningbo instead of Shanghai, and he would charge Tls.50 for the passage. They went away then."⁹

The witness, after testifying, was questioned first by the Consul, then by the plaintiff's lawyer, finally by the Consul again. The witness answered their questions one by one.

The testimony under oath, as required by the Court, of the second witness, Robert Davidson, Plato's First Mate, who appeared in Court on behalf of the plaintiff, reads roughly as follows: "On 23rd a leading Chinese from a Chinese ship on board the Rose who anchored near the entrance of Sin-yu-miou. Seeing this, Mr. Davidson reported to Captain James, the Captain of Halcyon, who was on the Plato at that time. The

⁷ Id.

⁸ Id.

⁹ Id.

boat was hailed to stop but refused to do so and passed the native Custom House. Robert Davidson saw the Rose, followed the native boat for about five miles, and then she took in money and goods, she started again after that and sailed northward for about two miles to the entrance of a creek, there she took in eight boxes of tea. The Chinese went on shore after that and the Rose proceeded to Shanghai. Davidson reported all this to Tide Surveyor Canham and Fitzroy, Commissioner of Customs.”¹⁰

Then, one by one, Davidson answered questions from the Consul, the assessors, and the plaintiff's lawyer.

Following the presentation of testimony by the plaintiff's two witnesses, the plaintiff's lawyer, Mr. Cowie, submitted three items of evidence to the Court. Then he once again called the Court's attention to 3rd Article of the Yangtsze Regulations and the 47th Article of the Treaty of Tianjin (Tientsin).¹¹

Then the defendant had the floor. Mr. Whittall, on behalf of the defendant, stated that the Rose had been in the habit of trading at Sin-yu-miou for the past two years, with the knowledge of Chinese authorities, as on several occasions she had taken letters for them to Sin-yu-miou, and they even lent her a gun to protect herself while trading, which also implied that the Rose received its sanction. Around last May when the Rose encountered a steamer and was asked for some papers while going up, the Rose was told not to proceed without pass. So she obtained the river pass from the Custom House after returning to Shanghai. In the following journey, the Rose traded at Sin-yu-miou, the pass being examined and she was allowed to proceed. But during another journey about the middle of June, the Master of the Rose was told not to go up to Sin-yu-miou after showing the pass. He insisted the Rose made no concealment during that journey and the following one. Mr. Whittall thus concluded that the trading of the Rose was with the sanction of the Chinese Authorities; and there was no breach of the Regulation, and as the Regulation of Yang-tsze had not been confirmed by the British Minister, he didn't consider that the Chinese Authorities had any right to fine an English subject, or any ship under them.¹²

Johann Matthews, the owner of the Rose, testified in Court after Mr. Whittall. He also gave an account of the first two journeys of the Rose to Sin-yu-miou, but mentioned that the officer who allowed him to trade there with a river pass was Captain James. Then Johann Matthews recalled his tackling the Plato and Haley on over the trading of the Rose near Sin-yu-miou in detail. Both of the two witnesses of the defendant were examined and cross-examined by the Consul and Mr. Cowie afterwards.¹³

After the defendant's statement, Mr. Cowie argued as follows: “the defendant mainly set up two objections to the plaintiff's charge: the first one was that their mode of trading had been sanctioned by the Chinese Authorities; the second was that the Provisional Regulation of Trade on the Yangtsze had never been confirmed by the H.B.M.'s Superintendent of Trade, as required by the Order in Council of the 13th June, 1853, it is not binding so as to enforce any penalty thereunder. In answer to the first objection, if the Rose had ever obtained any sanction---the evidence adduced did not prove such to have been the case---it was merely from the local authority at Sin-yu-miou, not from the Chinese Government, therefore the sanction was of no effect. No local government had any power to alter the Treaty of Tianjin (Tientsin) or the Provisional Regulation of Trade on the Yangtsze. As to the second objection, the Consular Notification of Mr. Meadows in March 18 stated that H.M.'s Envoy Extraordinary and Superintendent of Trade is prepared to give full effect to the Provisional Regulation of Trade on the Yangtsze. Since no instruction whatever to the contrary having yet been received, the Regulation should still be in full force. All that being the case, the defendants were clearly chargeable with a breach of the 3 Article of the said Regulation, which stated that any kind of trading between Shanghai and Zhenjiang (Chin-Kiang) might be punished as provided by the 47th article of the Treaty of Tianjin (Tientsin). It was clear that the plaintiff was entitled to a judgment in his favor. Acts of illegal trading had been proved against the Rose, therefore, she and her cargo were liable

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id.

to confiscation. The Master of the Rose had been warned previously on more than one occasion, but he disregarded them; the Chinese Authorities had been most lenient, now it's necessary to take active steps to repress illegal trading. Otherwise those who didn't conform to the said Regulation and Treaty, as the present case, would have an undue advantage over those who did." ¹⁴

(c) Judgment

After a brief consultation, the Court reopened and the following sentence was read by the Consul: "That first, the fact of trading between Zhenjiang (ChinKiang) and Shanghai is proven, but that the act having been encouraged by the actions of the Chinese Authorities on previous visits of the Rose to the same locality before, and by the undecided actions of the same Authorities when the breach of the treaty complained of was committed, any penalty imposed should be a mitigated one. That second, any penalty imposed for breach of the Yangtsze Regulation cannot be awarded, save under reference to H.M.'s Minister, as Article 4 of the Order in Council of June 13, 1853 provided that no penalty may be imposed on regulations made by H.M. Consuls, save under certain conditions which have not been fulfilled in regard to the Yangtsze Regulations. And third, that the defendants are not punishable under the 47th article of the Tianjin (Tientsin) Treaty, as the visit of the Rose to Sin-yu-miou for trading purposes was warranted by the encouragement given by the Chinese Authorities and by precedents established by themselves on other parts of the port" ¹⁵.

After the sentencing, the Judge and the two assessors signed the verdict. However, the lack of any follow-up report on the case by the North China Herald makes it impossible to know whether the defendant was finally punished or what kind of punishment he received.

3. Analysis of the Case

The detailed report on the case of August 1861 in the North China Herald presents a panorama of the trial procedure. Readers can become very informed of and enlightened on the courts and lawyer system in early China's Concessions. In addition, the exhaustively covered statements of all parties involved make informative the reading of the attitudes and positions of all parties and the examination of the characteristics of this case.

(a) The Plaintiff

The plaintiff in this case was His Excellency Woo, the Superintendent of Customs. H.E. Woo refers to Wu Xu, also the Shanghai Taotai from 1859 to 1862.¹⁶ After opening up to the Western world in 1843, Shanghai became a conduit for the transmission of all kinds of Western influences. As the top official of this port city, Shanghai Taotais stood at the frontline in dealing with foreigners almost totally helpless, as the Central Government was of no avail in offering them experience or instruction in this field.¹⁷ Liang Yuansheng termed the period between the opening of Shanghai to the West in 1843 and the establishment of Zongli Yamen in the Central Government in 1861, an era characterized by interpersonal diplomacy and self-determination of Shanghai Taotai.¹⁸ Among the 6 Shanghai Taotais in this period, Wu Xu was notorious in China for his good relation with the foreigners and his humbleness and obsequiousness before them.¹⁹ On

¹⁴ Id.

¹⁵ Id.

¹⁶ See Yuansheng Liang, *The Shanhhai Taotai --- Linkage Man in a Changing Society, 1843-1890*, translated by TongChen, Shanghai Classical Works Publishing House, pp.54-6 (2003).

¹⁷ Ibid, at p.56.

¹⁸ Id.

¹⁹ See Rulun Wu, *Li Wen Zhong Gong Quan Shu---Peng Liao Han Gao (The Full Collection of Li Hong Zhang: Letters to*

November 29, 1862, the North China Herald had an article about Wu Xu's leaving Shanghai for a new post in Nanjing, commending him "well up to his work", regretting the departure of this respectable Taotai, as he was quite well known, even somewhat liked by the foreigners in Shanghai,²⁰ thus proving Wu's popularity among the Shanghai Concessions.

Wu Xu had been famous for his talents in dealing with foreign affairs long before he was assigned the Shanghai Taotai, as early as during the First Opium War, when Wu Xu was engaged actively in Sino-British affairs together with other Zhe Jiang merchants.²¹ Contact with foreigners gave him opportunities and foresight to observe the technological, organizational and legal advantages of the West. When Shanghai was threatened by the Taiping rebellion he asked for F.T. Ward's military help, which was severely criticized by some Chinese, but Shanghai was saved from wreck and ruin anyway.²² Wu Xu maintained good relations with the foreigners for the sake of stability and peace, as the Shanghai Taotai, and as the top official, that was his priority concern. Compared with other officials, he had more in common with the foreigners in the Shanghai Concession: they were all merchants. Wu Xu did not get his post in the Government by passing the traditional civil service examination in China, but by donating money,²³ for he had been a merchant and achieved great wealth. A typical feature of Chinese mercantile history from the Late Ming onward was the merchants with the same regional origins dominating, even monopolizing a trade in a certain district, and then influencing the politics there directly or indirectly.²⁴ As a member of the Zhejiang merchants' group that played an active role in Shanghai's commerce, Wu Xu was an earnest advocate of external trade and cooperation between China and Western countries, which was in accordance to the interest of the port city Shanghai and the merchant group he represented. In the case mentioned-above, the defendant claimed that the Rose had been in the habit of trading at Sin-yu-miou for the past two years, with the knowledge of Chinese authorities, as on several occasions she had taken letters for them to Sin-yu-miou, and they even lent her a gun to protect herself while trading.²⁵ The tendency of Shanghai Customs to protect and even to encourage foreign merchants and their commercial activities is thus a plain fact, and it goes without saying that Wu Xu as the superintendent of the Customs exerted great influence there.

After 1840, China was forced to open more and more cities to Westerners, and measured solely against the baseline of Qing Dynasty's diplomatic policy, that opening up was quite impressive. However, the policymakers adhered to their old concept and ideology and denied the foreigners' access to the interior of China as much as they could. The illegal trading of the British ship, the Rose, near Zhenjiang had been found and reported, and those activities breached the treaties between China and the Unties Kingdom. As an official in the Chinese Government, Wu Xu had to fulfill his duty; but as an official who embraced the Western style, he employed a lawyer to sue the British ship in the British Consular Court,²⁶ as foreigners enjoyed immunity to Chinese law. That act was unprecedented. Just about a half year before, H.B.M. Consular Court heard another case, where the plaintiff was the Chinese Government, accusing two British of conveying prohibited articles, namely foreign fire-arms and percussion caps, into the interior of the country for the use of rebels. The Chinese Government sent no representative to the Court, and no lawyer appeared on its behalf.²⁷ Comparing these cases, the local initiative of Shanghai Customs was in full play.

Friends and Colleagues), Jin Ling Edition, p.19 (1908).

²⁰ See *The Taotai of Shanghai*, The North-China Herald, November 29, 1862.

²¹ See Zengping Lin, *The History of Modern China*, Hu Nan Normal University Publishing House, p.67 (2018).

²² See Achieves Bureau of Wu Jiang District, The Gazetteer Office of Wu Jiang District, *The County Magistrate of Wu Jiang*, Guang Ling Press, p.231 (2014).

²³ *Ibid*, at p.231.

²⁴ See Eiichi Motono, *Conflict and Cooperation in Sino-British Business, 1860-1911, the impact of the Pro-British Commercial Network in Shanghai*, Macmillan Press, p.1 (2000).

²⁵ See *supra* note 6.

²⁶ See *supra* note 6.

²⁷ See *supra* note 6.

(b) The Lawyer: Mr. Cowie and His Activities in China

Mr. Cowie was one of the earliest lawyers, if not the earliest, practicing law in China. His personal life and professional practice are of the same importance to the legal history in China's early foreign Concessions, but the research materials about him are all scattered and fragmented, and thus hard to find. It is the North China Herald, the North China Herald and Market Report, and the North China Herald and Supreme Court & Consular Gazette that provide us with more detailed reports in this regard. According to incomplete statistics, the North China Herald published dozens of reports about Mr. Cowie. The earliest report related to Mr. Cowie appeared in the North China Herald in 1859. On September 4 that year, he left Southampton for Shanghai by boat,²⁸ which was probably his first visit to China. In 1879, Mr. Cowie passed away in London. On hearing "the demise of this old resident in the Settlement, the community experiences a feeling of regret".²⁹ During his 20 years in China, Cowie's activities after arriving in Shanghai can be roughly divided into two categories:

(i) Legal activities

Mr. Cowie played mainly three roles in the legal activities he participated in: solicitor, assessor and plaintiff.

The position of solicitor appeared in England in the Middle Ages, when it was not classified under the category of legal professionals. Its original meaning in English referred to an instigator or agitator, who encouraged others to do things, having nothing to do with law. Only in the 15th Century did this term begin to refer to low-level legal professionals who were neither lawyers nor agents in court, but merely assisted the parties or agents to complete some auxiliary litigation work, that is, they were the assistants and servants of the parties or agents. In the middle of the 16th Century, solicitors developed into a new lawyer group comparable to agents. In the middle of the 18th Century, the solicitor and the attorneys could swap their qualification with each other, and they were integrated into one, thus forming a large branch of British lawyers in the modern sense, or the class of solicitors. This class is different from the barristers, another branch of British lawyers, in many aspects. The main feature of this type of lawyers lies in the fact that they are not allowed to appear in court as defending lawyers and can only engage in general legal affairs prior to litigation, such as providing legal advice, making legal documents, preparing litigation materials, etc. The materials they prepare are handed over to the barrister, who continues to complete the subsequent task of trial defense.

In the 1861 case detailed above, we saw Mr. Cowie participated in the trial as a solicitor representing Shanghai Customs, which was not the only case he had pleaded in the Consular Court. According to the author's findings, 1870 was the year that Mr. Cowie was most actively involved in law. The North China Herald reported five cases in which Mr. Cowie acted as a solicitor that year. In January, he appeared for a plaintiff named J. Morris and won the case.³⁰ He served as solicitor of Chinese clients against a foreign company in February,³¹ but the Chinese plaintiff's claim for an alleged breach of contract was disallowed. The North China Herald on June 2, 1870 reported another case with Mr. Cowie pleading in court for a Chinese client against a foreign plaintiff, where the court finally reached a judgment in favor of the plaintiff.³² A case between two foreigners was reported at the end of July, where Mr. Cowie pleaded for the

²⁸ See *Expected. - To Leave Southampton*, The North-China Herald, October 22, 1859.

²⁹ See *Death of Mr. Geo. J. W. Cowie*, The North-China Herald and Supreme Court & Consular Gazette, July 29, 1879.

³⁰ See *Mixed Court: Before Chen*, The North-China Herald and Supreme Court & Consular Gazette, January 25, 1870.

³¹ See *North-German Consulate: Sun-Tah Vs. Scheibler, Matthaei & Co.*, The North-China Herald and Supreme Court & Consular Gazette, February 1, 1870.

³² See *Mixed Court*, The North-China Herald and Supreme Court & Consular Gazette, June 2, 1870.

defendant. This case was left to be called later, but the author found no further report.³³ Mr. Cowie appeared in court again in September to defend a Chinese pawnshop against a foreign company and won the case.³⁴ All these cases are equally of great value to researchers, although not reported in detail, but due to the limited space here, they will be reserved for another article.

However, apart from Mr. Cowie, there was no shortage of other solicitors reported appearing in court. It can be seen that the initial composition of the Consular Court, whether in terms of the selection of judges or the qualification of lawyers, could hardly meet the requirements of the British domestic judicial system. But the editor of the North China Herald admitted that “it is necessary to know that in consequence of the early legal exigencies of Shanghai, it has been the custom to admit both barristers and solicitors to practise in the Courts, in the joint capacity of advocates and attorneys. In fact, complete reciprocity of professional privilege has been conceded, the barristers being admitted to the privileges of the lower grade, and the solicitor to the higher; an arrangement which has been attended with great convenience to the public, and appreciated accordingly.”³⁵ Thus it is evident that until 1866, advocates were in great need in Consular Courts of foreign concessions, barristers and solicitors had to admit each other into their own professional privileges.

In addition, Mr. Cowie regularly served as an assessor in Consular Court hearings. For example, two trials in June of 1863 he participated in were about the same case concerning the same real estate sales contract dispute, where the plaintiff, Barton, requested the defendant, Solomon David Sassoon, to perform a real estate sales contract.³⁶ In this case, both sides had someone else to defend themselves, but at the same time, they also appeared personally and stated their claims in court. While the profession of Mr. Lawrence, who defended the plaintiff, was not mentioned, it was clearly mentioned that Mr. Cooper, hired by the defendant, was a solicitor. During the second trial, “The Court” made statements many times to show its attitude, but it is not specified in the report whether the speaker was the Consul in charge or one of the two assessors. The answer might be affirmative, as in the case of August 17, 1861 mentioned above, the assessors examined the witness of the plaintiff, Shanghai Custom.

According to the Encyclopedia Britannica, assessors “had been introduced in the wave of egalitarian reforms that followed the French Revolution. Displeased with the freedom of the nonprofessional jury that was so contrary to the civil-law tradition of the professional judge, legislatures introduced assessors who would sit and decide cases alongside professional judges. In effect, the attempt to gain independence from professional judges was more or less destroyed. There are also lay assessors in England and the United States in maritime and admiralty courts and in various civil jurisdictions.”³⁷ Undoubtedly assessors should be professional, which was the original intention of introducing assessors into the courts with a professional judge, characterized by rapidity and informality, and maritime and admiralty courts introduced lay assessors as an expediency. But the Consular Courts in foreign concessions of China are quite similar to those maritime and admiralty courts in England in having lay assessors, as an article published by the North China Herald in 1856 said that “the power of adding neighbors, themselves Merchants, to sit as assessors, gives confidence to suitors pleading their own causes”.³⁸ Obviously, the author of the article applauded lay assessors. As a solicitor, although not an expert in all legal fields, Mr. Cowie was definitely more qualified than a “merchant neighbor”, but the Consular Court in 1863 seems not more advanced than that of 1856 in this aspect, lay assessors still constituted the majority. In the case of the Chinese Government accusing two British of conveying prohibited articles, Mr. Whittall appeared as one of the four assessors.

³³ See *Law Reports: Supreme Court Tapp v. Jones*, The North-China Herald and Supreme Court& Consular Gazette, July 28, 1870.

³⁴ See *Mixed Court: Tah Pawnshop*, The North-China Herald and Supreme Court& Consular Gazette, September 22, 1870.

³⁵ See *Editorial Article 1-No Title*, The North-China Herald, June 23, 1866.

³⁶ See *Consular Court: the Pleas in Defense Were*, The North-China Herald, June 6, 1863; *Consular Court: Before J.Markham Esq., Officiating Consul Barton v. Solomon David Sassoon*, The North-China Herald, June 20, 1863.

³⁷ See Introduction, <https://www.britannica.com/topic/assessor> (accessed on July 28, 2020).

³⁸ See *Article 3-No Title*, The North China Herald, April 26, 1856.

It's quite interesting that Mr. Cowie appeared as plaintiff in the North China Herald and Market Report on April 11 and 24, 1868, and these two legal reports were actually about two trials of the same equity dispute case.³⁹ It is noteworthy that Mr. Cowie also hired a lawyer, Myburgh, to defend him in court. D. Sassoon's Sons & Co. hired Harwood as its attorney agent. In the trial, the plaintiff's lawyer, Myburgh, first stated the plaintiff's claim: the object of this lawsuit was Tls.5254.79, for since September 1863, the plaintiff, Mr. Cowie, had been a partner of the Shanghai Brick Saw Mill Co. As the agent and treasurer of the company, he should be paid for his labor. In addition, in the course of doing business, Mr. Cowie also advanced significant expenses. The total of these two sums was exactly the amount claimed by the plaintiff. Then, at his lawyer Myburgh's request, Mr. Cowie testified as witness in court: since September 1863, when he and the defendant jointly operated the Shanghai Brick Saw Mill Co., he had paid out of his own pocket to cover a number of large expenses incurred by the company. In July 1866, the Brick Saw Factory closed its business and began to liquidate its assets. Mr. Cowie declared that he had transferred his equity in Shanghai Brick Saw Factory as early as December 3, 1864, and was no longer a partner of the factory. In addition, at the shareholders' meeting on April 27, 1867, the amount of money owed to him was also recognized by all shareholders, and therefore he requested the defendant to pay the expenses he claimed.

However, in his statement, Mr. Cowie also admitted that he did not know whether the transferee had signed the share transfer agreement or not, and he did not inform other shareholders of such transfer. This point then became the focus of dispute in this case. The defendant's lawyer claimed that Cowie's share transfer was invalid, so as a shareholder of the company, he was not in a position to sue other shareholders, or to make other shareholders satisfy all his claims, and that the defendant was willing to bear part of the compensation he claimed, but not all.

The case went through two rounds of trials. In the first round, the Court found that Mr. Cowie needed to provide further evidence to prove that the share transfer was effective; otherwise, the Court could not support his claim. In the second, given the fact that Mr. Cowie still failed to provide solid evidence, the Court finally decided against the plaintiff. As a solicitor, Mr. Cowie claimed that he had transferred his equity, but without knowing whether the transferee had signed the share transfer agreement or not, without informing other shareholders, it revealed he was not an expert in this field.

(ii) Other activities

In addition to legal activities, Mr. Cowie was also actively engaged in other activities in China.

In August 1861, when accepting the case of illegal trading of the Rose, he was working as a customs officer. The plaintiff of the case was Shanghai Customs of China, and the witnesses and lawyers of the plaintiff were all British nationals working in the Chinese Customs.⁴⁰ Foreign employees figured prominently among all the civil servants of the Chinese Customs and other government sectors, which is a well-known fact.⁴¹ The case reflected the true composition of the staff of the Chinese Customs at that time.

In the 1860s and 1870s, Mr. Cowie was also a regular attendee at the Land Renters Meetings⁴² and the Municipal Council Meetings⁴³ of the British Concession, and an occasional attendee at the Land Renters Meetings of the French Concession.⁴⁴ It's interesting that an article entitled "The Municipal Election"

³⁹ See Law Report: *Regina v. Woods*, The North-China Herald and Market Report (1868); *G.J.W. Cowie v. D. Sassoon*. The North-China Herald and Market Report (1868).

⁴⁰ See *H.B.M. Consular It Court, Shanghai: Before W.H. Medhurst, Esp.*, The North China Herald, August 17, 1861.

⁴¹ See Changtian Li & Liang Kong, *The Gate of China: A Report on Shanghai Customs*, Shanghai Art and Literature Publishing House, p.7 (2000).

⁴² See *Minutes of Meeting of Land Renter Held at the British Consulate*, The North China Herald, April 23, 1864.

⁴³ See *Municipal Council: Minutes of Council Meeting Report of Public Work*, The North-China Herald and Supreme Court & Consular Gazette, July 4, 1874.

⁴⁴ See *Public Meeting: the French Municipal Council*, The North-China Herald and Supreme Court & Consular Gazette, May 19, 1870.

published in 1878, stated that Mr. Cowie was a member of the old Municipal Council and a candidate for the new one, and that the people in the community were appealed to “Vote for Cowie and Mixed Court Law”.⁴⁵ It is evident that the professional qualification as a solicitor contributed significantly to Mr. Cowie’s popularity among the residents of the British Settlement.

In addition to acting as partner, agent and treasurer for other shareholders of the Shanghai Brick Saw Mill Company, as we learned from the above-mentioned case in 1868, Mr. Cowie was reported on October 17, 1863 to have “established himself at this port as General Commission Agent, under the style of Cowie & Co.”.⁴⁶ The 1870s saw Mr Cowie’s legal activities decreased dramatically and his commercial activities increased, participating in the commercial operation of several companies. For example, he was a regular participant in the shareholders’ meeting of Shanghai Gas Company.⁴⁷ In addition, the shareholders’ meeting of PooTung Dock Company was once held in Mr. Cowie’s own office,⁴⁸ attesting to his position in the company.

Due to the limited space here, Mr. Cowie’s other activities are highly condensed, but based on the author’s statistics, these activities represented a significant portion---no less than 2/3 of his life in China. In 1879, the North China Herald published an article “Death of Mr. Geo. J. W. Cowie”,⁴⁹ which commended his career as a “marked one”,⁵⁰ and told that he “was appointed to the indoor Custom’s Staff, serving between three and four years in the Accountants’ Office, a position, however, he voluntarily resigned for the purpose of commencing business on his own account”.⁵¹ His experience was the epitome of many British lawyers, who came to China in the early Foreign Concessions. The two assessors in the 1861 case and some other foreign lawyers who pleaded in the early Consular Courts also doubled as businessmen in China. Disagreement once arose over whether it was proper for a lawyer like Mr. Cowie to carry on the business of a Land Agent and Auctioneer. A motion against him was even brought forward to the H.B.M. Supreme Court,⁵² but ended up in eventual inaction, with the blame laid on “legal anomalies which exist in Shanghai”.⁵³ Barristers and solicitors were not admitted into the British Consular Court until more than ten years after its establishment, and after another five years Mr. Cowie appeared in the Court to plead for the first time. His enthusiasm for business was not unjustified, after all, being a businessman can achieve much more wealth than being merely a solicitor in the Shanghai Concessions.

(c) Language Chosen for the Court Hearing

English was used throughout the Court hearing, with no interpreter. The representative of the Shanghai Customs who appeared in Court didn’t say a word during the whole trial.⁵⁴ We are not sure about his ability to follow the accusing, defending and sentencing conducted in English. Despite the fact that the plaintiff was the Shanghai Customs, and Presiding Judge, Consul W.H. Medhurst, was proficient in Chinese (he was the son of the famous missionary W.H. Medhurst, and was an expert in Chinese),⁵⁵ and regardless of whether the

⁴⁵ See *Municipal Election*, The North-China Herald and Supreme Court& Consular Gazette, January 10, 1878.

⁴⁶ See *Classified Ad 1-No Title*, The North-China Herald, October 17, 1863.

⁴⁷ See *Public Meeting: Shanghai Gas Company Report Summary of Engineer’s*, The North-China Herald and Supreme Court& Consular Gazette, April 6, 1876.

⁴⁸ See *Public Meeting: Pootung Dock Company*, The North-China Herald and Supreme Court& Consular Gazette, February 6, 1873.

⁴⁹ See *Death of Mr. Geo.J.W.Cowie*, The North-China Herald, July 29, 1879.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² See *Editorial Article 1-No Title*, The North-China Herald, June 23, 1866; *H.B.M.Supreme Court, June 10, 1866, Before C. Goodwin Esq Mr....*, The North-China Herald, June 10, 1866.

⁵³ *Id.*

⁵⁴ See *H.B.M. Consular It Court, Shanghai: Before W.H.Medhurst,Esp.*, The North China Herald, August 17, 1861.

⁵⁵ See Yi Zhou, *Pidgin English as a Cultural Phenomenon*, Si Chuan University Publishing House, p.164 (2006).

representative of the Shanghai Customs could understand English, the Court still chose English for the trial, because the rest of the people in Court were all foreigners.

In fact, before that, a Court interpreter appeared in another case reported by the North China Herald in March 1860. The interpreter was asked to take an oath to ensure the truthfulness of his interpretation.⁵⁶ In that case, the plaintiff was Chinese and the defendant was a foreigner. The plaintiff requested the defendant to pay the remuneration owed to him.

In the case where Cowie served as solicitor, further study is needed as to why the representative of the plaintiff, the Shanghai Customs, failed to request interpretation if he had not understood English. Obviously, the case was of great importance to the Customs as it concerned the execution of the Treaty of Tientsin, and thus following the trial was absolutely a necessity. Since the Custom Court's opening up, many officials and clerks had been assigned to Shanghai just because they were skilled at foreign affairs. For example, another Taotai named Wu Jianzhang could speak English, although not quite skillfully. It's possible that the representative of Shanghai Customs understood and spoke English too, but then it begs the question of why he was recorded speechless in the trial, especially before the formal trial in response to the dialogue between the Consul in charge of the trial and Mr. Cowie.

(d) Positions of the Judges

The clear-cut statements made by Presiding Judge Medhurst before trial clearly betrayed his attitude of favoring the defendant. He had always been known for his tough attitude toward China and partiality toward British businessmen. Wu Xu, Shanghai Taotai, once asked the British Consul Medhurst to give a warning to and detain an English ship that had reached Shanghai carrying 1500 packages of salt smuggled out of Wenzhou. Such conduct constituted a serious offense. However, Medhurst shrugged it off, saying lightly that the fact that the salt was allowed to be shipped out of Wenzhou proved that it was legal; it was unnecessary to warn the ship, let alone detain it.⁵⁷

As mentioned above, most of the assessors in the British Consular Court were merchants. As for the two assessors in this case, one of them was a shareholder of Shanghai Riding Course,⁵⁸ the other was listed as representative of a commercial firm.⁵⁹

British Settlement was initially a settlement for British businessmen, so it was a consistent policy of British Consuls in China to safeguard the interests of British businessmen. Nevertheless, Chinese laws and the treaties between the two countries had to be taken into consideration while doing so. In 1851, the detention of a boat John Dugdale became "a topic of the week" in the little community in British Settlement. The fact of its smuggling tea was evident. The Consul immediately communicated with the Taotai of Shanghai, and the offending parties were amerced by the infliction of double duties on the quantity not previously paid and a further fine to the Queen. According to the editor of the North China Herald, this decision made out of great leniency by the Consul would be heartily approved.⁶⁰ But this incident became the prominent interest in the Settlement not only for a week, as accounts differ and opinions vary, but four letters to the editor had been published successively in the following two months. Amongst these letters, one from a merchant who claimed himself an old resident at the port was very wordy and indignant, expressing his disapproval with the Consul's decision, claiming that smuggling was not a crime, but "wholly the result of vicious commercial and financial legislation", and the decision was a "partial, and wanton sacrifice of British

⁵⁶ See *Article 3-No Title*, The North-China Herald, July 20, 1861.

⁵⁷ See Changlin Ma, *Shanghai De Zu Jie (The Concessions in Shanghai)*, Tianjin Education Press, p. 18 (2009).

⁵⁸ See *Appeal: Appellant, Alladinbhoy Habibbhoy Respondents, Chanf-ching-chung and Hoo-tib-shing Statement of the Consul's Ground, of Decision to the Chief Superintendent*, The North-China Herald, March 17, 1860.

⁵⁹ See *Article 4-No Title*, The North-China Herald, November 17, 1855.

⁶⁰ See *Editorial Article 2 -- No Title*, The North-China Herald, January 11, 1851.

property”.⁶¹ Others considered smuggling a great wrong---morally, politically and commercially, but to stop it, the Consul must “insist on the Chinese providing efficient Establishment”.⁶²

Since the 1840s, we saw the reluctant and gradual opening to the West of Qing Empire on one hand, and on the other hand the Westerners felt dissatisfied, even indignant for being unable to get free access to the vast territory of interior China. The widespread criticism of the Consular Court is attributable to the fact that most of the successive Presiding Judges of the British Consular Court were consuls doubling as businessmen. But we know undoubtedly that in commercial profits lay Britain’s original intention to force open China’s door and its core interests in China. Therefore, it is no surprise that the British Consul presiding over the trial and the assessors, most of them merchants too, tried their best to justify the British businessmen in the above-mentioned and other commercial cases of Sino-foreign disputes.

(e) Trial Procedure

Despite the apparent similarity of the lawyer’s and the judge’s questioning of the plaintiff and the witness in this case to the cross examination in the adversarial litigation mode of the common law system, they are obviously different. In cross examination, the party providing a witness first conducts the main examination of its own witness, and then the opposite party conducts cross examination on the witness. The main examination and cross examination can be repeated to find out the truth to the maximum extent. The judge is expected to remain neutral and typically does not intervene in this procedure. However, in the case of the Rose discussed above, apart from the plaintiff’s lawyer, the Consul serving as Presiding Judge and the assessors directly questioned the witnesses, which obviously went against the purpose and premise of cross examination, to which, however, Mr. Cowie, the plaintiff’s lawyer, did not raise any objection.

Analyzing the hearing process of this case revealed that in some aspects, the Consular Court in early Chinese Concessions bears indeed similarities to European Participatory Adjudication of Commercial Courts in the 11th and 12th Centuries. From then on, a great expansion of agricultural production and a dramatic increase in the size and number of cities led to the rise of a merchant class, which in turn led to a boost of oversea trade, especially in seaport towns. The situation where foreign merchants often lacked rights under the local laws or protection by local rulers made it a necessity for merchants engaged in international trade to create a universal law of their own. The universal character of mercantile law was secured by treaties among rulers of different states under such circumstances. Italian cities entered into bilateral treaties at least from the 12th Century in which each side agreed that the citizens of the other side would be free to settle, to own property, to run businesses and to have access to courts within its borders. These treaties aimed at settling commercial disputes according to mercantile custom, but in the absence of customs, according to good conscience, and such courts usually had a judge and two or three assessors elected from among their members. Speed and informality were procedural characteristic of all types of Commercial Courts. Professional lawyers were generally excluded, and technical skills of argumentation were always frowned upon.

The institution of Italian Commercial Courts was soon adopted by other European countries, including Britain, where so called courts of staple were established in 14 towns. Trials in such courts involved both foreign and English merchants and required a mixed jury composed of half British and half foreigners.⁶³ Foreign merchants were provided with protection, and they also participated in the election of the mayors in these British towns.

The similarity of trials in Commercial Courts of Middle Age Europe to this case of the Rose’s illegal

⁶¹ See *Article 6-- No Title*, The North-China Herald, January 18, 1851.

⁶² See *Letter to the Editor 1-- No Title*, The North-China Herald, February 8, 1851.

⁶³ See Harold J. Berman, *Law and Revolution, The Formation of Western Legal Tradition*, Harvard University Press, pp.333-47 (1983).

trading are obvious: international commercial disputes in port cities, staff selection and organizational operation of the court, etc. The Consular Court drew on the experience of the Commercial Courts dating back several centuries, and the differences were obvious as well.

(f) Laws Cited

The Commercial Courts in Europe of the Middle Ages decided international disputes according to treaties among states or countries. In the Court hearing of the *Rose* against the Chinese Custom, the legal bases cited by the prosecution were Sino-British treaties and the defense cited Orders of the British Council, and the Court decided in favor of the defense.

The legal bases cited by the plaintiff's lawyer in Court came mainly from the Treaty of Tianjin and the Provisional Regulations for Trade on Yangtze. The latter, signed at the beginning of 1861, mainly stipulated the trade affairs of Britain in Shanghai, Zhenjiang, Jiujiang, Hankou and other open ports of the Yangtze River. Among them, Zhenjiang was mentioned many times because it was the place ships going upstream and downstream must pass. According to the third paragraph quoted by Cowie, "When the ship set sail from Shanghai to the Yangtze River, it is at the discretion of the Shanghai Customs to send one or two officers or servants to escort the ship to Zhenjiang. The shipowner must not stop them, and shall provide them with accommodation, which is to be funded by the customs. The ship is not allowed to trade anywhere from Shanghai to Zhenjiang. Any unauthorized trade constitutes a breach of Paragraph 47 of the Treaty of Tianjin, and may be handled according to the provisions specified in the Treaty".⁶⁴

It can be seen that the main basis cited by the plaintiff's lawyer in this case was Paragraph 47 of the Treaty of Tianjin (Tientsin). The signing of the Treaty of Tianjin in 1858 led to the immediate abrogation of the Treaty of Humen, but many of its provisions were absorbed or amended by the Treaty of Tianjin (Tianjin). Paragraph 47 repeatedly quoted by Mr. Cowie in this case stipulated that "If any British merchant vessel be concerned in smuggling, the goods, whatever their value or nature, shall be subject to confiscation by the Chinese authorities, and the Ship may be prohibited from trading further, and sent away as soon as her accounts shall have been adjusted and paid."⁶⁵ Article 49 specifically explained that "All penalties enforced or confiscations made under this Treaty, shall belong and be appropriated to the Public Service of the Government of China".⁶⁶

Although Britain established the treaty port system virtually by the Treaty of Tianjin of 1858, which allowed British merchants to carry out commercial activities according to the economic principle of 'free trade', it was far from satisfactory for British merchants in China.⁶⁷ Actually, since the date of its promulgation, the Treaty of Tianjin (Tientsin) had been a source of untold disputes between China and Britain as well as between British merchants in China and British government, because many of its provisions involved anti-smuggling, tariff collection and other major British concerns. The Treaty of Tianjin (Tientsin) was intended to confirm the anti-smuggling measures ratified in early treaties, pointing out the end of the era when the Consul took the initiative to take the anti-smuggling measures as a reference in decision-making.⁶⁸ Foreign businessmen, as well as many Consuls, strongly questioned whether the customs officers employed by the Chinese Government had the right to punish tax law breakers with a fine or confiscation of their goods. Foreign tax law-breaking businessmen seemed to think that the extraterritorial privileges recognized in the Treaty could shield them from punishment by Customs officials, especially foreign officials,

⁶⁴ See Tieya Wang, *Zhong Wai Jiu Yue Zhang Hui Bian (The Collection of Old Sino - Foreign Treaties)* (Volume I), SDX Joint Publishing Company, p.155 (1957).

⁶⁵ See *China's External Relations--A History*, <http://chinaforeignrelations.net/node/144> (accessed on June 28, 2020).

⁶⁶ Id.

⁶⁷ See supra note 24, at p.1.

⁶⁸ See N.A.Pelcovits, translated by Yan Chen & Zaihua Jiang, *Zhong Guo Tong Yu Ying Guo Wai JiaoBu (Old China Hands and the Foreign Office)*, the Commercial Press, pp.21-3 (1959).

because they were also under the Consular jurisdiction.⁶⁹ As a result, businessmen trading at open ports repeatedly flouted bans and defied the jurisdiction of the Chinese Customs. Consuls constantly consulted the British Government and British lawyers for clear policy and legal opinions.

Actually, many merchants had a substantial number of complaints concerning the Shanghai Customs. In this respect, just about two months before the case report of the British ship *Rose*, the Chairman of the British Chamber of Commerce wrote a letter of protest to Medhurst relating to the late innovation of the Shanghai Customs, which the merchants considered to be against the spirit of the treaties between China and Great Britain, and they requested the immediate attention of the Consul and begged him to take steps to protect the treaty rights and interests of the English merchants. In reply to this letter, Medhurst mentioned the unsatisfactory outcome of his negotiation with the Superintendent of the Shanghai Customs and promised to transmit the protest to the British Minister.⁷⁰ Herein lies the cause of many problems with the breach of treaties in Shanghai at that time. Moreover, China was forced to open to the West all of a sudden with the imposition of the notorious unequal treaties, but most of the articles in the treaties were quite broad, and when it came to interpretation and operation, neither the Central Government nor the local Port City Governments was ready to handle the problems boosted by the foreigners or international trade. As a result, the foreigners might have thought it justifiable to get around the articles of the treaties.

For these reasons, in the Court hearing, the defendant and the Consular Court, persistently ignoring the perfect clarity of the definition and punishment of British illegal trade in China specified under the treaties between China and Britain, would exculpate the accused on the pretext of any Order in Council. “Order in council, in Great Britain, [was] a regulation issued by the sovereign on the advice of the Privy Council.”⁷¹ But “once powerful, the Privy Council has long ceased to be an active body, having lost most of its judicial and political functions since the middle of the 17th century. The council system worked well as long as the king was capable of choosing the right men and providing leadership. The kings from the house of Stuart were unable to do this, and jealousy and anger at the council’s political activities grew among parliamentarians and common lawyers. Amid the religious and constitutional controversies of the mid-17th century, the council system was swept away, but the Privy Council was never formally abolished. Usually it functions through committees, the most noteworthy being the Judicial Committee of the Privy Council, which was established by statute and hears appeals from ecclesiastical courts, prize courts, and courts from the colonies as well as some independent members of the Commonwealth.”⁷² Being a legacy of the Council system that had aroused anger among British parliamentarians and common lawyers, Order in Council turned out to become a life-saver for those merchants who tried every way to circumvent the Sino-British treaties.

(g) Special Status of the International Settlement

Despite the fact that the Chinese tended to regard the International Settlement in China as “a state within China”, as it was not governed by Chinese law due to its Consular jurisdiction, the study of this case and other historical events that happened in the Concessions reveal that many acts in the British Concession were not subject to the jurisdiction of the British Minister or even the British Government. For example, the

⁶⁹ See The Compilation Committee of the General Administration of Customs of the People’s Republic of China on the Selection of General Orders Issued by the General Department of Customs and Excise of China before the Founding of The People’s Republic of China, *Jiu Zhong Guo Hai Guan Zong Shui Wu Si Shu Tong Ling Xuan Bian (the Selection of General Orders Issued by the General Department of Customs and Excise of China before the Founding of The People’s Republic of China)* (Volume III) (1831-1942), China Customs Press, pp. 293-4 (2003).

⁷⁰ See *Article 5-No Title*, The North-China Herald, August 3, 1861.

⁷¹ See <https://www.britannica.com/search?query=Order+of+Council+> (accessed on July 28, 2020).

⁷² See <https://www.britannica.com/topic/Privy-Council-United-Kingdom-government> (accessed on July 28, 2020).

establishment of the Shanghai Municipal Council was not recognized by the British Government.⁷³ In 1862 Walter Henry Medhurst refused the Shanghai Circuit Intendant's request to help with a census of the Chinese population in the British Concession in order to collect tax from them, on the grounds that those Chinese in the Concession were also protected by Britain.⁷⁴ Such attitude came under fire from the British Envoy and Government. This matter ended up unsettled nevertheless.

It is safe to say that, in some matters, the British Concession administrators, who mainly represented the interests of British businessmen, would cite orders or laws of the British Envoy and the British Government in an effort to defend themselves before the Chinese people or the Qing Government; in other matters, they would argue with the envoy or the British Government, desperately seeking justification in their favor. Sometimes they would even make things a *fait accompli* by acting first and reporting afterwards, or by obeying apparently but defying in secret, and their purpose was nothing but to safeguard and expand their own business interests. An influential British businessman, while talking to Consul Rutherford Alcock, did not mince his words, "You are the consul of Her Majesty. Naturally, you're duty-bound to seek permanent interests for Britain. But what I care about is how to seize any chance to get rich... I hope to get rich and leave here in two or three years at the latest, so what has to do with me should Shanghai be flooded or burned down by a fire in the future? Please don't expect people like me to voluntarily live like an exile for many years in a place they can't get used to, just for the sake of future generations. We're here to make money, as hard as we can, the more the better, and the quicker the better. To this end, whatever methods and means permitted by law come in handy."⁷⁵ In the final analysis, the underlying reason why the case discussed in this paper eventually ended with such a judgment can be found in what this British businessman said, only that he had put it in a different form and style.

4. Conclusion

Tracing the first of any significant development is always difficult, but meaningful, and not only meaningful in revealing some names and life stories, but in casting light on the historical context of those names and stories, and in analyzing the influence of the pioneers on the latecomers, whether the influence is weak or strong, implicit or explicit.

The most interesting finding in tracing the first lawyer who appeared in Court of inland China was that he pleaded for the Superintendent of Shanghai Customs, not a British agent. Qing Empire's lagging behind the West in legal system development was a well-established fact, for which it had been fiercely criticized; however, while the Western community in Shanghai Concession felt so unhappy to see lawyers starting to plead in the Consular Court in 1856, that was more than ten years since the Consular Court had been established. Even so, few Westerners would like to spent money on having a lawyer to plead for them. More interesting than that, this Chinese merchant-official, Wu Xu, who had been criticized for disgracing China for his humbleness and for his good relation with the foreigners, was finally removed from his post and fell into disrepute. Ironically, he attained his post in Government by donating money, in order to save his reputation and to please the Central Government. Wu Xu donated a large sum of money, possibly larger than that by which he obtained his post, to help the Government in charities and military expenses. That was the struggle and choice of a Chinese merchant-official in the port city Shanghai: actively engaged in commerce all his life; generously giving up the wealth accumulated in commerce in pursuit of success of an official career in the bureaucracy; heartily admired the Western military forces and embraced the Western legal system; yet strongly sticking to traditional Chinese values. He never rejected the social norms and values that had governed China for thousands of years, what set him apart from other merchant and officials "was not

⁷³ See Longfei Jiang, *Shanghai Zu Jie (Shanghai Concessions)*, Wen Hui Publishing House, p.87 (2014).

⁷⁴ See Daode Cheng, *Jin Dai Zhong Guo Wai Jiao Yu Guo Ji Fa (the Diplomacy and International Law in Modern China)*, Xian Dai Publishing House, p.61 (1993).

⁷⁵ See Shixun Kuai, *A draft history of the Shanghai Settlements*, Shanghai People's Publishing House, p.348 (1980).

what they might have lost, but what had become necessary for them to learn. This included both foreign language skills and knowledge of the world that lay beyond China”.⁷⁶

The life of Geo. J. W. Cowie, the lawyer hired by Wu Xu, is a revelation of a British lawyer in the legal system of the early foreign Concession. The foreign Concessions are isolated in the sense that they are far from their motherland geographically, and they are far from the Chinese communities culturally. Located in Chinese port cities, in order to protect the core interest of the residents, most of them merchants, the Consular Courts stood ready to accept or refute any legal resources to achieve this end, whether they were common sense or Common Law, whether they were Sino-British Treaties, Order in Council or Medieval Commercial Court Law, which thus made their legal order pluralism. Being fully aware of this, some lawyers like Mr. Cowie engaged themselves more actively in business than in law to achieve wealth and social recognition in the little community of the foreign Concessions.

The different attitudes of Geo. J. W. Cowie and Wu Xu toward commerce are the epitome of cultural conflict between China and the West, the former commerce-oriented, the latter still deeply indulged in anti-commercialism. Many other disputes in the Chinese Concession centered on this conflict, the Western merchants copied the Commercial Courts in Middle Age Europe in their Consular Courts, but China had totally different commercial and legal traditions. The same mode could hardly work here, therefore Medhurst and the two assessors excused the Rose for the “undecided action” of Shanghai Customs;⁷⁷ British merchants condemned the “vicious commercial legislation”⁷⁸ and inefficient Establishment in China;⁷⁹ as to lawyers’ doubling as merchants, the blame was on “legal anomalies which exist in Shanghai”.⁸⁰ As far as Chinese parties were concerned, they became speechless as they were almost totally unprepared for the international disputes, and it was thus natural for the Courts to defend the Westerners’ interests. China entered the international commercial stage and started to integrate herself in it for decades. Facing more international trade disputes, even trade war, sticking to the opening policy, more changes and challenges were in the way of China’s entering the world stage, understanding the core interest of other countries, having lawyers who could handle international disputes with ease, creating a narrative that might be widely accepted. The Chinese Government and Chinese people still had a long way to go.

Meanwhile, these lawyers who doubled as businessman definitely made their contribution to the development of the legal system in the Concessions; otherwise, advocates and professional assessors could not have been allowed into the Consular Courts to plead and decide cases together with non-professional judges. Moreover, as the author had mentioned that the people in the community were appealed to “Vote for Cowie and Mixed Court Law”, what exactly was their contribution and how should people now assess their contributions to China’s legal history, as the various courts set up by foreigners in China serve as a model for the Chinese legal reform toward modernism? All these are questions to be explored further.

This study, limited in scope, does not strive to address the wider historiography, but simply shed light upon the valuable primary sources in the North China Herald. These early English newspapers are a great asset in answering questions such as how the early Chinese legal system was shaped by the intriguing interaction between the British Government, Chinese Government, and the Chinese, and British agents on the ground.

⁷⁶ See Wen-hsin Yeh, *Shanghai Splendor: Economic Sentiments and the Making of Mordern China, 1843-1949*, University of California Press, p.15 (2007).

⁷⁷ See *H.B.M. Consular It Court, Shanghai: Before W.H.Medhurst, Esp.*, The North China Herald, August 17, 1861.

⁷⁸ See *Article 6-- No Title*, The North-China Herald, January 18, 1851.

⁷⁹ See *Letter to the Editor 1-- No Title*, The North-China Herald, February 8, 1851.

⁸⁰ See *Editorial Article 1-No Title*, The North-China Herald, June 23, 1866; *H.B.M. Supreme Court: June 10, 1866, Before C. Goodwin Esq Mr.*, The North-China Herald, June 23, 1866.

Key Issues on Constructing Public Enterprises with a Comprehensive Approach

Lichun Pan¹

Abstract: Public enterprises refer to institutions that provide public goods and services for the society. While in China, public enterprises are state-owned enterprises (SOEs), it is not necessary that public enterprises must be owned by the government. We learn from the overseas experience that public enterprises can be owned and operated through various models successfully under a well-established legal system. With the deepening of the reform of SOEs, there is no doubt that China gradually expands public enterprises to include a comprehensive approach, one that explores various forms of ownership including the state-owned mode, public-private-partnership mode, and private mode. In the construction of public enterprises with a comprehensive approach, it is indispensable to be well aware of the corresponding issues of each mode. As to the state-owned mode, the corporate governance mechanism must be optimized. The board of directors should be given due respect and the decisions such as number and names of the special committees under the board should be left to the board at its self-discretion. With respect to the public-private-partnership mode, the respective concerns from both the public and private sectors cannot be neglected, and issues of transparency, discourse power, prolonged procurement time, risk prevention and founders' excessive earnings must be resolved. With regard to the private mode, a smooth transition from nationalization to privatization must be ensured. The research methodology applied here is analytical borrowing, by analyzing laws and regulations of British and American public enterprises, this article attempts to address the above-mentioned issues with the help of the experience of the UK and the USA. It has to be realized, however, some solutions fit for other countries may not fit for China, the setting up of golden share is the case. Before the establishment of a scientific legal framework, the use of golden shares has for the time being more disadvantages than advantages for the smooth transition of the public enterprises from nationalization to privatization.

Key words: Public Enterprises; State-owned Enterprises; Public-private-partnership

1. Introduction

China lacks a universal definition of “public enterprises” at the present moment. Instead the interpretation encompasses several expressions referring to public utilities, public services, public fields, public corporations, and public companies. In this article, these are collectively referred to as “public enterprises”.

In contrast to this and outside of China, public enterprises are often interpreted to be institutions that provide public goods and services to the society and encompass a variety of ownership models. For instance, with the backdrop of evolution and development of the public enterprises in the UK and the US; water, electricity, gas, telecommunications and other industries in the UK have been sold to the private sector so it is the private sector that is mainly responsible for providing public goods and services to the public in today's UK. The US, on the other hand, has sold only a part of the above-mentioned

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industries to the private sector, and what the US prefers to do is to sign outsourcing contracts with the private sector, requiring the private sector to provide certain public goods and services according to the contracts. Taking residential water as an example, in the 1940s, residential water in the UK was provided by the state-owned public enterprises; while in the 1990s, residential water was largely provided by the private enterprises. In today's US, residential water is either provided by private enterprises or jointly provided by the public and private sectors. It seems that there were no state-owned public enterprises in the US and the UK, but the fact is there are some state-owned ones in both of the countries. Tennessee Valley Authority of the US and Caledonian MacBrayne of the UK are the examples. The former is an American electricity corporation and the latter is a British passenger ferry company.

In China, while it is true that public goods and services are mainly state-owned, the current reform efforts have trended towards utilizing the private capital. This can prove to be a viable option in the future. In consideration of the specific characteristic that China does have a large number of state-owned enterprises, it is practical for China to adopt a comprehensive approach to construct its public enterprises, which is an integration of the state-owned mode, public-private-partnership mode and private mode, with the state-ownership and the public-private-partnership being the dominating modes.

In the construction of the public enterprises with a comprehensive approach, we need to deal with the existing issues and potential issues in accordance with different options on the modes.

2. Supply Responsibility of Public Goods and Services

Samuelson,² Musgrave,³ Olson⁴ and Buchanan⁵ focused their studies on the definition of public goods and services. While they had different perspectives, they shared the common understanding that public goods and services are for the entire society, and thus is indiscriminate towards the general public's right to use it. From this perspective, the four scholars all agree that the most significant characteristic of public goods and services is being non-exclusive and non-competitive. Public goods and services are either provided to all individuals of the society or none, and it is not easy to charge each single consumer for the use of public goods and services. On the basis of this discovery, Zhongyi Li and Xunan Hu summarized another two features of public goods and services in their research. First, once public goods are produced and provided to the society, the entire society seldom have free choices but to accept them passively, such as transportation; second, the initial investment of public goods and services is huge, but the subsequent operating capital will be gradually reduced, such as telecom industry.⁶ Olsen explained on this point that the large initial investment of public goods and services is determined by both the scale and the nature of those, as the result, the unit price of the first batch of public good (services) is usually higher than that of the subsequent ones.⁷

² See Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 *The Review of Economics and Statistics* 387, 389 (1954).

³ See Richard A. Musgrave, *Comparative Financial Analysis* (translated by Qinfa Dong), Shanghai People's Publishing House, pp.6-7 (2007).

⁴ See Mancur Olson, *The Logic of Collective Action* (translated by Yu Chen, Yufeng Guo and Chongxin Li), Shanghai People's Publishing House, pp.29-30 (2018).

⁵ See James M. Buchanan, *The Demand and Supply of Public Goods*, Shanghai People's Publishing House, p.47 (1999).

⁶ See Zhongyi Li & Xunan Hu, *Features, Equilibrium and Effective Supply of Public Goods*, 6 *State Economy Review* 30, 32-3 (2014).

⁷ See supra note 4, at p.28 (2018).

In compliance with the above attributes, most people hold the opinion that it is the government's responsibility to supply public goods and services to the society. Although market allocation has an obvious priority, it also has its limitations.⁸ Market allocation is prone to internal deficiencies, thus results in market failures. The manifestations are mainly reflected in the failure of competition, the formation of market monopoly, unemployment, unbalanced regional economic, excessive use of public resources, and insufficient supply of public goods.⁹ In consideration of the shortcomings of market mechanism, it is believed that simply relying on the market for resource allocation and benefit distribution cannot achieve the desired effect.¹⁰ In addition, government should take its responsibility. Keynesian economics emphasizes on the importance of government intervention to the economy stabilization.¹¹ Government intervention is a special response to market failures. Government needs to balance the two ends of both supply and demand, focusing on the links of production, sales and consumption of the public goods.¹² Moreover, the supply of public goods and services reflects the value of fairness and justice.¹³ According to the public choice theory, one of the main responsibilities of the government is to make up for market failures, thus government has to perform its specific functions to resolve the problems that market cannot resolve, and the provision of public goods and services is the one.¹⁴ Besides, public goods and services are not supposed to be supplied by the market, because the cost of public goods and services usually far exceeds the benefit.¹⁵ When government supplies some public goods and services to one individual, it has to supply the same standard to all other individuals.¹⁶

However, even if it is accepted that government is obligated to provide public goods and services, determining the method in providing the goods and services is a main topic. Should government be a producer or a provider? Stiglitz suggests that to be realized that in the supply of public goods and services, "to be provided" doesn't mean "to be produced".¹⁷ The two phrases are different. Government's "providing" public goods and services contains two kinds of situation – either government directly produces them, or government provides them without direct production.¹⁸ The former is to provide by administrative mode, the latter is to provide by public enterprise mode.

After comparing administrative mode with public enterprise mode, Osborne and Gabler conclude that public enterprises are likely to provide better quality of public goods and services.¹⁹ Zink states that public enterprise mode is prior to administrative mode in the aspects of both efficiency and flexibility.²⁰

⁸ See Gongyun Gu, *Course of Economic Law*, Shanghai People's Publishing House, p.257 (2013).

⁹ See supra note 4, at p.256.

¹⁰ See Zhen Gao & Ruochen Jiang, *Essence of Enterprises: Perspectives on Market Failure, Organization Failure and organization Evolution*, 37 Lanzhou Academic Journal 156, 166 (2017).

¹¹ See Peiying Guo, *An Analysis of the Evolution of Keynesian Macroeconomic Theory*, 40 Jilin Financial Research 20, 25 (2020).

¹² See Rui Li, *Research on Theoretical Path of Market Regulation of Epidemic Prevention Supplies in Magnitude Outburst Public Health Incident*, 41 Law Science Magazine 22, 31 (2020).

¹³ See Shouwen Zhang, *Legal Adjustment to the Relationship Between Government and Market*, 30 China Legal Science 60, 62 (2014).

¹⁴ See Thomas R. Dye, *Understanding Public Policy*, China Renmin University Press, p.22 (2011).

¹⁵ See Gongyun Gu, *The Function of Government in Economic Governance*, 15 Economic Law Review 25, 27 (2015). ¹⁶ See James M. Buchanan, *The Demand and Supply of Public Goods* (translated by Jun Ma), Shanghai People's Publishing House, p.47 (1999).

¹⁷ See Joseph Stiglitz, *Why Does Government Intervene in Economy --- the Role of Government in Market Economy* (translated by Bingwen Zheng), China Materials Publishing House, p.8 (1998).

¹⁸ See supra note 16, at p.10.

¹⁹ See David Osborne & Ted Gabler, *Reinventing Government* (translated by Dunren Zhou), Shanghai Translation Publishing House, p.17 (2006).

²⁰ See Harold Zink, *Modern Governments (2nd ed)*, Princeton Press, pp. 157-161 (1962).

In fact, to establish a public enterprise, and provide public goods and services through the public enterprise is the common practice of the world. As North says, an efficient economic organization is the key to economic growth, which explains the reason for the rise of the western world.²¹

To the question of whether private capital be applied to the supply of public goods and services? Coase's answer is yes. After studying the British lighthouse system, he found that from 1610 to 1675, the Pilotage Union as the public sector did not build a single lighthouse, while private individuals had built at least 10 lighthouses; by 1820, there were 46 lighthouses in the UK, of which only 11 lighthouses were built by the Pilotage Union, and as many as 34 lighthouses were built by the private individuals.²² These data show that in the early days of the UK, private individuals played an important role in the construction of lighthouses. The example of lighthouses is used to reveal that public goods and services can be provided with private capital / by the private sector. Unlike Samuelson's viewpoint that public goods and services should be provided by the government only,²³ Coase believes that the private sector should not be excluded from participating into the construction and management of public goods and services. He further questions how to ensure that government can be efficient under the condition of both owning and managing lighthouses.²⁴

As a matter of fact, many public goods and services are provided by the private sector in many other countries. Peters considers it a good choice to let the private sector supply public goods and services, because what the private sector values most is efficiency and it can meet the needs of the public to the most extent.²⁵ The reform of privatized public enterprises in many countries is based on this concept. Like Peters, Moore,²⁶ Mariam²⁷ and Starr²⁸ all advocate to provide public goods and services by the private sector. They believe it will eliminate monopoly, save money and increase profits. Thus, the costs that are undertaken by the public will be reduced, and the direct beneficiaries are the public themselves. Howse,²⁹ Trebilcock³⁰ and Butler³¹ hold the same position, but they look at the advantage of using private capital to public goods and services from another perspective. They think it will not only decrease government's intervention in the commercial behavior of the enterprises, but also enable government to concentrate on the things that have to be done by the government only. Healey suggests government not be biased for state-owned enterprises while against private ones,³² so that the private sector will be willing to participate in the supply of public goods and services.

²¹ See Douglass North & Robert Thomas, *The Rise of the Western World: A New Economic History* (translated by Yiping Li & Lei Cai), Huaxia Publishing House, p.4 (2014).

²² See Ronald H. Coase, *The Firm, the Market, and the Law* (translated by Hong Sheng & Yu Chen), Shanghai People's Publishing House, p.156 (2014).

²³ See supra note 2, at p.389.

²⁴ See supra note 22, at p.163.

²⁵ See B. Guy Peters, *The Future of Governing* (translated by Aiming Wu & Hongtu Xia), China Renmin University Press, pp.34-5 (2001).

²⁶ See Moore, *Contracting Out: A Painless Alternative to the Budget Cutter's Knife*, *Prospects for Privatization* 60, 65 (1987).

²⁷ See Yacob Haile-Mariam, *Privatization of State-owned Enterprises and the Law: Issues and Problems*, 7 *Emory International Law Review* 35, 72 (1993).

²⁸ See Paul Starr, *The Meaning of Privatization*, 6 *Yale Law & Policy Review* 30, 32 (1988).

²⁹ See Robert Howse, *Smaller or Smarter government*, 40 *University of Toronto Law Journal* 509, 513 (1990).

³⁰ See Michael J. Trebilcock & Edward M. Lacobucci, *Privatization and Accountability*, 116 *Harvard Law Review* 1424, 1430 (2003).

³¹ See Stuart M. Butler, *Commentary on Privatization: Forms, Limits, and Relations to a Positive Theory of Government*, 71 *Marquette Law Review* 529 (1988).

³² See Deborah Healey, *The Political Economy of Competition Law in Asia: the Australian Position*, Edward Elgar Publishing, p.13 (2013).

On the contrary, some scholars strongly oppose the idea of letting the private sector control public goods and services. Appleby worries that a large number of layoffs will be followed by the privatization.³³ Minow questions whether the private sector will adequately represent public interest in the first place.³⁴ Volokh finds water quality dropped after the private sector undertook the job of water supply.³⁵ Butler points out once the private sector that provides public goods and services go bankrupt, the government will at once be thrown into trouble if it relies on the private sector too much. As Roland concluded, where public goods and services are provided by the private sector, there must be corresponding institutional constraints.³⁶

3. Concept and Classifications of Public Enterprises

At present, Chinese scholars define “public enterprises” from different perspectives. First of all, from the perspective of the ownership and control of the enterprises, public enterprises are generally considered as commercial entities which are wholly or partially owned as well as controlled or managed by the government with a general concept that it is the state or government that truly owns the public enterprises. Hence the view that public goods and services should be provided by the state and the government becomes prevalent. However, this view is not absolutely true because some countries and regions do allow the private enterprises to provide public goods and services to the society, on the condition that they can meet rigorous legal requirements. Secondly, from the perspective of goods and services provided by the enterprises, public enterprises are responsible for providing public goods and services, which are enjoyed by the public with no individual being excluded or prejudiced. From this point of view, public enterprises are not necessarily owned by the state, nor are they fully controlled by the government. In this way, public enterprises may also take other modes, and the private mode can be the one. According to Ye Chang-lin, the main business activity of the public enterprises is to provide public goods and services to the society and are thus subject to the special control of the government; however, as long as the public interest will be guaranteed, the operation modes of the public enterprises may vary: state-owned, public-private-partnership, private and even some other ways are all acceptable.³⁷

Generally speaking, the emergence of public enterprises is to solve the problem of market failure, enhance social fairness and justice, and effectively balance macroeconomic development. Public enterprises usually fall into the category of monopoly industries and are controlled by the state. The state implements both its economic policies and economic plans through public enterprises. Meanwhile, public enterprises are expected to assume social responsibility, which is to provide public goods and services at a reasonable price and create jobs for the public. The target group who will receive the services from public enterprises is supposed to be the whole public instead of a particular class of the population. Even when financed by the government public enterprises are generally financially independent.

³³ See Lawrence Appleby, *Privatization: Government Abandons its Citizens*, 54 *Guild Practitioner* 65, 71 (1997).

³⁴ See Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 *Harvard Law Review* 1229, 1260 (2003).

³⁵ See Alexander Volokh, *Privatization and the Law and Economics of Political Advocacy*, 60 *Stanford Law Review* 1200 (2008).

³⁶ See Gérard Roland, *Transition and Economics* (translated by Fan Zhang & Zuohong Pan), Peking University Press 196, 197 (2002).

³⁷ See Changlin Ye, *Public Enterprises: Meaning, Features and Functions*, 10 *Chinese Public Administration* 47, 48 (2005).

independent.

Friedmann emphasizes that the main difference between public enterprises and government departments is that public enterprises have significant functional characteristics.³⁸ No matter how broad the objectives of public enterprises are defined (some of the public enterprises bear more responsibilities and are granted more powers, such as the British National Coal Board and the British Transport Commission), a public enterprise is by no means a multi-purpose organization, but a functional organization created for a specific purpose. Such functional organizations provide transportation and broadcasting services, hospital and medical service management, national resource development, compensation management of the nationalization of the land development; moreover, they also provide housing for specific groups of people, import and sell life necessities. These services have a certain span in nature, from commercial trade to supervision and management, together with the provision of public services. All of these directly determine the legal status of public enterprises.

Therefore, most of public enterprises share the following commonalities despite different priorities:³⁹ Above all, public enterprises are the corporate bodies with independent legal personalities. A public enterprise, like an ordinary enterprise and a natural person, is obliged to take its legal obligations and entitled to enjoy rights. This is the most prominent feature of public enterprises from legal aspect. In addition, there is generally no real shareholder in the state-owned public enterprises, because the shareholder of the state-owned public enterprises is merely a symbol. In the case, it is the government that represents the state actually. Besides, the administration of public enterprises is entirely in the hands of the board of directors. However, most of the board members of the state-owned public enterprises are appointed by the government. Furthermore, all the public enterprises have dual attributes. They are not only the tools for the implementation of the state policies, but also the organizations with autonomy, as they are independent legally and have commercial characteristics in certain aspects. But as the purpose of establishing public enterprises is not the same, the extent of the autonomy is different accordingly. Also, all of public enterprises ought to assume the social responsibilities stipulated by the government, which is considered as one of their primary obligations. Moreover, all public enterprises are not only supervised by the accountant and the auditor, but also by the government and the public. This kind of supervision is reflected especially in the pricing of the public goods and services, as well as in the scale and planning of the specific public enterprise. The supervision process needs to be both open and transparent. Lastly, when public enterprises need capital (except those with the function of supervision and management), they can raise capital by purchasing the assets of private enterprises and issuing stocks or bonds which are guaranteed by the Treasury; provided that the public enterprises are the state-owned ones.

The main criteria for judging whether an entity is a public enterprise or not are as follows:⁴⁰ On the form of organization: is it a corporate entity or non-corporate entity? On legal status: is it a public company, a joint-stock company, or a government department? On location: is it inside or outside the government? On employee identity: are they civil servants or non-civil servants? On governance: is the administration in the hands of the board of directors or one person only? Besides, another two factors have to be taken into consideration: whether it takes legal liabilities independently and whether it is entitled to the exemption in budget, audit and other control.

³⁸ See W. Friedmann, *The Legal Status and Organization of the Public Corporation*, 16 Law and Contemporary Problems 578 (1951).

³⁹ See *supra* note 38, at p.579.

⁴⁰ See Harold Seidman, *The Government Corporation in the United States*, 37 Public Administration 106, 109 (1959).

In compliance with the above commonalities and characteristics, although the classification standards of the public enterprises have not been unified at present, there are mainly four types of the classification.

The first type divides public enterprises into two categories:⁴¹ the first category is the public enterprises with the industrial or commercial characteristics and closely related to people's livelihoods, such as some large enterprises in coal, electricity, steel, natural gas, water supply and drainage, transportation, aviation, food and so forth. These enterprises, although they have commercial characteristics in nature and are organized in accordance with commercial principles, are different from the ordinary commercial enterprises to a great extent. The main purpose of such enterprises is to assume public responsibilities and realize the public interest instead of making profit. Tennessee Valley Authority and Saint Lawrence Seaway Development Corporation in the US, the National Coal Board, the National Electricity authority, British Steel, Transportation Commission, British Gas and British Airways all belong to the first category of public enterprises. The second category is the public enterprises characterized by the provision of social services and are established to provide specific social services to the public on behalf of the government. Although such public enterprises also need to carry on a large amount of business and management work, including staff recruitment, purchase of equipment, management and so on, their main role is to provide social services on behalf of the government. Therefore, these public enterprises are supposed to receive much more supervision than other commercial companies, such as the Federal Farm Credit Banks Funding Corporation, the Federal Housing Finance Agency, the Federal Deposit Insurance Corporation and some cooperative banks in the US, the Newtown Community Development Corporation, local hospitals and commissions, the HM Land Registry, the Agricultural Land Commission in the UK, etc.

The second type divides public enterprises into three categories:⁴² the first category is the public infrastructure and basic industries, including railways, highways, urban transport systems, post and telecommunications systems, and systems for the protection and governance of the public resources and environment, oil bases, coal bases, steel bases and other energy bases, as well as agricultural, animal husbandry and fishery bases. The second category is social security, including medical care, health care, insurance, maternity, retirement, employment injury and so on. The third category includes basic research and application of a country's major science and technology, as well as facilities for basic education, social education and especially the basic theoretical research, which demands a huge volume of investment but gets little direct benefit.

The third type is based on economic fields in which public enterprises operate. It includes the public enterprises in credit and financing, in commodity trading and purchasing, in transportation and communications, in manufacturing, and in public utilities such as water, electricity and gas.

The fourth type is in accordance with Canada Financial Administration Act 1951, which divides public enterprises into the companies of the government's administrative departments, the companies of the government's professional agencies, and the operating companies. Respectively, the companies of the government's administrative department, with the function of administration, supervision and regulation, are closely related to the government administration sectors and are funded by the government financial allocations; the companies of the government's professional agencies provide services to other government departments and are funded by the government's circulating capital; and the operating companies provide products and services to the public and are self-sufficient in funds. This

⁴¹ See supra note 38, at p.581.

⁴² See supra note 37.

classification, however, is not widely accepted.

Furthermore, another two kinds should be included: the mixed ownership public enterprises and the public enterprises wholly owned by the government. The former will eventually turn into private companies. For the latter, however, the government plays the role of entrepreneur or banker.

In this article, the scope of the public enterprises is limited within the infrastructure and the utilities, such as transportation, telecommunications, water, electricity, gas, etc.

4. State-Owned Mode Must Optimize the Corporate Governance Mechanism

As discussed previously, state-owned enterprises are not identical to public enterprises. Public enterprises are the ones that provide public goods and services only, while not all state-owned enterprises in China provide public goods and services for the public, and those that do not provide public goods and services are not public enterprises, though they are SOEs. It is true that in current China, public enterprises are all SOEs; but in theory and in practice, public enterprises do not have to be state-owned. In fact, across the world, public enterprises have been operated in a variety of ownership and state-owned mode is just one path.

No matter which mode a public enterprise adopts, it's well acknowledged that all public enterprises need to undertake social responsibilities, but whether a good effect will be achieved largely depends on the institutional arrangement of establishing the modern enterprises. Only by establishing a scientific corporate governance mechanism can public enterprises assume their responsibility.⁴³ As early as the Third Plenary Session of the 14th Central Committee of CPC in 1993, the central government required that SOEs aim to set up a modern enterprise system, and the promulgation of the Company Law in the same year brought the public calls to carry out corporatization reform of SOEs to a climax. After 20 years of corporatization reform, a great deal has changed in terms of the organizational structure and operational mechanism of SOEs in China; this is a positive response to further market economy development. However, the corporate governance structure established for SOEs in the Chinese Company Law is still not well established; there is a gap between legislation and reality.⁴⁴ To address new SOE reforms, the Central Committee of the Communist Party of China and the State Council issued guidance in August 2015, requiring SOEs to complete corporate reform by 2020, marking an official new period of SOE corporate reform.⁴⁵

(a) Achievements and Perplexities of the Corporate Reform

After issuing the guidance of August 2015,⁴⁶ SOEs in China have carried out a new round of corporatization reform, and remarkable results have been achieved. As an example, China Railway Group Limited was formally established in 2013 as a wholly state-owned enterprise with the total

⁴³ See Kexiang Xu, *A Preliminary Study on the Implementation Mechanism of Public Responsibility of Public Enterprises*, 2 Administrative Tribune 90, 93 (2007).

⁴⁴ See Gu Gong-yun, *Course of Economic Law*, Shanghai People's Publishing House, p.525 (2013).

⁴⁵ See the Central Committee of the Communist Party of China and the State Council, *Guidance of the CPC Central Committee and the State Council on Deepening the Reform of State-owned Enterprises*, August 24, 2015, http://www.gov.cn/zhengce/2015-09/13/content_2930440.htm (accessed on July 9, 2020).

⁴⁶ See supra note 44.

investment from the Ministry of Finance of the People's Republic of China in order to separate the functions of the government from those of the enterprise in the railway system. Since being officially completed in 2017, 18 railway bureaus under China Railway Group Limited all became the Single-member Limited Liability Companies wholly owned by China Railway Group Limited with the names changed into Railway Group Co., Ltd.⁴⁷ China Railway Zhengzhou Group Co., Ltd. is one of the 18 companies, which has set up Zhengzhou Railway Equipment Manufacturing Co. Ltd., a Single-member Limited Liability Company wholly owned by China Railway Zhengzhou Group Co., Ltd. Meanwhile, China Railway Group Limited, China Railway Zhengzhou Group Co., Ltd., and Zhengzhou Railway Equipment Manufacturing Co., Ltd. have all established boards of directors and carried out activities in accordance with the corporatization mode.

This is a significant change since the implementation of the corporate reform in SOEs. As the Single-member Limited Liability Companies, China Railway Zhengzhou Group Co., Ltd. and Zhengzhou Railway Equipment Manufacturing Co. Ltd. can independently take legal responsibilities to bring lawsuits or respond to lawsuits, which resolved the long-standing difficult issue of Chinese SOEs in foreign trade and economic activities. Kosar commented that the practical significance of suing or responding in their own name for SOEs means that there will be no concerns for private enterprises to sign outsourcing contracts with SOEs. This is because once the contract is breached, they can go through normal judicial procedures and seek out-of-court settlement. Otherwise the court trial proceedings are cumbersome and even when the private enterprise contractor wins the lawsuit ultimately; they have to wait for approval at all levels before obtaining compensation.⁴⁸

There is some confusion given the achievements made in the corporate reform of the SOEs. The State Council promulgated the "Implementing Opinions on Promoting the Pilot Reform of State-owned Capital Investment and Operation Companies" in July 2018, states that the governance structure of wholly state-owned enterprises and wholly state-owned companies shall be Party organizations, boards of directors and managers; the executive directors and external directors of the board of directors shall be appointed by State-owned Assets Supervision and Administration Commission of the State Council (SASAC for short); and the board of directors shall have five special committees.⁴⁹ What remains bewildered is that: is it appropriate for the executive directors and external directors of the board of directors to be appointed by SASAC? Is it necessary for the board of directors to set up five special committees as specified in the implementing opinions?

(b) Advice on Optimizing the Current Corporate Governance Mechanism

With the above question, it's better to refer to the practice abroad. Tennessee Valley Authority was established by the US Congress in 1933. It is of the US federal government and the largest electricity enterprise in the United States. It supplies electricity to more than nine million people in seven states of the southeastern country at a price lower than the national average. It sells electricity to 155 electricity dealers and 56 end-user companies and federal agencies. As a state-owned public enterprise, the analysis

⁴⁷ See Organization of China Railway, <http://www.china-railway.com.cn/gsjz/zzjg/> (accessed on August 5, 2020).

⁴⁸ See Kevin. R. Kosar, *Federal Government Corporations: An Overview*, Congressional Research Service, p.18 (2011).

⁴⁹ See the State Council, *Implementing Opinions on Promoting the Pilot Reform of State-owned Capital Investment and Operation Companies*, <http://www.sasac.gov.cn/n2588025/n2643309/c9311993/content.html> (accessed on July 9, 2020).

of its law will help to provide a solution to the problems related to the state-owned mode in our country.⁵⁰ Meanwhile, the British water industry was mainly state-owned before the year of 1989, the study of its Water Act of 1963 and 1973 will be conducive to the comprehension of the governance mechanism of British state-owned public enterprises.

The Tennessee Valley Authority Act and Bylaw in the US has nine board members of Tennessee Valley Authority be all appointed by the President; Tennessee Valley Authority Bylaw states that Tennessee Valley Authority's Board of Directors currently has a total of 5 committees. At first glance, it seems that the implementing opinions promulgated by the State Council in July 2018 are the same as the provisions of Tennessee Valley Authority by the Federal Government of the US. However, a closer look reveals that although Tennessee Valley Authority Act stipulates that nine board members must be appointed by the President; and it also stipulates that seven of the nine board members must be permanent residents of the areas under Tennessee Valley Authority's service and that the nine board members must fully disclose to the US Congress all their investments and the financial returns in the energy industry prior to the appointment.⁵¹

The Water Act 1973 of the UK states that when electing directors for the Water Authority (a state-owned public enterprise), the Secretary of State, the minister, and local governments should respectively test them in the following aspects: the Secretary of State mainly tests whether the candidate has the experience and ability to govern the Water Authority; the minister mainly tests whether the candidate has the experience and expertise in agriculture, fisheries, and ground pollutant discharge; and the local governments mainly consider whether the candidate is familiar with and knows the situation and needs of the Water Authority.⁵²

In terms of the special committees of the board of directors requirements, Tennessee Valley Authority Act states that the responsibilities of the board of directors, that is, one of the duties of the board of directors is to establish the committees that the board deems necessary. Meanwhile, Tennessee Valley Authority Act specifies that there must be at least one audit committee within the board of directors and the board of directors may establish one or more internal committees of the board of directors at any time on the above basis in accordance with resolutions adopted by the majority of directors.⁵³ It can be seen that the requirement for the special committees of the board of directors of wholly state-owned companies is flexible in the US. Except that the audit committee must be set up, the enterprise itself will decide how many and what else to be set up and the board of directors has the power to make decisions. The British law surrounding public enterprises does not specify the scale of boards of directors; and it is the Secretary of State or the minister who chooses the appropriate number of directors that can join the boards of directors. The boards of directors of the public enterprises are not required to be the same in number. The scale of the boards of directors depends on how many responsibilities a public enterprise has to undertake. If there is a wide scope of responsibilities, the scale of the board will increase accordingly.⁵⁴

In light of the experience of UK and US, there are the following suggestions for the current governance mechanism optimization of the wholly state-owned enterprises and wholly state-owned companies in China.

Firstly, when appointing the executive directors and external directors of the board of directors of

⁵⁰ See About TVA, <http://www.tva.com/abouttva/index.htm> (accessed on May 5, 2020).

⁵¹ See 16 U.S.C.A. Chapter 12A, Section 831a.

⁵² See Water Act 1973. CH. 37. Section 3.

⁵³ See *supra* note 51.

⁵⁴ See William A. Robson, *The Public Corporation in Britain Today*, 63 Harvard Law Review 1321 (1950).

the wholly state-owned enterprises and companies, State-owned Assets Supervision and Administration Commission of the State Council should refine the qualifications of the candidates in detail and specify it in the specific administrative laws and regulations.

Secondly, the requirement for the special committees of the board of directors of the wholly state-owned enterprises and companies should be flexible; for example, there should be 1-5 special committees for the board of directors. To some extent, it is necessary to set up special committees of the board of directors. Above all, as an advisory as well as a decision-making body, the board of directors must make all important decisions. However, the number of directors in large companies is often so large that it is not easy to convene the conference and the meeting time is sometimes insufficient, which tends to result in hasty decisions. Besides, due to the leadership monopoly of the general manager, the board of directors are apt to fail to really play its role independently. In addition, there is a need for a certain professional division of labor within the board of directors.⁵⁵

However, it should be noted that the only aim of setting up special committees under the board of directors is to ensure that the directors play a better role in decision-making, supervision, and checks and balances within the board. The board of directors can decide the internal setting up without the intervention of outsiders. Therefore, it is not recommended that there must be five mandatory special committees in the implementing opinions and the five special committees must be the Strategy and Investment Committee, the Nomination Committee, the Risk Control Committee, the Audit Committee, and the Compensation and Appraisal Committee. According to the international division of the special committees of the board of directors, there are generally two categories: one emphasizes governance, including the Audit committees, the Compensation Committee, the Nomination Committee and the Executive Committee; the other focuses on management, including the Strategy and Risk Management Committee, and the Policy and Public Relations Committee.⁵⁶ For example, the five board committees of Tennessee Valley Authority are the Audit, Risk, and Regulation Committee, External Relations Committee, the Finance, Rates and Portfolio Committee, the Nuclear Oversight Committee, and the People and Performance Committee. In accordance with the Water Act 1963, as for the River Authority, a public enterprise, the special committees under its board of directors are the Finance Committee and the Internal Management Committee.⁵⁷ Since the public enterprises are in different fields with different focuses, it is inappropriate for SASAC to limit the number and the names of the special committees strictly. Those should be left to the board of directors at its self-discretion.

5. Public-Private Partnership Mode Must Resolve the Concerns of the Public and Private Sectors

In 2015, the State Council of China issued a series of documents, advocating the vigorous development of mixed ownership economy. The central government pointed out clearly the six modes for achieving mixed ownership economy, and public-private partnership is an important one. In fact, public-private partnership has been actively adopted to the supply of public goods and services in the UK and the US in recent years, which proves to be an effective way to use private capital in infrastructure

⁵⁵ See Zengyi Xie, *Board Committee and Corporate Governance*, 5 Chinese Journal of Law 60, 69 (2005).

⁵⁶ See Jiyin Zhong, *Committee of the Board of Directors*, 4 Board College 92, 93 (2008).

⁵⁷ See *supra* note 52, at Section 4.

and the utilities. This is also one way for China to provide public goods and services for the public at this stage and in the future. But according to the investigation conducted by Shanghai Municipal Government in 2018, 51.50% of private enterprises think the threshold for participating in public-private-partnership projects too high; 39.52% of private enterprises think the transparency and fairness of government procurement insufficient; meanwhile, some chambers of commerce report that many private enterprises are often excluded from government procurement activities, and some private enterprises themselves are unwilling to participate at all.

The public-private-partnership mode involves both the public sector and the private sector. In accordance with the contract made by the two sectors, the private sector usually serves as the project company of a joint project, which provides public goods and services such as infrastructure. Partnership encompasses not only cooperation but also conflict,⁵⁸ in which the public sector and the private sector inevitably have their own concerns. One of the biggest concerns is the cooperation transparency, that is, both sides are worried that the lack of transparency will result in damage to them. In addition, the private sector is also concerned about how to have the same discourse power as the public sector and what should be done once the public sector prolongs procurement time indefinitely. What makes the public sector worried is how to minimize the risk of the public sector and restrain the excessive earnings of the founders. As to the public-private-partnership mode, the key to success is whether they can understand the concerns from both sides and resolve them to the greatest extent by means of rules. In this respect, some specific measures taken by the UK and the US deserve our attention.

(a) Transparency

Transparency is at the core of the public-private-partnership mode. It is necessary for the private sector to get sufficient information from the public sector to facilitate effective business arrangements and project delivery, while the public sector also needs information from the private sector to ensure the supervision and management of their contract. It is generally believed that since there is a “public” factor in the public sector, the information asymmetry leads to a natural disadvantage in accessing information for the private sector. This phenomenon is undeniable, but in the public-private-partnership mode, the public sector is also likely to have poor access to the information after signing a project contract. Although the contract stipulates what information the public sector has the right to obtain, the contract usually specifies that the private sector should be in charge of providing relevant financial and management information. In practice, the private sector often neglects to provide the information or provides it passively only when the public sector inquires. Furthermore, the public sector itself has not fully exercised its right to obtain information, so it is not clear what information it should get.

Concerning the poor access of the public sector to information, first of all, the public sector must participate in investment so that the two sides can be more unified to jointly improve the project performance and strengthen risk management because of the joint input of funds; after participating in investment, the public sector will automatically get better informed about its projects as it has members in the board of directors. Thus, it is necessary to reduce the dependence of the public sector on the private sector and to tighten the specific regulations on the information dissemination and dissemination procedures of the private sector so that information can be transmitted to the public sector in a timely

⁵⁸ See Gairong Hu, *Conflict and Coordination of Interests Between Public and Private Sectors in PPP*, 29 Law Science 30, 40 (2015).

manner; it is required that the private sector regularly provide information on actual and expected equity returns and deal with the project life-cycle funds in an open and transparent manner.

On the other hand, concerning the poor access of the private sector to information, firstly, it is necessary to develop the business approval query system in which the project approval procedures by the government are open to enterprises to make it convenient for enterprises to make specific plans in advance. Secondly, the government should be required to examine and approve projects with transparent procedures and detailed steps. The British government divides the public-private-partnership approval into six stages, each of which has two or three steps that can be found on a specialized project approval query system.⁵⁹ Therefore, China should not only open the business approval query system but also refine the query content. Meanwhile, the public sector should be required to regularly disclose the information of all the projects and their financial status in which the public sector is one of the shareholders.

Additionally, public's supervising the implementation is also needed. The government should issue simple guides that explain the technical details of the public-private partnership and make it user friendly and accessible to the public. At the same time, the bidding information of the project exceeding a certain amount should be published on the Internet so that it can be freely accessed by the public. For instance, the UK has published all the information of the projects over 10,000 pounds on the Internet so that the public can access it at any time.⁶⁰ As a matter of fact, public enterprise laws in both the UK and the US attach great importance to public supervision. Tennessee Valley Authority Act stipulates that one of the four auditing reports must be submitted to the Tennessee Valley Authority headquarters for public scrutiny when the Auditor-General of the US has completed his business audit of Tennessee Valley Authority.⁶¹ The Electricity Act of the UK states that the public are authorized to review the copies of the financial statements and audit reports of all the electricity authorities.⁶² In order to make the cooperation transparent, the UK government requires the public and private sectors to review the actual and expected expenses of projects every five years; any actual surplus shall be recorded and fairly distributed to the public and private sectors after the termination of the contract, which merits our attention.

(b) Discourse Power

In the case of the public-private partnership, one of the greatest concerns of the private sectors is that they cannot have the same discourse power as the public sectors. Although the private sectors invest a lot of capital in projects, they cannot dominate on important issues; or even worse, they have to be dragged down into inefficiency by the low operation efficiency of the public sectors. In order to motivate the private enterprises to willingly participate and to ensure the balance of the cooperation relationship, the government should arrange institutions from the perspective of competitive neutrality and the protection of private sectors' discourse power. In this regard, first of all, the UK stipulates that the public sector can only hold minority equity in public-private-partnership projects. Since the equity of the public sector is in the minority, its discourse power must also be in a minority. Besides, in order to allay the

⁵⁹ See HM Treasury, A New Approach to Public Private Partnership, Section 5.7, 2012.

⁶⁰ See *supra* note 58.

⁶¹ See *supra* note 51.

⁶² See Electricity Act 1989, CH.29, Section 55-9.

private sector's concern that the public sector may be favored, the government stipulates that the terms for the equity investments of the public sector must be exactly the same as those of the private sector, which will resolve the concern about discourse power to a certain extent.

(c) Prolonged Procurement Time

Another major concern that causes the private sector to be reluctant in participating is the likelihood of bankruptcy if the public sector extends the project procurement time. On one hand, the government should streamline the procurement process and specify the main procurement stages so as to prevent an arbitrary extension of procurement time; on the other, the government should start with standardizing the contract and clearly specify the drafting standards and details of contracts specifically for the public-private partnership.

The UK has stipulated eight procurement stages that the public sector must strictly observe: the stage of prior information notification that ensures the market to have a general understanding of the future procurement plans of the procurement department; publishing bidding information in official publications of the European Union, which indicates the start of formal procurement; the pre-qualification stage in which the shortlist of bidders is selected through questionnaires; the stage in which the shortlisted bidders are invited to participate in the dialogue to formally formulate detailed requirements, business conditions and evaluation criteria of procurement agencies; the appraisal of the responses of the shortlisted bidders by the procurement agencies, which usually has to undergo two rounds of selection; determining the winning bidder; publishing the bidding results and preparing to sign a contract with the winning bidder; Signing the commercial and financing contracts, by which the procurement time can be basically limited, and the private sector is apt to meet the expectations for each stage.⁶³

(d) Risk Prevention of the Public Sector

In a public-private partnership where the public sector provides goods and services in a joint investment with the private sector, there is a concern with the public sector's capital risk and failing to deliver projects on time. Concerning this issue, it should firstly stipulate that although the public sector should invest in the project, it only holds minority equity in the project. Therefore, the main risk of the project is still faced by the private sector. Secondly, the payment ability, delivery ability, and value for money should be assessed in detail, so as to avoid the project's failure due to inadequate investment when it is under progress. Prior to the project establishment, it has to undergo two rounds of approval in the UK (integrated assurance approval and commercial approval. Besides, a director is appointed by the Ministry of Finance on behalf of the interests of the public sector, who has the right to vote on the decisions made by the shareholders.

(e) Founders' Excessive Earnings

⁶³ See supra note 59.

The project founders usually sell the equity at the later stage of construction in order to recover investment funds because of asset-liability or the investment in a new project. Since there are no major risks related to the construction, commission, etc. in the existing project at this stage, investors in the secondary market are usually willing to pay price premium, which often brings founders excessive returns that far exceed what was expected. To prevent such problems, we can refer to the following measures taken by the UK:⁶⁴ First, establishing a sharing mechanism to share the remaining funds in the reserve. Second, specifying that if the financed projects are refinanced within the contract period, the public sector will share the returns. Third, cancellation of soft services like catering and cleaning. Contractors often include risk premium in the pricing of soft services, so the actual cost is likely to be lower than expected. Last, implementing equity bidding mechanism to encourage long-term investment in the project so that equity trading and its quantity can be reduced in the secondary market.

Only by understanding the concerns of the public and private sectors in the public-private partnership and resolving transparency issue of mutual concern in the mode, the discourse power and the prolonged procurement time that concern the private sector, together with the risk prevention and founders' excessive earnings that the public sector concerns can the public-private-partnership mode become more effective and efficient.

6. Private Mode Must Ensure a Smooth Transition from Nationalization to Privatization

Although Keynes advocated government intervene to the economy,⁶⁵ more scholars recognized the limits of state intervention and reconfirmed the role of the market as the invisible hand since the late 1970s. The origin of market failures is not the problem of the market itself, but the excessive government intervention, because government itself has insurmountable deficiencies.⁶⁶ North believes that nationalization is prone to inefficient ownership, so that sustained growth cannot be achieved, which will eventually result in economic recession.⁶⁷ Peters concludes that complex organizations of the public sector tend to increase the costs of public goods and services and lead to low effectiveness.⁶⁸ He suggests private organizations or semi-private organizations provide public goods and services. Most privatization are driven by the combination of these motivations, for enhancing productivity and efficiency is vital to a country's economic development.⁶⁹

Even if the state-owned public enterprise is converted into a private one, public interests should still be put into the first consideration because of the "public" characteristic of public enterprises. Therefore, the institutional arrangements of price, transparency and consumer protection related to the public interests are still important to the privatized public enterprises. For public interests, the most important factor in the private mode is to ensure a smooth transition from the state-owned public

⁶⁴ See supra note 59.

⁶⁵ See supra note 11, at p.25 (2020).

⁶⁶ See supra note 17, at pp.4-5.

⁶⁷ See Douglass North, *Structure and Change in Economic History* (translated by Yiping Li), The Commercial Press, pp. 23-4 (2002).

⁶⁸ See supra note 25, at pp.34-5.

⁶⁹ See Thomas J. Casey & Simon Wu, *Telecommunications Privatizations: An Overview*, 17 *Hastings Int'l & Comp. L. Rev.* 782 (1994).

enterprises to the private ones. The reason is that in this process, it is not feasible to replace the state-owned enterprises with the private ones only, and the simple change of the ownership of the enterprises cannot guarantee a good result. The key is whether the rules and regulations have been perfected enough to ensure a smooth transition.

In the mid and late 1980s, the telecommunications industry, electricity industry and water industry in the UK all carried out the reforms of privatization of the state-owned public enterprises. Regardless of the analysis on the advantages and disadvantages of the privatization in the UK, the Telecommunications Act, the Electricity Act and the Water Act, which were revised for the ownership transition of the public enterprises at that time, all clearly specified the detailed steps for the ownership transition of the state-owned enterprises, which deserve our attention. Firstly, the Secretary of State assigned several successor companies for such state-owned public enterprises as telecommunications authorities, electricity authorities, and water authorities, and made it clear that the successor companies should be wholly state-owned.⁷⁰ Secondly, within the stipulated transfer date, the property and debt of all the public enterprises shall be transferred to the successor companies, and one chairman of the former enterprises shall be assigned to handle the follow-up so that the former enterprises can be dissolved after the completion of all the matters.⁷¹ Lastly, the successor company issued stock to the public.⁷² Shareholders who held more than 5% of the equity must register with the government. Meanwhile, the government's shareholdings are also specified, and they should be reduced year by year. Taking the telecommunications industry as an example, the British government's shareholdings in British Telecommunications Limited Company accounted for 22% in 1992 and only less than 2% by 1994.⁷³ As a result, the transition from the state-owned public enterprises to the private ones was realized step by step with clear and specific legal provisions in each stage.

In addition, the British government also set up golden shares in order to ensure success in the privatization. It is undeniable that transfer of ownership from the public to the private sector is a delicate operation, it is charged with protecting national interests and preserving national independence.⁷⁴ Towards this end, government often retains some power and influence with regard to the newly privatized company, one common protective tool is the golden share.⁷⁵ The main objective of golden shares is the protection of a state's strategic interests by maintaining special rights in privatized companies.⁷⁶ "British control provisions in the Articles of privatized companies may be entrenched by special rights attached to a golden share held on behalf of the British government by the Treasury Solicitor".⁷⁷ Golden shares cannot be transferred, mortgaged or guaranteed, nor can they get involved in dividend distribution or daily business activities of enterprises. However, the holders of gold shares retain veto power over the major decisions of the privatized public enterprises. Golden shares have been met with a mixed academic reaction: supporters believe that they are one of the key factors for the

⁷⁰ See Telecommunications Act 1984, CH. 12, Section 60-61; Water Act 1989, CH.15, Section 83-84; Electricity Act 1989, CH. 29, Section 65-70.

⁷¹ Id.

⁷² See Telecommunications Act 1984, CH. 12, Section 63-69; Water Act 1989, CH.15, Section 86-93; Electricity Act 1989, CH. 29, Section 71-4.

⁷³ Id.

⁷⁴ See Alice Pezard, *The Golden Share of Privatized Companies*, 25 Brook. J. Int'l L., p.85 (1995).

⁷⁵ See Christine O'Grady Putek, *Limited but not Lost: A Comment on the ECJ's Golden Share Decisions*, 72 Fordham Law Review 72 (2004).

⁷⁶ See Ivan Kuznetsov, *The Legality of Golden Shares under EC Law*, 1 Hanse Law Review 22 (2005).

⁷⁷ See Tim Emmerson, *EC Takeovers, Golden Shares and British Control*, 7 International Financial Law Review 12 (1988).

success of the transition of the British public enterprises from nationalization to privatization, while critics argue that they interfere with corporate autonomy and hinder the operation freedom of the enterprises.

The key to a successful transition from the state-owned public enterprises to the private ones lies in a set of optimum institutional arrangements. If China chooses the private mode to provide public goods and services in the future, it is necessary to learn from the clear procedural provisions and detailed content settings in the transition process in the UK. What the government needs to do is to help the state-owned public enterprises with a smooth transition in the process of the privatization and to help the private enterprises wedge into project investment instead of being squeezed out. Furthermore, the government should dedicate itself to the improvement of business environment and invest its revenue in the areas in which even the state-owned enterprises have difficulty in running, and thus make the privatized public enterprises more competitive.⁷⁸

However, setting up golden shares in China is not the best choice, at least at the present stage. Although golden shares seem to be nominal ones that cannot be transferred nor paid dividends, the setting up of golden shares marks that the government has been given the exclusive power in corporate governance over the private enterprises.⁷⁹ There are conditions for the use of golden shares, that is, only when the major decisions of the enterprises are related to national interests and national security, can the veto power of golden shares be used. However, even in the countries with sound legal systems such as the UK, some scholars still worry that golden shares may cause the government to interfere in common commercial acts of an enterprise, provided the government claims that the acts are related to the national interests.⁸⁰

It is true that the setting up of golden shares aims to protect public interests, but as Honggao Hu said, “to protect public interests, we must uphold the concept of law-based administration of the government; the private rights must not be infringed in the name of protecting public interests.”⁸¹ China has suffered from the direct state intervention for a long time. It has been criticized by all parties, and it is also a problem that should be coped with in today’s economic reform. Golden shares should be adopted under an ideal legal framework. Or otherwise, the precipitate adoption will encourage the government’s interference in the enterprises, reduce the opportunities of absorbing the private capital, and even lead to the depreciation of the common stock prices in the absence of the necessary institutional framework.⁸² Only when China’s legal system is sound enough to implement competitive neutrality effectively can the application of golden shares be launched.

7. Conclusion

The function of public enterprises is to provide public goods and services to the society, therefore

⁷⁸ See K.S. Jomo, *A Critical Review of the Evolving Privatization Debate, Privatization Successes and Failures*, Chinese People’s Publishing House, p.193 (2011).

⁷⁹ See Tim Emmerson, *EC Takeovers, Golden Shares and British Control*, 7 *International Financial Law Review* 12, 15 (1988).

⁸⁰ See Saule T. Omarova, *Bank Governance Systemic Stability: The Golden Share Approach*, 68 *Alabama Law Review* 1043, 1047 (2017).

⁸¹ See Honggao Hu, *On the Legal Definition of Public Interest—The Mode of Element Interpretation*, 24 *China Legal Science* 60, 63 (2008).

⁸² See Fucheng Zeng, *Mixed ownership reform of Public SOEs and the Application of Golden Shares*, 11 *Development Research* 88, 92 (2017).

the guarantee of the public interests should be kept as the essential principle. Public enterprises do not have to be the state-owned enterprises only; with a well-established legal system, other modes of operation can also achieve the function of public enterprises. Due to the current situation of China, in which public goods and services are mainly provided by the state-owned enterprises, it is practical to adopt a comprehensive approach to construct China's public enterprises. This comprehensive approach is the integration of the state-owned mode, public-private-partnership mode, and private mode, with the state-owned and the public-private-partnership modes being the majority. To achieve this, a few issues have to be realized and settled. First, the corporate governance mechanism must be optimized in the state-owned mode. When appointing the executive directors and external directors of the board for the wholly state-owned enterprises, the qualifications of the candidates should be defined in detail and specified in the specific administrative laws and regulations; meanwhile, the requirement for the special committees of the board of directors of the wholly state-owned enterprises should be flexible. Second, the respective concerns of the public and private sectors must be resolved in the public-private-partnership mode. All concerns on transparency, discourse power, prolonged procurement time, risk prevention and founders' excessive earnings should be thoroughly analyzed and actively resolved. Third, a smooth transition from nationalization to privatization must be ensured in the private mode. On the one hand, it is indispensable to have the clear procedural provisions and detailed content settings; on the other, the government cannot blindly copy the overseas experience, and before the establishment of a scientific legal framework, the setting up of golden shares in China has for the time being more disadvantages than advantages for the smooth transition of the public enterprises from nationalization to privatization.

Language and Law: Problems and Challenges Faced by Chinese Immigrants to Spain

Qiaofang Wu & Feifan Xia¹

Abstract: This article mainly discusses the obstacles and problems encountered by the immigrant groups in Spain and the Chinese citizens who will immigrate to Spain. It starts with a detailed analysis of the problems and causes and concludes with proposals of feasible solutions. There is a history of Chinese immigrating to Spain throughout different periods for different reasons, but those immigrant groups all face the common problems, with the most important one being the language barrier. It is even more difficult for non-native speakers to deal with the legal matters. Immigrant groups have to face language difficulties and most of them have no knowledge of immigration law, which creates uncertain circumstances where the rights of the immigrant groups cannot be guaranteed. In order to solve these problems and integrate the Chinese immigrant groups into the Spanish community, this paper attempts to study the immigration terminology and offer solutions to improve the Spanish immigration law with the aim to ensure the legal rights and freedoms of the immigrants.

Key words: Spain; Residence Permit; Immigration Agency; Immigration Terminology

1. Background of Chinese Immigrating in Spain

With the globalization of the world, the growing trade between countries, and people's increasing demands for the quality of their own life, the term "immigration" has become more and more common. According to the global migration flow data map released by Visual Capitalist in 2018, it is very intuitive to see the migration trends of high-net-worth people with assets greater than one million dollars. From the statistics, we can learn that: China has become the country with the largest outflow of high-net-worth people, which means that every year a large number of high-net-worth people choose to emigrate to other countries even though they are already very rich in China. In contrast, we can see that Australia, the United States and Canada occupy the top three places in the inflow of high-net-worth people. That is to say, whether from China or other places of the world, most high-net-worth people consider one of the three countries as their first choice of immigration destination. In addition to the three countries where China's high-net-worth people are most likely to emigrate, there is also a wave of immigration into European countries. Among them, Spain is one of the main destination countries for contemporary Chinese immigrants. We can also see that Spain, Portugal, and Greece are tied for the seventh place (See Table 1 and 2).²

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² See *Millionaire Migration of Visual Capitalist*, <https://www.visualcapitalist.com/wp-content/uploads/2019/04/hnwi-migration-2019-prev.png> (accessed on September 6, 2020).

Table 1: High Net Worth Individuals Top Countries by Inflow

Country	Amount
China	15,000
Russia	7,000
India	5,000
Turkey	4,000
United Kingdom	3,000
France	3,000
Brazil	2,000

Table 2: High Net Worth Individuals Top Countries by Outflow

Country	Amount
Australia	12,000
United States	10,000
Canada	4,000
U.A.E	2,000
Switzerland	2,000
Spain	1,000
Greece	1,000
Portugal	1,000
Israel	1,000

Of course, high-net-worth people account for only a small part of the immigrant group, and the main force of this wave of immigration is non-high-net-worth people from China. According to the data provided by datosmacro.com,³ a macro statistics website in Spain, Spain ranks the tenth in the overall world and the fourth among European countries as the immigration destinations for Chinese groups (See Table 3). It can be seen that Spain is indeed one of the main destinations for new Chinese immigrants.

Table 3: Emigrants from China by Country of Destination 2019

Countries	Number of Chinese Immigrants
The United States	2.899.267
Japan	784.763
Canada	691.489
Australia	641.624
South Korea	620.295
Singapore	380.145
Italia	228.231
United Kingdom	225.385
Bangladesh	164.917
Spain	164.695

For more than three decades after the reform and opening up of China, Spain has been flooded with new Chinese immigrants. What is the history of Chinese immigration to Spain? How does the purpose of the Chinese immigrant vary with the changes in different periods? What is the difference between the types of immigrants? What problems have been encountered by different types of immigrants? What

³ See *China - Immigration 2019*, datosmacro.com (accessed on September 6, 2020).

caused these problems? Will there be other areas of concern in the wave of immigration? These are the questions worth thinking about and exploring.

Nowadays, there are Chinese immigrants of all ages in Spain, all of which represent a relatively long history of immigration that has evolved over a long period of time. In the 1950s,⁴ it can be said that China's first immigration into Spain was caused by internal factors, such as political conflicts, a surge in population, insufficient food supply and natural disasters. It was not until 1978 that the Chinese government became interested in the communities established by overseas immigrants in what is now called overseas Chinese and established economic development ties with overseas Chinese and strengthened their nationalism.⁵ At this time, the Spanish also knew about the Chinese immigrant group. The main impressions were Chinese restaurants, Chinese fairs, hairdressers, etc.⁶

In the 1980s,⁷ the situation of Chinese immigrants in Spain has been improved for the better. China has also formulated policies to encourage international migration. As mentioned earlier, most of the early immigrant groups were forced to migrate to Spain due to (China's) internal factors like political conflicts, a surge in population, insufficient food supply and natural disasters. The situation improved and gradually transformed into spontaneous migration. The number of immigrants in Spain has greatly increased since 1990,⁸ making it the country with the fastest growing number of immigrants in Europe. The main reason for this phenomenon is that many Chinese people could easily obtain residence permits with the help of their relatives or compatriots who first came to Spain and successfully emigrated. In Europe, the laws of countries such as Spain and Italy make it easier for immigrants to obtain legal resident status through family reunion.⁹

After entering the 21st century, a new special group of Chinese immigrants appeared in a large number through groups of students who came to Spain to obtain their master's degree and opening the prelude to the new immigration era. Today, this group has become an important part of the Hispanic Chinese community.¹⁰ Most of them have undergraduate degrees majoring in Spanish language and culture from domestic universities in China and some of them are non-Spanish major students who are attracted by Spanish culture and life and then embarked on a journey to Spain for their studies. This is because, as a European country with a long history, Spain has opened a warm embrace to Chinese students. As early as 2007, the education authorities of China and Spain signed an agreement on mutual recognition of academic degrees. Since then, Spanish official academic degrees have been recognized by the Chinese Ministry of Education.¹¹ In addition, Spain's higher education is very high-quality. In the Financial Times European Business School Rankings from 2019,¹² two of the top ten business schools in Europe are located in Spain. Spain's domestic business education level is quite high, which has attracted many students who majored in business to study in Spain. At the same time, international students can not only

⁴ See Campos R. Ivonne, *Reseña de "La inmigración china a España: una comunidad ligada a su nación" de Gladis Nieto.*, 2 Estudios de Asia y África 523, 525 (2008).

⁵ Ibid, at p.526.

⁶ See Amelia Sáiz López, *La migración china en España Características generales*, 68 Revista CIDOB d'Afers Internacionals 151, 152 (2005).

⁷ See supra note 5, at p.527.

⁸ See supra note 5, at p.527.

⁹ See supra note 5, at p.528.

¹⁰ See Education Exhibition Network, *The number of international students going to Spain continues to grow*, https://www.thea.cn/xgz_zx_845680-1.htm (accessed on September 6, 2020).

¹¹ See *Agreement Between The Government Of The People's Republic Of China And The Government Of The Kingdom Of Spain On Mutual Recognition Of Academic Degrees (2007)*, Cdgdc.edu.cn (accessed on September 6, 2020).

¹² See *Financial Times European Business School Rankings (2019)*, <http://Chasedream.com> (accessed on September 6, 2020).

enjoy the educational resources of Spain, but also fully enjoy the educational resources of the European Union. Students from Spanish universities can participate in exchange activities among universities in the European Union, such as Erasmus,¹³ and can also enter the job market of the other European countries after graduation. This is one of the reasons why Spain's universities are increasingly attractive to Chinese students.¹⁴ In addition to the education quality, the lower cost compared to other countries such as the United Kingdom and United States is another important reason for Chinese people to choose to study in Spain. Spanish education expenditure is mainly funded by the State. Therefore, undergraduate education in public universities in Spain is free, and students can apply for corresponding academic degrees based on their own academic qualifications.¹⁵

Today, in addition to students, more and more Chinese are joining the wave of Spanish immigration. As a country that is part of the "Belt and Road Initiative",¹⁶ Spain has developed rapidly in trade in goods with China and established close commercial relations. For example, Spanish-produced wine, ham and olive oil, cheese and other products are very popular in the Chinese market.¹⁷ At the same time, Spain has also become a popular destination for Chinese outbound travel. Not only are more Chinese people travel to Spain, but it is also more convenient for Spanish people to travel to China. Since May 1, 2018, the visa-free policy for people from 59 countries (including Spain) has been implemented in Hainan Province.¹⁸ This shows that apart from the close trade ties, China and Spain are also deepening exchanges and cooperation in culture, tourism, sports, finance, telecommunications and renewable energy. Taking this opportunity, a growing number of Chinese people have initiated career movements or even emigrated to Spain.

As mentioned above, the Chinese immigrants cohort can be divided into the following categories according to their purposes: Due to the existence of the first groups of Chinese immigrants, a large number of Chinese people will choose to immigrate for family reunion in the future; There are investment immigrants, entrepreneurial immigrants, established business immigrants with the purpose of doing business in Spain; There are many college students (especially those majoring in Spanish) who are eager to study in Spain and take short-term residence or emigration for the purpose of studying for a graduate degree. As more and more immigrants or foreigners come to live in Spain for long periods of time, problems naturally arise. No matter what the purpose of coming to Spain is, whether it is for short-term residence, long-term residence or immigration, a basic premise is to obtain a legal residence status. The process of applying for legal residence is complicated due to varieties of visa applications. For ordinary people, immigration itself is a relatively unfamiliar field, the problem is even more complex due to language barriers. Moreover, there are only a handful of Chinese scholars like Wu Yang,¹⁹ Li Minghuan,²⁰

¹³ See *What Is Erasmus+? - Erasmus+ - European Commission*, https://ec.europa.eu/programmes/erasmus-plus/about_en (accessed on September 6, 2020).

¹⁴ See *Why Has Spain Become The Most Popular Country For Chinese Students?*, Austargroup.com (accessed on September 6, 2020).

¹⁵ See Tong Wang, *Studying In Spain, Connecting China And The World*, http://www.wrsa.net/content_40606642.htm (accessed on September 6, 2020).

¹⁶ See *Belt and Road Initiative Portal*, <https://www.yidaiyilu.gov.cn> (accessed on September 6, 2020).

¹⁷ See Mo Chen, *China-Spain Economic And Trade Cooperation Is Not Only Ham And Wine*, <http://mobile.oushinet.com/ouzhong/ouzhongnews/20180604/292886.html> (accessed on March 20, 2020).

¹⁸ See *Hainan 59 Country Visa Free Entry Policy Guide*, CS.FMA.GOV.CN (accessed on September 6, 2020).

¹⁹ The related study of the scholar Yang Wu: *Struggle and Hope -- Analysis of the Status Quo of Chinese Immigrants in Spain*. *Journal of Southwest Petroleum University (Social Science Edition)*.

²⁰ The related study of the scholar Minghuan Li.

Ma Kangshu&Luo Linghui²¹ and Bai Ningdi²² who have done direct research on Chinese immigration related to Spain, and only a few scholars are more inclined to study the sociology of immigration and there is a lack of research on the legal terms of immigration related to Spanish and Chinese languages.²³

In light of this, this article attempts to comprehensively sort out the language problems related to immigration laws encountered by contemporary Chinese people in the process of immigrating to Spain, analyze in detail the problems encountered in the process of immigrating and applying for legal residence, and explore the cause of the problems and the professional terminology that come up during the immigration process. The following chapters will use specific linguistic tools combined with legal linguistics such as lexicography and corpus linguistics to provide a reliable basic glossary for the comprehensive understanding of the linguistic field of immigration to Spain and explore legal linguistics from a practical perspective.

2. Problems Encountered by Chinese Immigrants to Spain

Although Spain has become one of the main destinations of the new immigration boom,²⁴ most Chinese immigrants and students who need to apply for legal residence status have a slight lack of understanding of the relevant content in the field of immigration coupled with the language problem mentioned above. Most of them will choose to go through all kinds of formalities through Chinese or Spanish immigration agencies on their behalf. As a result, the Chinese immigration agencies in Spain are “the only one” a “monopolist”, and the applicants with language barriers and knowledge blindness are more trusting to the advice of the Chinese immigration agencies, thus forming a fuse that causes many problems. This chapter will analyze and discuss the problem of language, law and the dark minded Chinese immigration agencies in Spain.

According to the latest detailed data provided by the Spanish Immigration Statistics (Secretaría General de Inmigración y Emigración),²⁵ as of December 31, 2019, there are 225,019 legal residence holders in Spain. Among them, the largest and most common type of residence is the long-term residence (Residencia de larga duración), that is, they have the right to live and work in Spain under the same conditions as the Spanish do. There are 196,927 people holding this type of legal residence. If you decide to officially emigrate to Spain, this long-term residence permit is the final step on the immigration path.²⁶ Since the condition for applying for long-term residence is legally continuous residence in Spanish territory for five years, it is necessary to apply for other types of temporary legal residence so as to meet the requirements. The Spanish Immigration Office has divided different types of residence for the various groups who decide to come to Spain for various purposes, such as “temporary residence for studies” for student groups, the “temporary residence for self-employment” and “temporary residence or employment” for working groups, the “temporary non-profit

²¹ The related study of the scholar Kangshu Ma & the scholar Huiling Luo and their related study: *The characteristics of Chinese immigrants in Spain and their socio-cultural comparison*.

²² The related study of the scholar Dining Bai: *Research on the Status of Chinese Immigration in Contemporary Spain — Taking Tortosa as an Example*.

²³ The research mentioned above and most of the other studies are related to other disciplines such as sociology, economics, and anthropology, and there is no research specifically aimed at immigrant linguistics.

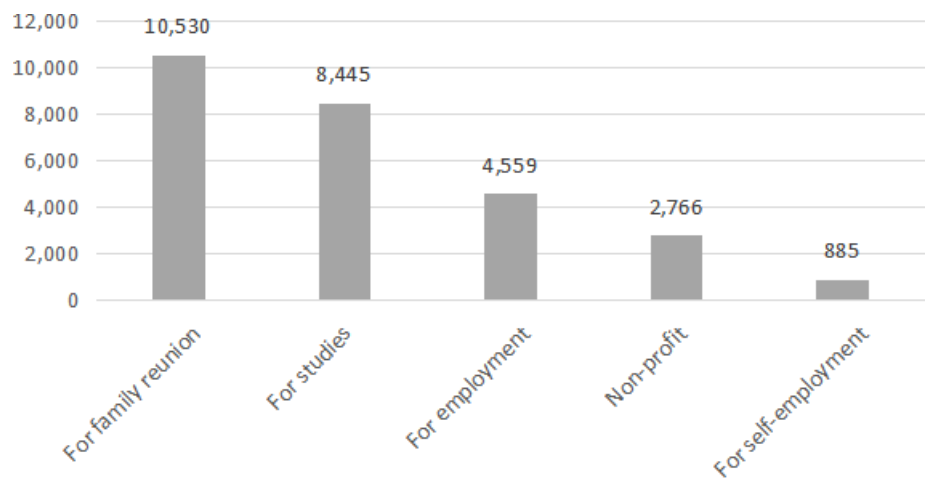
²⁴ See Zigang Wang, *Breakthrough and Innovation: Development Strategies of Ethnic Chinese Companies in Spain after the 2008 Financial Crisis*, 3 Overseas Chinese History Studies 49, 50 (2019).

²⁵ See *Extranjeros con certificado de registro o tarjeta de residencia en vigor, Resultados detallados (2019)*, <http://extranjeros.inclusion.gob.es/es/Estadisticas/operaciones/con-certificado/index.html> (accessed on May 2, 2020).

²⁶ Id.

residence” for general groups, and “temporary residence for family reunion” and so on. (see Table 4 for details).²⁷

Table 4: Statistic on the Number of Legal Residents of Various Types of Chinese in Spain



(a) Problems Encountered by the Student Groups of Chinese Immigrants

The data provided in Table 1 shows clearly the current distribution of the immigrant group in Spain. From this, it is not difficult to see that the Spanish immigrant groups can be roughly divided into student and non-student groups. This section will focus on the problems encountered by the Chinese students in the process of applying for the status of legal residence and immigration.

International students are an important part of the Chinese immigrant community. Although the study abroad programs in Spain started late, it still has a lot of room for growth. According to the statistics provided by the Spanish Immigration Office, as of December 31, 2019, there were 8,068 legal international students from China. It is not a very large number, but in terms of absolute quantity or relative growth, it ranks first among international students in Spain (see Table 5 and Table 6 for details).²⁸

²⁷ Data source: The data in this table is mainly from the statistical table of foreigners authorized to study abroad in the statistical report of the Spanish Statistics Office (Secretaría General de Inmigración y Emigración). Since the data for 2019 is only counted until June 30, 2019, only the data up to 2018 is selected.

²⁸ Id.

Table 5: Statistics of the Number of Legal Chinese Students Studying in Spain from 2010 to 2019

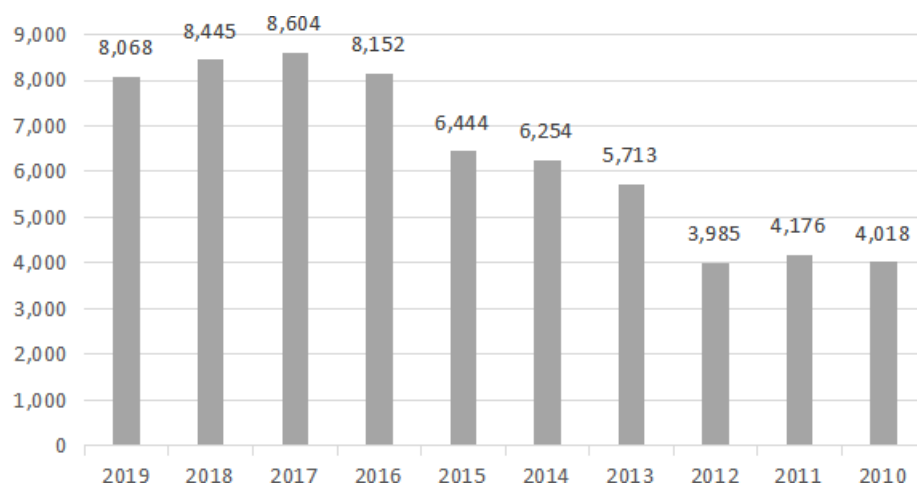
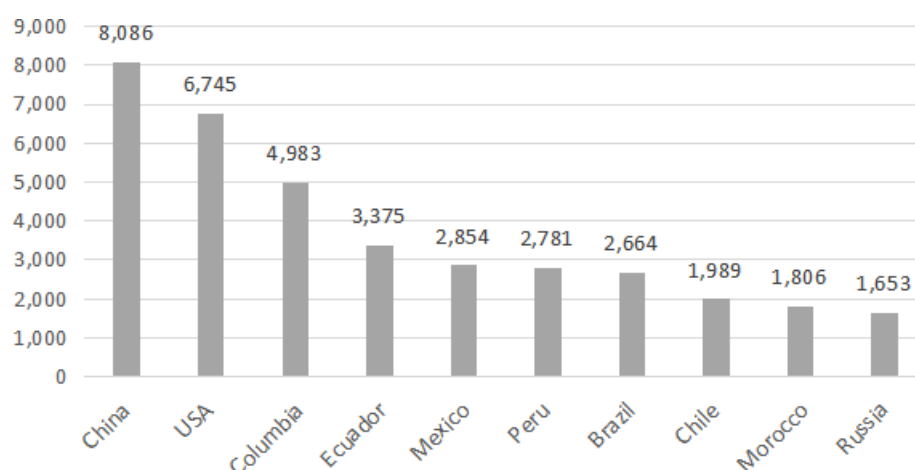


Table 6: Statistics of the Number of Legal International Students in Spain in 2019



It can be seen from Tables 2 and 3 that in 2010, the total number of Chinese students studying in Spain was only 4,018. As of December 31, 2019, the number of Chinese students studying in Spain reached 8,086. Nowadays, with a large number of international students studying in Spain, China has become the first source country for international students in Spain. Among Spanish international students, Chinese students have already become the largest group.²⁹ All of the other countries following China have Spanish as their mother tongue, with the exception of the US, Brazil, Morocco and Russia. Spanish is also one of the main languages in the US and Morocco. It can be seen that compared with international students from other countries, Chinese students are lagging behind other international students at the starting line in terms of language proficiency, so language barriers are the most serious problems facing Chinese students.

²⁹ See supra note 25.

According to an article titled “El máster de la Complutense en el que la mayoría de los alumnos son chinos” published in the Spanish newspaper El País on March 28, 2018, among the 120 graduate students majoring in journalism at the Complutense University of Madrid, Spain, 102 are Chinese students, accounting for 85% of the total number.³⁰ If you overlooked several Spanish students in the back row in the classroom, you might even think that this is a university in Beijing, China. The few Spanish students in the class complained that because most Chinese students in the class could not understand Spanish, the professors wasted time in class in explaining to Chinese students the meaning of Spanish words and phrases, local customs and professional basic knowledge of journalism, instead of focusing on the professional knowledge. The professor of the Department of Journalism said in an interview that when he asked how many people in the class knew Spanish at the beginning of the semester, only three raised their hands, and the situation did not improve from the beginning to the end of the semester. This report aroused heated discussion on the Internet, attracted the attention of the Chinese community, and was reprinted by Xinhua International Headlines. Zhang Zhipeng believes that the situation in this report is only an isolated phenomenon and does not represent all Chinese students.³¹ However, many international students said that some Chinese students had poor language proficiency and the learning environment was dreadful. These problems do exist and should also be tackled.

As one of the main forces of the new immigrant group, the language problems encountered by the international students should be paid attention to. First of all, since Spanish is neither the mother tongue nor the second foreign language of most people in China, Chinese students do not have an advantage over foreign students from other European, American and African countries in terms of language proficiency. Thus, the language problem becomes the first obstacle in the immigration process. Second, in order to develop financial resources, some Spanish universities ignore their own reputation and have no bottom-line standards from enrollment to class sizes to exams, which makes many students take advantage of the loopholes.³² When international students encountered language problems in the process of immigration, instead of coping with them positively, they chose to avoid the problems. From a narrower point of view, this is self-deception and irresponsibility for (students) themselves and it is a waste of time and money; from a large (broader) point of view, they represent the image of the entire group of Chinese immigrants. A series of problems in the classroom caused by the language problems (the inadequacy of language preparation) of the student group may make the Spaniards develop a prejudice against the entire Chinese immigrant group, making the situation of the Chinese immigrant group more difficult.³³

Therefore, it can be seen that language is one of the major problems that need to be solved urgently.³⁴ The impact may not only be a waste of money and time, but it may also be serious enough to involve the violation of law and discipline, which can have serious consequences. As of December 31, 2019, among the Chinese students in Spain, more than 50% of their residence types fall into the category of “residence renewal” (see Table 7 for details),³⁵ which means that the cohort of the international students have been in Spain for at least one year for undergraduate or master studies. Under the Spanish Immigration Act, these students need to go through the residence renewal procedures to obtain a new one-year legal residence status. However, most of the international students in this case

³⁰ See Montero, M., *The Complutense master's degree in which most of the students are Chinese*. EL PAÍS., https://elpais.com/politica/2018/03/04/actualidad/1520170966_204927.html (accessed on May 6, 2020).

³¹ The chairman of China-Spain Higher Education Development Association.

³² This means that some universities do not care about whether the language level of the students meets the admission requirements for the benefit, even if doing so will affect the image of the university.

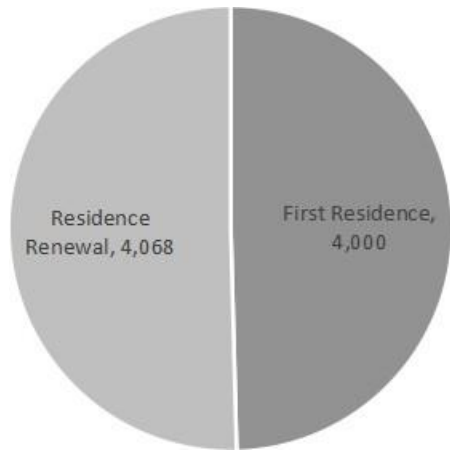
³³ For example, the magnification of racial discrimination, abuse and so on.

³⁴ This refers to the most basic daily languages.

³⁵ See supra note 26.

will choose to entrust some Chinese agency in Spain for such reasons as “saving trouble”,³⁶ “existing language problems”,³⁷ or “lack of knowledge of the process”.³⁸ This is also the beginning of a series of subsequent problems.

Table 7: Types of Residence of Spanish Chinese Students in Spain in 2019



According to a report by the “European Times” in June 2019,³⁹ dozens of Chinese students in Spain were detained and questioned by the police on suspicion of “forgery of documents” on the grounds that there is a suspicion of fraudulent use of medical insurance, studying certificate and certificate of registration by the international students for legal residence status. If found guilty, they will face imprisonment from six months to three years.⁴⁰ Most Chinese students with language problems entrust their residence renewal procedures to the Chinese intermediary agents. The preparation of documents and the purchase of insurance are all handled by the Chinese intermediary agents, so they know nothing about their materials, certificates, insurance, etc. submitted to the authorities on their behalf. Many of the students involved did not know until they talked to the immigration office that their documents were false or questionable, and then they tried to contact their agents and only found that the agents can no longer be reached. That is to say, the culprit leading to all these consequences is the Chinese agents who were hired by the students. The agents took advantage of their language competence and long-term accumulated experience to exploit the students by selling them fake insurance certificates, fake academic credentials, forging immigration documents, etc. So Chinese international students who have no knowledge of this field and have language barriers are the best targets for them. These Chinese international students are cheated very easily and become unknowingly involved in criminal offences.

In addition to facing the professional language problems in the classroom and the communication problems in daily life, the foreign student group in Spain has to face the cumbersome steps of renewing

³⁶ The Spanish Immigration Office is open from Monday to Friday from 9:00 to 14:00, which often overlaps with students’ school hours.
³⁷ This refers to the problem of professional terminology needed to go through various procedures.
³⁸ The procedures are often publicized on the official website of the Immigration Office or need to go to the Information Office of the Immigration Office to inquire, which also involves language issues.
³⁹ See Luman He., *Spain Strictly Investigates The Phenomenon Of “Forged Documents” By International Students*, <http://www.chinanews.com/hr/2019/06-10/8860137.shtml> (accessed on April 13, 2020).
⁴⁰ See *Forged Documents in Spain*, <https://www.xifa.es/post/102551> (accessed on April 13, 2020).

their residence status every year. When it comes to various materials concerning immigration rules,⁴¹ with the long articles on the official website of the Immigration Bureau⁴² and the ineffective communication with their staff,⁴³ foreign students with language barriers are often helpless, which leads to follow-up problems. In summary, it can be argued that in the field of immigration and legal linguistics, the demand for interpretation and translation between Spanish and Chinese has been getting higher and higher. For international students, resolving language barriers in immigration, that is to say, comprehension of the true meaning of the terminology in the area of immigration, is an indispensable task and the key to solving language problems related to immigration. It is worth mentioning that, based on the investigation and research carried out in this paper, there is no specific professional Chinese and Spanish glossary in this field. It can be argued that if there is a professional Chinese and Spanish glossary dedicated to immigration and applying for legal residence, it will definitely help a large part of the international student community.

(b) Problems Encountered by the Non-student Groups of Chinese Immigrants

In addition to the international student group, most of the remaining Chinese immigrant groups can be divided into the following two categories: the first is “retirement plan” immigrants who invested in estate property and obtained non-profit residence and the second is the workers of various occupations with legal residence such as residence for self-employment and employment. The largest number of occupations held by the Chinese in Spain is “bosses”,⁴⁴ who are the owners of Chinese restaurants, barber shops, and grocery stores which can be seen in many areas of Spain. The “boss” accounts for a large proportion of this group (see Table 8 for details⁴⁵) because it is also closely related to China’s early immigration motives. Professor Minghuan Li, Vice Chairman of the Chinese Overseas Chinese History Association, states that most of the early Chinese immigrants to Spain came from rural areas. In their hometowns, if a person can be a “boss” in a foreign country they symbolize success.⁴⁶ Early Chinese immigrants to Spain often like to stick together and be active in the local Chinese community. Therefore, although Chinese people are very common in Spain, Chinese people are the most difficult immigrant group to be integrated with local Spanish communities. When it comes to Chinese people, many Spanish think that they always mind their own business, live in an isolated community, have never thought of integrating into Spanish society or culture, and are reluctant to learn the Spanish language. This is because the Chinese people who immigrated into Spain early had their own “closed community”,⁴⁷ i.e., a small group of Chinese people, symbolizing solidarity and mutual assistance in Spain. They have a long and stable history of immigrant life and experience, share real-time information with each other, and most of the holders of employer residence are already eligible for permanent residence, so for them, there are no immigration problems, and they are undeniably the first generation of successful immigrants.

⁴¹ See Portal de Inmigración, *Modificación de la situación de estancia por estudios*, <http://extranjeros.mitramiss.gob.es/es/InformacionInteres/InformacionProcedimientos/Ciudadanosnocomunitarios/hoja065/index.html> (accessed on April 13, 2020).

⁴² See Portal de Inmigración, <http://extranjeros.inclusion.gob.es/es/index.html> (accessed on April 13, 2020).

⁴³ This means that when applying for renewal of residence, need to ask the staff of the Information Office about progresses, requirements and so on.

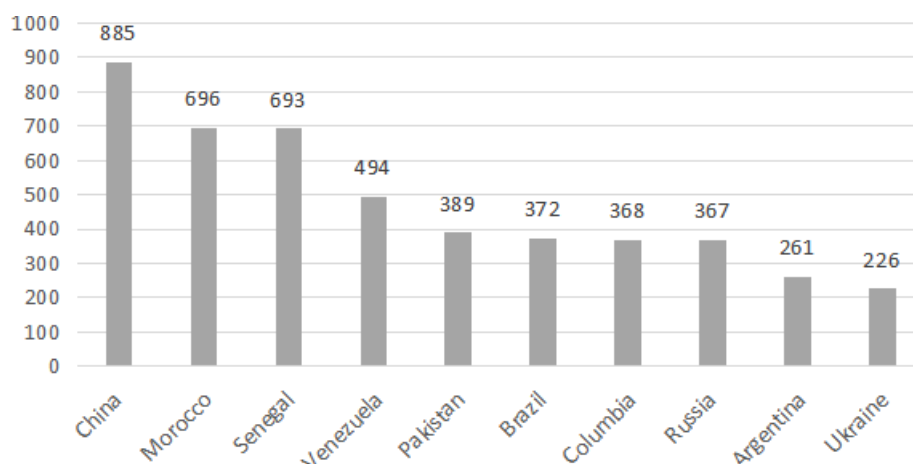
⁴⁴ Chinese people are used to calling business owners as bosses.

⁴⁵ See supra note 5.

⁴⁶ See supra note 21, at p.17.

⁴⁷ See Ping Xie, *Overseas Chinese in Spain rarely integrate into the local society and are regarded as a closed community*, <http://www.chinanews.com/hr/ozhrxw/news/2007/11-19/1081397.shtml> (accessed on August 2, 2020).

Table 8: Statistic of the Number of Residences for Self-Employment of Spanish in 2019



However, the new immigrant groups that are constantly pouring into Spain are now “investment immigrants”⁴⁸ and “non-profit immigrants” who are the main forces in the Chinese immigrants to Spain, and they are the main cohort who have encountered immigration problems. Investment immigration covers a variety of investment types, such as real estate, bank deposits, funds, bonds, shares, etc. For the Chinese intending to immigrate into Spain, most immigration intermediary agents will recommend them to apply for investment immigration, which is called “prime investment immigration with 500,000 euros”.⁴⁹ According to the translation of the description of non-profit immigrants in the official website of the Spanish Ministry of the Interior (Gobierno de España Ministerio del internos),⁵⁰ it states that if the applicant is a non-EU country person with social insurance authorized by Spain and has reached the legal age with no criminal record and major infectious diseases, does not engage in any work or profitable activities in Spain, and has sufficient financial ability to support himself and family members, he is qualified for the temporary legal residence, and can apply for permanent residence after staying for a required number of days specified by the Immigration Office.

The majority of Chinese people who choose investment immigration or non-profit immigration often have little knowledge of the Spanish language, even if they have successfully obtained temporary residence and already live in Spain. They also have little knowledge of the Spanish immigration laws and immigration process, so they can only seek help from Chinese immigration agents whenever they need it. Due to the existence of the interest chain, Spanish real estate is a key sector to make exorbitant profits in the eyes of Chinese agencies. Therefore, most of them would recommend buying houses for investment to people who have money but no knowledge of immigration. Thus, the investment immigrants often face greater problems.

After the Chinese media “Ouhua Network” in Spain reported that a Chinese immigrant described the twists and turns of being cheated in his investment in Spain,⁵¹ “China Overseas Chinese Network” cited

⁴⁸ See Economic and Commercial Counseling Office in Spain, *Frequently Asked Questions about Spanish Investment Immigration*, <http://es.mofcom.gov.cn/article/ddfg/tzzhch/201401/20140100477931.shtml> (accessed on August 2, 2020).

⁴⁹ See *500,000 euros immigration to Spain policy*, <https://m.uoolu.com/guide-detail-8079.html> (accessed on August 2, 2020).

⁵⁰ See Servicios de Ciudadano, *Residencia Temporal*, <http://www.interior.gob.es/web/servicios-al-ciudadano/extranjeria/regimen-general/residencia-temporal> (accessed on August 2, 2020).

⁵¹ See Ouhua Network, www.ouhua.info (accessed on August 2, 2020).

two cases in which Chinese immigrants were cheated by the Chinese agents in the process of buying a house for investment immigration, several of which thus aroused the vigilance and reflection of the Chinese immigrant community.⁵²

Case 1: The agency deliberately concealed the information, the customer could not pay for the house, which resulted in the deposit being forfeited.

Ms. Zheng from Henan province, China, signed a contract with a domestic immigration agency for “one-stop” immigration to Barcelona, Spain.

After arriving at Barcelona, Ms. Zheng took a fancy to a high-end villa. The intermediary agent and its Spanish partner lawyer took advantage of Ms. Zheng’s lack of understanding of international remittance procedures and her anxiety for immigration, and made Ms. Zheng sign a contract promising to pay the house in full within 30 days according to the “rules in Spain”.

After returning to China, Ms. Zheng paid a 10% deposit totaling 62,000 euros to the landlord. At this time, Ms. Zheng did not understand the procedures for large-value international remittances and did not prepare relevant documents in advance. On the other hand, the agent and Spanish lawyers used excuses to delay and conceal relevant information. One week before the contract expired, Ms. Zheng was told that it was necessary to submit a proof of income to the bank for large remittances.

In the last week, Ms. Zheng put aside the business of the company and rushed around to prepare documents. Unfortunately, Ms. Zheng was still unable to remit the house payment within the stipulated time, because the relevant certification procedures could not be completed within a few days. Under the contract, the deposit of 62,000 euros was possessed by the landlord. Ms. Zheng called the agent and asked to have the deposit back. The agent claimed that it was Ms. Zheng herself who was unable to prepare the remittance documents, and Ms. Zheng’s loss had nothing to do with them. At present, Ms. Zheng has filed a civil lawsuit against her immigration agency in China following the advice of her lawyer.

⁵² Case source: The case in this chapter comes from China Overseas Chinese Network, <http://www.chinaqw.com/hqhr/2015/12-11/73435.shtml> (accessed on August 2, 2020).

Case 2: Choosing cheap immigration services leads to material seizure and hidden risks in property safety

After his retirement, Mr. Hu, the music teacher, decided to emigrate to Spain with his wife and enjoy the twilight years. Mr. Hu and his wife paid a field visit to Spain. While looking at a house in a Chinese community in Madrid, Mr. Hu met a Chinese agency. The agency claims to be able to handle the whole process for non-profit immigration for just over 1,000 euros. After Hu paid the deposit, the agent accompanied Hu and his wife to go through the procedures of applying for foreigner ID Card number, opening bank account and authorization, etc.

After Mr. Hu came (went) back to China, he learned from the immigrant group that several families who dealt with immigration through the agency suspected that there might be problems with the real estate they bought through the agency. For fear of being cheated, Mr. Hu discussed with the agency that he would not emigrate for the time being. Upon learning that Mr. Hu wanted to terminate the service, the agent immediately claimed that the materials were all handled by them. If Mr. Hu does not continue to process immigration, he has no right to request the return of materials that had been processed in Spain.

In this way, Mr. Hu's immigration plan was affected: first, he had to come to Spain again to handle all the procedures; second, the bank authorization letter and remittance documents of Mr. Hu were also detained by the intermediary agent. Mr. Hu was worried about the safety of his future investment in Spain.

Then, the lawyer wanted to help Mr. Hu to handle the cancellation of bank authorization. But Mr. Hu only knew that the intermediary agent asked him to authorize a Spaniard to manage his account. Because the two parties were unable to communicate, Mr. Hu did not even know how to spell the name of the Spaniard, let alone his identity information. This makes it difficult to cancel the authorization. Afterwards, the matter was resolved satisfactorily after many efforts were made to retrieve the authorized person's information.

What the above two cases have in common is that the clients tried to proceed immigration process through Chinese intermediary agencies because they do not understand the process, and they think the agencies are reliable and have the expertise. But in the end, they were all deceived by the agencies, resulting in financial losses and even damaging the safety of property and privacy. In the above cases, the agencies concealed the key information mentioned in the Immigration Act and the authentication materials were illegally detained by the agencies. There were also cases such as developers raising prices privately, agencies colluding with landlords (the developers) to deceive clients to sign equivocal contracts, etc., which infringed the rights of immigrant clients. This is the biggest problem encountered by this type of immigrant group during the immigration process, which involves legal knowledge. When encountering legal problems, that person will inevitably have something to do with the Spanish Immigration Act. It is the imperfection of the Spanish Immigration Act that indirectly or directly causes the above consequences. Legal problems become additional obstacles on their road of immigration.

The full name of the Spanish Immigration Act is Ley Orgánica 4/2000, de 11 de enero, sobre derechosy libertades de los extranjeros en España y su integración social, i.e. the Organic Law No. 4/2000,⁵³ which specifies the rights and freedoms of foreigners in Spain and their social integration, referred to as the Immigration Act. The Act regulates the entry and residence of non-EU foreigners in Spain and list their rights and freedoms of these foreigners. The law was last revised on October 30, 2015.

After careful study and review of the law, it is found the law contains five parts and 71 regulations.⁵⁴ The regulations related to new Chinese immigrant groups can be roughly divided into the following three parts: the rights and freedoms of foreigners in Spain, the legal system of foreigners in Spain, and the illegal acts of foreigners in Spain and their sanctions. Under the title of the legal system for foreigners in Spain, all kinds of residence and related regulations are covered and described in detail regarding family reunification, residence is attributed to the rights and freedoms of foreigners.

Does the immigration act really cover everything and leave nothing to be desired? The answer remains to be seen. It is argued here that most of the problems behind this wave of immigration in recent years are rooted in three aspects: the language barriers of immigrants, the legal blind spots of immigrants, and the existence of intermediary agencies who are morally corrupt. These three reasons seem to be independent of one another, but in fact they are interlinked and closely related. It is verified that the Immigration Act does not have an official version of Chinese translation, thus immigrants from non-EU countries with poor Spanish fail to have reliable reference to the Spanish immigration law and naturally they are unable to fully understand the Spanish laws for immigrants. In turn, they seek help from those unethical intermediary agencies which complicated the problems. So how to solve this series of problems? In the next section, the author will analyze the language problems as well as legal ones mentioned above and explore feasible solutions.

(c) Problems Encountered by the International Companies

In addition to the problems encountered by individual groups mentioned above, as the business relationship between China and Spain becomes closer, there appears to be even more extensive problems. For example, legal problems related to international trade. Those who encounter these problems are not only self-employed individuals who come to Spain to do business, but also many large Chinese companies that invest in Spain. Most of such problems take place in the implementation of the “Belt and Road Initiative” projects. The following case shows in detail the legal problems encountered by Chinese companies when investing or trading in Spain.⁵⁵

⁵³ See Organic Law 4/2000, of January 11, on the Rights and Freedoms of Foreigners in Spain and their Social Integration, <https://www.boe.es/buscar/act.php?id=BOE-A-2000-544> (accessed on August 2, 2020).

⁵⁴ Id.

⁵⁵ Case source: Wu, L., 2020. *Several Spanish Companies Involved in International Trade Disputes*.

Economic recession caused many Spanish companies to have international trade disputes

A company in Shenzhen, China, filed a lawsuit against a Spanish company in 2020 to recover the USD 450,000 in payment owed by the company. The Shenzhen company used this to issue a serious warning to the Spanish company, hoping that both parties will act in accordance with the prevailing international trade regulations, otherwise it will seriously affect the investment and bilateral trade between China and Spain.

It is understood that the Shenzhen company mainly imports and exports products of insulation bags, and supplies the Spanish company all the year round. The two companies have cooperated for eight years and the cooperation has been very pleasant. Since June last year, Spanish companies have defaulted on payment and related expenses. By the beginning of this year, they had owed USD 450,000. At present, both parties have appointed lawyers to start this international trade and economic dispute. According to the relevant provisions of the “Civil Procedure Law” of the EU member states, foreign companies must appoint a lawyer with the nationality of an EU member state to sue and respond in the courts, and enjoy the same benefits as citizens, legal persons and other organizations of EU member states, litigation rights and obligations.

China is a very important trading partner of Spain. Since 2008, due to the impact of the financial crisis, Spain has experienced a serious shortage of foreign exchange. Many business owners have defaulted on a considerable amount of debts to Chinese companies, and some have withheld and embezzled the profits due to the other party. Some business owners simply announced the company went bankrupt and refused to pay its debts. Therefore, the Shenzhen company had to file a lawsuit without knowing how long it would take to recover the debt.

In addition to the kind of cases mentioned above, there is another problem facing Chinese companies: the Spanish import company may order about USD 10,000-50,000 worth in goods and even pay for them in advance. This way, Spanish importers often gain the trust of their Chinese partners. They will then order about USD 100,000 to 500,000 worth of goods and request credit from their Chinese partners.⁵⁶ Chinese exporters are confident that this larger business will go as smoothly as the last smaller one. However, Spanish importers will then refuse to pay after receiving the goods, and after illegally transferring them to another company, Spanish importers will choose to file for bankruptcy. Many Chinese international companies are often helpless or take a long time in dealing with an international lawsuit. Therefore, some Chinese companies have to give up debt collection.

With the increasing number of international trade and investment disputes brought about by the construction of the policy “Belt and Road”, such debt related cases are more and more common. Therefore, for international companies, this is a problem that needs to be addressed.

⁵⁶ See Schmidt, D., *European Debt Collection: Britain, Germany, Italy, Spain: Debt Collection and Fraud Cases In International Trade*, <https://www.52by.com/article/11684> (accessed on August 2, 2020).

3. Solutions to the Problems of Chinese Immigration to Spain

According to the conclusions drawn from the analysis in the previous chapter, the most common and fundamental problems encountered by Chinese people emigrating to Spain are the language barriers and the legal problems related to the Immigration Act of Spain.

(a) Feasible Solutions to Language Problems

There are two groups of immigrants who face this problem when dealing with immigration-related issues:⁵⁷ those international students who have studied in Spain or at a domestic university for a period of time, have some language foundation, and need to go through the residence renewal procedures; And those who have no language foundation and plan to immigrate into Spain from China. For the former, their daily communication in Spain may not be enough a problem to worry about, but they should have a full understanding of the legal terminology of the immigration field that they have never learned before; For the latter, they have to face a more serious dilemma. It can be seen that popularizing professional terminology in the field of immigration will substantially help them.

After investigation,⁵⁸ it is found that there is no Chinese and Spanish dictionary for applying for legal residence in Spain in the immigration field. Only a few such legal terms have been annotated or explained on the Internet,⁵⁹ and yet they are not accurately translated. Therefore, with the growing number of new immigrant groups, there is an urgent demand for interpretation and translation of legal terms in the Spanish immigrant field. Establishing a professional Chinese and Spanish glossary related to legal residence applications in the field of immigration is of particular importance which will substantially help both the immigrants and the professionals or businesspeople in this field. This is also one of the most direct and wide-reaching methods for addressing language barriers in this field.

To build a professional bilingual glossary of immigration related legal terms, it is necessary to use Antconc,⁶⁰ a language tool for creating vocabularies and observing the selection of words or word groups in selected contexts. For the topic to be studied in this paper, this is a survey on the language of immigration laws, so a corpus composed of this type of texts is needed for analysis. No doubt, this glossary is to help immigrants to obtain legal residence in Spain more smoothly. Therefore, the corpus is selected from the immigration section of the official website of the Spanish government.⁶¹ Each text lists the application criteria, conditions, required documents, steps and so on for each type of residence permit. The immigration legal terms involved are the most important and authentic ones, and all texts are published by professionals and targeted at the general population. The immigration legal terms enumerated by the above method are more suitable for immigrants to consult. After analyzing the corpus, the results are given in the following table as an example,⁶² in the translation part of production process,

⁵⁷ See supra note 25.

⁵⁸ After searching Google Scholar, the Library of the University of Salamanca, the Library of the University of Alicante and other databases, it was found that there was no Spanish-Chinese bilingual glossary dedicated to immigration terms.

⁵⁹ See *Common words in immigration*, <https://www.xifa.es/post/10599> (accessed on August 2, 2020).

⁶⁰ See Laurence Anthony, Antconc, <http://www.laurenceanthony.net/software/antconc/> (accessed on September 2, 2020).

⁶¹ See Spanish Immigration Office, <http://extranjeros.mitramiss.gob.es/es/index.html> (accessed on September 2, 2020).

⁶² The vocabulary from the analysis is all collected in the various residence application instructions on the official website of the Spanish Immigration Office, <http://extranjeros.mitramiss.gob.es/es/index.html> (accessed on September 6, 2020).

I adopted some Spanish-Chinese dictionary,⁶³ Spanish-English dictionary⁶⁴ and English-Chinese dictionary⁶⁵ related to the law and immigration to get the final translation results.⁶⁶

Spanish	English	Chinese	定义及用法
Solicitud	Application	申请	指对申请各类居留，续居留，申诉，居留恢复，按指纹等各类在移民局所需要办理事项的申请。 ⁶⁷
Autorización	Authorization	许可	在法律领域，授权许可是由权威机构执行的行为，通过该行为主体可以被允许采取某些行动，而在另一种情况下，该行为将被禁止。在移民法律中多用来指代各类居留许可。 ⁶⁸
Residencia	Residence	居留	指放一个人持续居住在某地。即移民西班牙前必须要在当地拥有合法居留并居留到达一定规定时间。 ⁶⁹
Documentación	Document	文件	指办理移民，续居留等各项手续所需要准备的纸质认证文件等。
Plazo	Term	期限	指合同或者法律中的法律效力的产生或终止的时间。通常用于临时居留卡，以及为移民所用的各类公证认证文件的截止有效日期。 ⁷⁰
Extranjero	Foreigner	外国人	指不享受其所在国家的国籍的人。即不论持有短期居留，长期居留或者是永久居留，只要没有入西班牙籍的外来移民都成为外国人。 ⁷¹
Duración	Duration	持续时间	指法律效力的持续时间。如一般居留卡，签证的持续有效时间。 ⁷²
Visado	Visa	签证	为由当局附在护照上的文件，以表明该文件已经通过审核检查并被认证为对进入或离开一个国家的人有效。在进入该国并初次申请居留许可时会被使用。 ⁷³

⁶³ Refer to Larousse, *Diccionario Compact Español-Chino* (2010).

⁶⁴ Refer to Juan Checa, *Diccionario de términos jurídico-policiales español-inglés*(2015).

⁶⁵ Refer to Chaofan Cheng, *English-Chinese and Chinese-English two-way law dictionary* (2007).

⁶⁶ To define the most frequent and important professional terminology, after a variety of legal dictionaries were used, and thereafter, I refined and translated them for the Chinese audience.

⁶⁷ See *Definición.de*, <https://definicion.de/solicitud/> (accessed on September 2, 2020).

⁶⁸ Ibid, at <https://definicion.de/autorizacion/> (accessed on September 2, 2020).

⁶⁹ See *Enciclopedia Jurídica*, <http://enciclopedia-juridica.com/d/residencia/residencia.htm> (accessed on September 2, 2020).

⁷⁰ See *Real Academia Española*, <http://dej.rae.es/lema/plazo> (accessed on September 2, 2020).

⁷¹ Ibid, at <http://dej.rae.es/lema/extranjero>.

⁷² See supra note 67.

⁷³ See supra note 67.

Spanish	English	Chinese	定义及用法
Extranjería	Immigration Office	移民局	整合国家总局负责移民事务和省级移民事务的不同部门的单位。即所有和移民相关的事物以及信息咨询等都在此处。 ⁷⁴
Resolución	Result	结果	为政府或司法机关的决定，协议，行政行为，指示，规定，命令或裁定。指各种申请（居留，续居留，申诉等）的裁定结果。 ⁷⁵

The migration-related terms listed in the above table are selected from the most frequently used terms, which appear repeatedly in the text. Knowing these terms is essential for Chinese immigrant groups in the process of immigration. As a result, a trilingual glossary of immigration laws is highly demanded, which may contain Spanish, Chinese and English and the definition of the word item and how it is used in a text or context. However, the terms listed above are relatively common and non-professional, whose meaning can be understood under the help of literal translations by translators. However, literal translation does not work in all the situations. Taking the term “住家证明(certificate of residence)” as an example, its literal translation from English into Spanish is “Certificate de Residencia”, which must be confusing to Spaniards, because the correct translation in Spanish immigration terms should be “Padronamiento”. There are many cases as such.⁷⁶ It can be seen that a professional trilingual glossary focusing on immigration and legal residence is necessary. It will not only enable users to learn and use such terms easily and to resolve the difficulties and problems encountered in the immigration procedure, but also is helpful for the study and research by interpreters and translators.

(b) Feasible Solutions to Legal Problems

In addition to the language problems discussed in the previous section, there is another stumbling block on the way to immigration: legal problems. It is presented here that the key to solving legal problems lies in the improvement of the Spanish Immigration Act. As far as the current Immigration Act is concerned, it needs to be improved on two aspects.

First of all, it is found that there is no official Chinese translation of the Immigration Act. Like the immigration legal terms mentioned in the previous subsection, only scattered pieces of translation information of such laws can be found and there is no complete official translation of the text. If there were an official Chinese translation of the Spanish Immigration Act,⁷⁷ supplemented with the immigration legal glossary mentioned in the previous section, it will not only enable some highly inquisitive immigrants to help themselves, or with the help of others, to proceed through the immigration application smoothly, but will also enable the clients who entrust a legal intermediary agency for immigration to know more about the situation of immigrants, understand each step clearly, and emigrate with peace of mind. If

⁷⁴ See supra note 69.

⁷⁵ See supra note 70.

⁷⁶ Such as 申诉 (appeal), its literal translation from English/Chinese into Spanish is “apelación”, but it should be “recurso”.

⁷⁷ See Translation of the original Spanish Immigration Act, <https://www.skymigration.com/news/2015/0821/2776.html> (accessed on May 2).

there is an official Chinese translation of the Immigration Act, it can greatly reduce the emergence of problems and help solve them. Furthermore, an official translation will eliminate lots of hoax schemes or malpractices of those dishonest intermediary agencies.

Secondly, as far as the current Immigration Act itself is concerned, additional clauses should be added to legally bind the third party, namely the immigration intermediary agency, to protect the rights and interests of immigrants themselves. Immigration agents are closely related to immigrants, and to some extent, are also a special small group of immigrants. Therefore, a management system and guidelines for immigration agents should also be incorporated into the Immigration Act. With the beginning of the immigration boom, immigration agents began to emerge in an endless stream because of market demand. Since immigration agents are solely profit-seeking businessmen, they tend to play around in the gray areas with regard to the immigration policies issued by the government of the destination country; therefore, it is necessary to regulate the intermediary agencies so that their operation will be law-binding. At present, the problems of immigration agencies can be divided into the following five categories: illegal operations or operation with no license, unreasonable fees, providing fake documentations, fraudulent advertising and irregular contracts. So, improvements to the immigration act could include provisions related to tackling these five points under the heading “Laws for Aliens in The West”.

It is argued that the amendment of the Immigration Act can be considered from the following aspects. First of all, the qualifications of intermediary agencies should be monitored: many agencies do not meet the minimum standards by common sense or do not have a legal business license. They carry out their business on the internet in a very furtive manner, which not only disrupts the market order, but also puts immigrants at risks. Therefore, it is suggested that the Spanish regulatory authorities should strengthen the management and certification of this type of intermediary agencies. They should clearly specify the threshold for qualification recognition and set up a license office and a review system. Both the high street intermediary agencies and online intermediary agencies shall be subject to corresponding rules and regulations. At the same time, the sanctions system for illegal acts by immigration agents should be revised so as to deter any illegal acts.

Secondly, for service contracts between immigrants and immigration agents, regulations should also be refined and detailed. The regulatory authorities should standardize the service contract, and officially regulate the core content in the regulations to ensure that each contract is legal and reasonable. In order to attract clients, many illegal or even legal immigration agents often bypass the main points in their advertisements and boast themselves as “100% successful immigration agencies”, ignoring immigration laws and playing down the risk of failure, thus failing to perform the contract. Immigrants who are new to the field of immigration have no idea about the terms in their contracts and some even sign contracts in Spanish without a true understanding of the contracts. Immigrants with language barriers and lack of legal awareness are lured by false advertising to sign their contracts. When their applications are rejected, they are unable to defend themselves because there is no valid evidence to support their defense. Therefore, it is very necessary to add regulations on false advertising and standardizing the core content of the contract. It is important to also provide punishment measures for fraudulent advertising so as to give full play to the disciplinary role of the law as a warning to deter any offender.

As mentioned in the previous chapter, overseas students studying in Spain who used false materials provided by immigration agents to renew their residence were apprehended by the regulatory authorities, and they were detained (charged) for “the offence of forging documents” and were liable to imprisonment. The core cause was also the illegal behavior of the agents. However, due to the lack of contract content, there is not enough clear evidence to prove whether the international students “deliberately broke the law”. Although only a few immigration agents have been caught and punished, it is certain that this is only the

tip of the iceberg. More immigration agents have hidden operations and are difficult to be seized by the regulatory authorities. On the other hand, if there is no demand, there will be no business. The regulatory authorities should also strengthen the review and penalty systems, so as to give a warning to illegal immigration agents as well as to those students who want to take chances, thus putting an end to such problems. By doing so, the legitimate interests of law abiding immigrant groups can be well protected.

In summary, this special group of immigration agencies falls in a gray area in the Spanish Immigration Act. With the arrival of growing numbers of Chinese immigrant groups, the hidden problems have become more apparent and various new problems have emerged. The Spanish immigration Office and the regulatory authorities should attach importance to these problems by incorporating new rules on intermediary services into the current Immigration Act so as to plug loopholes in the contract law. There should be mandatory norms to cover the illegal acts of those unlawful intermediary agencies to protect the legal rights and interests of every foreign immigrant, and to fundamentally resolve the legal problems encountered in the immigration process.

(c) Feasible Solutions to Problems Faced by Chinese Companies

For the cases of international trade economic disputes mentioned in the previous chapter, we divided the solutions into two categories: prevention and resolution.

For such cases, settlement is a key link. If you can take precautions in advance and handle documentary credit business in accordance with the “Uniform customs and Practice for Documentary Credits” formulated by the International Chamber of Commerce, you can avoid such a huge amount of arrears and a lawsuit that you do not know how long it will last.

In order to take preventive measures, Chinese companies should retain various documents and vouchers for foreign trade transactions, which may be used as evidence in the future. These documents and vouchers include mail records, chat records, contracts, order certificates, invoices and delivery certificates, Bill of lading, customs declaration, etc. Once it is discovered that the customer has the motive of not repaying the arrears, a written dunning is required. If the other party delays in payment or does not reply to the dunning letter, the judicial process must be opened as soon as possible for recovery. Letter of credit is the most important and most commonly used method of payment in international trade. It means that the bank (issuing bank) shall, in accordance with the requirements and instructions (of the applicant) or on its own initiative, provide the required written documents for payment by a third party or its designated party. That is, a letter of credit is a written document issued by a bank with a conditional promise of payment.

In international trade activities, buyers and sellers may not trust each other. The buyer is worried that the seller will not deliver the goods as required by the contract after the advance payment ; the seller is also worried that the buyer will not pay after the goods are delivered or the shipping documents are submitted. Therefore, two banks are required to act as guarantors for both the buyer and the seller, and present documents on behalf of the collection, and use bank credit instead of commercial credit. The tool used by the bank in this activity is the letter of credit.⁷⁸

If a payment in arrears really occurs, the Chinese company should not give up the receivable accounts. Since China is far away from Spain, debtors may feel that even if they default on payment, they will not be punished, at least not immediately. But the fact is that the Spanish legal system does not

⁷⁸ See Yanxi Guo, *Several Spanish Companies Involved In International Trade Disputes*, http://m.haiwainet.cn/middle/3540917/2016/0329/content_29782800_1.html (accessed on August 15, 2020).

favor a certain debtor because he is a local resident. This means if a Chinese is deceived by a Spanish, the legal consequences that Spain has to bear are the same as the legal consequences that Spanish people have to bear when disputes arise. For this reason, all creditors should recover their due accounts in Spain and protect their legal rights.⁷⁹

Therefore, in response to this problem, Chinese companies actively take preventive measures when trading with or investing in Spanish companies, and even after encountering problems, they should actively and reasonably solve them instead of avoiding them.

4. Conclusion

Immigration has become an everyday topic, and it's getting closer and closer to our lives and more people are getting involved in it. It has also driven the development of many other industries, promoted the economic development of immigration countries, and increased employment opportunities and cultural exchanges between the two countries.⁸⁰ As the conclusions drawn from the analysis of the full text, with the immigration market becoming active, the problems also follow. After discovering the cause of the problems and thinking about the solutions to deal with them, then making a deeper analysis of the problems, it is not difficult to see that this is also a collision between the fields of language and law. For non-native researchers, language and law are closely related, and they are presented as carriers of each other.

There has been very little research on the Hispanic immigrant group in China, and few studies on legal Spanish. For example, as a branch of legal Spanish, the immigration term for applying for legal residence is often overlooked, but it is indeed an essential part of the immigration process. Moreover, with the promotion of this wave of immigration, it is of great significance to study the legal language of immigration.

The Chinese immigrant group represents the image of the Chinese people, especially the new generation of youth, which represents the future of China. Therefore, one should pay more attention to his own image and show the people of Spain and the world the fair, positive and upward outlook of the future of China. Consequently, if one decides to study in Spain, in addition to upholding good moral character, they also need to improve his language level and master certain professional knowledge. They should not be criticized for the language problems in daily communication. They can start with themselves to solve the language problems and spread the national image of the new generation of China to the world.

In short, the study of language and law in the field of Spanish immigration is not only of academic value, but also of important practical value for the general population, which is also one of the purposes of this study. At the same time, the research can also promote the development of the field of immigration, so as to promote the exchanges between the two countries, drive the development of related industries, and achieve the goal of all-win.

⁷⁹ See supra note 57.

⁸⁰ See supra note 20, at p.21.

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