

---

## CHINA'S ROLE IN INTERNATIONAL INVESTMENT ARBITRATION AND THE LESSONS FOR EUROPEAN INVESTORS

Investor-State arbitration is an efficient and fair international legal procedure available to investors to directly bring a claim against a foreign State on the territory of which they have invested. Claims may arise from any kind of active or passive adverse State interference and are usually brought on the basis of bilateral investment treaties (BITs) between States to provide foreign investors with substantive legal protection.

Over the past 20 years, China signed more and more such BITs and currently has over 100 BITs in force with States from all over the world. This includes Germany, whose current BIT with China entered into force in 2005. BITs typically require that State parties guarantee foreign investment protection based on substantive standards, which include non-discrimination principles and fair and equitable treatment. They usually also contain an expropriation provision, which mitigates an important risk faced by investors. Expropriation clauses do not take away the State's right to expropriate property, but make the exercise of this right subject to certain conditions, including fair compensation.

International investment claims are heard by neutral tribunals composed of competent, highly specialized arbitrators that are freely chosen by the parties and that have the power to issue legally binding awards. The proceedings are mostly brought under the auspices of ICSID (International Centre for Settlement of Investment Dispute), an institution of the World Bank specialized in the administration of investor-State arbitrations. Awards rendered by ICSID tribunals are directly enforceable in all ICSID member States, including China, Germany, and over 160 States worldwide.

We see two main reasons why investor-State arbitration is likely to gain relevance for European investors in China in the coming years:

1. In line with its evolution from a capital-importing to a capital-exporting country, China signed more and more BITs in recent years. Chinese investors have taken a more active role as claimants in investor-State arbitrations, and this trend is officially embraced by a new guide issued by the Chinese Ministry of Commerce. Consequently, from a Chinese perspective, involvement in such cases is increasingly seen as normal. It is therefore time for foreign investors to overcome their hesitations in exercising their rights under applicable BITs.
2. Recent legal measures taken by the Chinese State and further expected measures may affect the legal position of foreign investors in China as guaranteed under existing BITs and give grounds for investor claims.

---

In detail:

## 1. China's Role and Position in Investor-State Arbitration

### a) Early Phase and New Generation of BITs

China's role in investment arbitration has developed over the years from a very cautious to a more proactive approach.

Many of China's early BITs of the last century stipulated that if an investor-State dispute could not be settled through negotiations, it should be submitted to Chinese courts. These BITs usually excluded the jurisdiction of ICSID or stated that the parties would consent to ICSID arbitration after they had all become parties to the ICSID Convention.

In 1993, China ratified the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "Washington Convention" or "ICSID Convention") and thus became a member of ICSID. Since 1998, China entered into a new generation of BITs whereby investor-State disputes may be submitted to ICSID arbitration. While providing for investor-State arbitration, these new-generation BITs also impose certain pre-conditions before foreign investors may submit a dispute to international arbitration. For example, the Protocol to the China-Germany 2003 BIT provides that, before a German investor can resort to investment arbitration, it must have filed an administrative review application against the administrative act of which it complains, and have waited for three months. An investor's right to initiate arbitration proceedings may also be restricted where it has previously submitted the same dispute to Chinese courts.

It is therefore important for foreign investors to familiarize themselves with the pre-conditions for investment claims and with the legal remedies available under Chinese law against governmental acts, and to seek specialized legal advice before initiating arbitration proceedings.

Up to this day, and with just a few exceptions, foreign investors in China have hardly used the opportunity offered by investment arbitration to enforce their international rights. However, several signs show that this trend is about to change.

### b) Recent Developments: Investment Arbitration May Become the New Normal

Recently, China has been taking a more active attitude towards BITs and investment arbitration. On June 28, 2021, China's Ministry of Commerce (MOFCOM) released a *Reference Guide for Enterprises to Use Investment Agreements* ('the Guide') to help Chinese investors navigate the terms and conditions of China's BITs. China has meanwhile signed a multitude of BITs, including many with developing countries and countries that are part of the belt and road initiatives. Mainly due to the increased outbound investment of Chinese companies under these initiatives, China now sees its role not so much just as a host country, i.e. a recipient of foreign direct investment, but more and more also as a country whose investors need legal protection abroad. This has led to a more active and open attitude to investment arbitration.

One indirect repercussion of China's newly developed familiarity with investment treaties is that foreign investors may expect a more open attitude towards investment claims in general, and should not fear negative consequences when bringing BIT claims against China. Such fear or hesitation may be a reason why western investors have previously initiated only a very limited number of cases against China.

---

### c) Who can Claim Against the Chinese State?

Any foreign person or entity from a state having a BIT with China can bring a claim against China if it holds an "investment" on Chinese territory which has been negatively affected by state measures.

Under most BITs – including the German-Chinese BIT – the term "investment" includes "every kind of asset invested directly or indirectly [...], in particular, shares, debentures, stock and any other kind of interest in companies; claims to money or to any other performance having an economic value associated with an investment; intellectual property rights, and business concessions conferred by law or under contract permitted by law, including concessions to search for, cultivate, extract or exploit natural resources." The definition of "investment" is thus very broad and encompasses virtually any economic activity on Chinese territory.

The German-Chinese BIT offers wide protection to investments against adverse interferences by public authorities including, but not limited to, expropriation. Under most BITs, expropriations of foreign investments are unlawful, unless taken for the public benefit and against prompt and adequate compensation. The level of compensation must be "equivalent to the value of the investment immediately before the expropriation is taken or the threatening expropriation has become publicly known, whichever is earlier". The state must also provide due process and ensure that the investor is given the opportunity to contest the expropriation at the national level.

A classic example of expropriation in China is the requisition by a local Chinese government of land use rights and buildings owned by a foreign investor due to redevelopment programs in the area. However, the term "expropriation" is broad and also encompasses measures that, although not formally confiscating property, have the effect of depriving the investor from the benefit of its investment. For example, the cancellation of a license necessary for the investor to pursue its business can result in an indirect expropriation.

Most BITs – including the German-Chinese BIT – further accord foreign investors the right to fair and equitable treatment and provide protection against discriminatory treatment. They also contain a guarantee for the repatriation of all investment and returns, which means that measures imposed by China's foreign exchange authorities preventing the full payment of dividends by a foreign-invested enterprise to its foreign shareholder would be unlawful.

### d) Applicable Law: Domestic Chinese Law vs. International Law

In theory, ICSID tribunals apply international law and the domestic law of the respondent state. In practice, an arbitral tribunal hearing a BIT claim against China will primarily apply rules of international law – in particular, the rules of the applicable BIT – designed for the protection of foreign investors.

While the Chinese side will often tend to advocate a wide application of Chinese law, domestic law usually plays a minor role, limited to issues for which international law does not provide any rules. For example, the question whether a foreign investor acquired certain property rights in China is governed by Chinese law, while the issue whether such rights have been sufficiently protected is governed by international law. In an expropriation case where the appropriate amount of compensation is in dispute, the tribunal will apply compensation standards set out by the applicable BIT rather than Chinese law.

---

## 2. Current Examples of Critical Measures that Might Give Rise to Investor-State Arbitration

Based on our advisory practice in China, we would like to highlight some measures or legal developments currently unfolding in China that may give rise to investment disputes with European investors.

- a) First, requisition of industrial land use rights owned by foreign investors in China remains a classic scenario, which falls squarely within the ambit of BITs.
- b) Second, possible future amendments of the negative list introducing further restrictions for foreign investment market access could require shareholding restructurings or buy-outs of foreign investors in their existing enterprises in China in accordance with the Foreign Investment Law. Under Art. 36 of the Foreign Investment Law in force since 1 January 2020, “where a foreign investor invests in a field prohibited by the foreign investment access negative list from investment, the appropriate department shall order cessation of the investment activity, disposition of shares and assets or adoption of other necessary measures during a specified period, and restoration to the state before investment; and its illegal income, if any, shall be confiscated.” If, in such a situation, shares held by a foreign investor have to be sold below market value, or if there is a dispute about the question whether income derived from the investment shall be deemed illegal or not, an investment dispute could be triggered.
- c) Third, the “Provisions on the Unreliable Entity List” issued by the Chinese Ministry of Commerce on 19 September 2020 could lead to the freezing of assets of foreign-invested enterprises and thus interfere with foreign investors’ enjoyment of their investments. Under these Provisions, the following measures may be adopted with respect to a foreign entity which is included in the Unreliable Entity List:
  - (1) Restricting or prohibiting the foreign entity from engaging in China-related import or export activities;
  - (2) restricting or prohibiting the foreign entity from investing in China;
  - (3) restricting or prohibiting the foreign entity's relevant personnel or means of transportation from entering into China;
  - (4) restricting or revoking the relevant personnel's work permit, status of stay or residence in China.

Foreign investors could be listed as an Unreliable Entity under the Provisions if they are found to have suspended normal transactions with, or applying discriminatory measures against, an enterprise, other organization, or individual of China, in a manner that violates normal market transaction principles and causes serious damage to the legitimate rights and interests of that enterprise, other organization, or individual.

Obviously, the problematic cases here could be those where a foreign investor that already has substantial prior investment in China is subjected to one of the measures under the Provisions, especially the restriction or prohibition of investment. In such cases, the implementation of the measure could lead to expropriation or similar scenarios.

- 
- d) Finally, the proposed draft of the revised Government Procurement Law published on 8 December 2020 by the Chinese Ministry of Finance continues to set forth a “Buy China policy” which requires agencies and procuring entities to purchase – with certain limited exceptions – domestic goods and services; exceptions apply only where the relevant goods or services are not available in China, cannot be obtained in China on reasonable commercial terms or are designated for use abroad. Such discrimination is likely to have an adverse effect on a number of foreign investors and is not compatible with anti-discrimination provisions typically contained in BITs.

### 3. Conclusion

Within the next few years, we anticipate an increased utilization of the dispute settlement mechanisms offered by the wide network of China’s BITs. This evolution is likely to concern arbitration claims brought by Chinese outbound investors as well as claims brought by foreign investors against China as a host country. Even though cases initiated by European or other western investors remain rare, recent cases brought by Chinese investors in connection with so called belt and road projects and the participation of China as respondent in cases recently brought by foreign investors support this view.

In light of the developments that may threaten their investment position in China, and having regard to the Chinese state’s more open stance towards investment arbitration, foreign investors should be aware of the rights they enjoy under international law and of the remedies that are available to them. These considerations should become part of the country risk analysis of every serious investor in China.

Please do not hesitate to contact us if you have any questions on this topic or need our support:  
[snb@snblaw.com](mailto:snb@snblaw.com).