

# China and ICSID Arbitration

## Can the ICSID arbitration regime serve as a suitable tool for dispute resolution in investment contracts with Chinese governmental authorities?

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### I. Introduction

Depending on the size and scope of investment, foreign investors may not only find themselves negotiating with Chinese private and state-owned corporations but may just as well be signing agreements with Chinese governmental authorities (e.g. for land use contracts). Irrespective of the content of such agreement, any contract with a national state as a contracting party implies some uncertainty when it comes to finding a suitable mechanism on dispute resolution. A foreign investor understandably will tend to avoid having his contract being governed by the national courts of that country his contracting governmental counterpart is domiciled in, as it may be doubtful whether such court would really deliver a judgment in his favor and help him enforcing his claims if necessary. Such concerns – at least in the past – have been particularly common for foreign investors in the People’s Republic of China (“PR China”).

However, the PR China has done a great deal of work in bringing itself in line with international standards on the protection of foreign direct investment and with an increasing number of Chinese companies investing abroad, the PR China has become more and more aware of the necessity of mutually improving investment conditions. The PR China ratified the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the “Washington Convention”<sup>3</sup>), establishing an arbitration regime for the settlement of investment disputes between a foreign investor and its host State and forming the International Centre for Settlement of Investment Disputes (“ICSID”), as early as 1993<sup>4</sup>. Apart from that, the PR

China is party to an ever increasing number of Bilateral Investment Treaties (BITs)<sup>5</sup> which – among others – include provisions for investment related dispute resolution between nationals and governmental authorities of the respective contracting party.

With this article we would like to focus on the ICSID arbitration regime and analyze whether or not it may serve as an adequate tool for dispute resolution between foreign investors and Chinese governmental authorities. Having outlined the main problems for finding a suitable mechanism for dispute resolution (see no. II. below) we will provide a short introduction to ICSID and the PR China’s accession to such treaty. Subsequently we will investigate several BITs with regard to special provisions dealing with dispute resolution (see no. III. below). Given the total number of BITs the PR China has signed, such investigation can – of course – not be comprehensive but must be limited on several states only. For the purpose of this article we have decided to focus on the BITs the PR China has entered into with Austria, Bahrain, Belgium and Luxembourg, Bosnia and Herzegovina, Botswana, Brunei, Chile, Czech Republic, Denmark, Finland, Germany, Japan, Korea, Peru, Portugal, Singapore, Spain and the United Kingdom. However, non-surprisingly many provisions contained in these BITs can be found almost identically in other BITs. Thus, the following comments may be useful even to those nationals whose BIT has not been subject of our investigation.

Following our remarks on BITs we will introduce alternatives which may be considered for dispute resolution with Chinese governmental

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<sup>3</sup> An English version of the Washington Convention is available at <<http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>> visited September 7th, 2011.

<sup>4</sup> As of September 30th, 2010, 156 nations have signed the Washington Convention. A list of contracting states is available at <[www.icsid.worldbank.org](http://www.icsid.worldbank.org)> visited September 7th, 2011.

<sup>5</sup> According to UNCTAD (United Nations Conference on Trade and Development, <[www.unctad.org](http://www.unctad.org)>) as of June 1st, 2011 CHINA has been party to a total number of 128 BITs.

authorities (see no. IV. below) before we will conclude in summarizing our results and giving a practical solution/recommendation (see no. V. below).

## II. Difficulties for finding the right option

Dispute resolution with contractual partners from the PR China is a sensitive matter. Legal proceedings in the PR China may not comply with Western standards and, thus, decisions of local courts in the PR China are sometimes (still) non-predictable. Moreover, at least in cases of “public interest”, Chinese governmental authorities may take influence in such proceedings resulting in further uncertainty for foreign investors. Such difficulties can easily be multiplied when contracting with a Chinese governmental body as the PR China’s national courts most likely will even refuse accepting claims against Chinese governmental authorities.

In such cases, arbitration can be an alternative. However, as precondition for enforcement measures in China arbitral awards need to be declared enforceable by Chinese national courts which again might be refused for reasons unforeseeable. In consideration of these concerns, the Washington Convention and its ICSID arbitration regime might be a further alternative, as many states, including the PR China, are parties to such international treaty. However, the PR China has made several reservations when joining ICSID which may be in conflict with the nature and content of the intended investment agreement between the Chinese governmental authority and the foreign investor and, thus, will need to be considered carefully.

It needs to be pointed out that cases of successful enforcement of either judgments or arbitral awards issued in favor of foreign entities against Chinese governmental bodies are – apparently – not reported. Moreover, we would like to add that enforcement measures against Chinese governmental authorities within the PR China will most likely be non-accomplishable / non-practical. However, according to our experience, the aim of a provision regarding dispute resolution / arbitration in contracts entered into with Chinese governmental bodies should not be the actual possibility of enforcing such judgment / arbitral award, but to clarify to the Chinese party involved that a breach of contractual obligations will not be without serious international consequences being disadvantageous for the reputation of the PR China.

## III. ICSID Arbitration with Chinese governmental authorities

When looking for a suitable instrument for dispute resolution in investment contracts agreed

upon with national states or one of their governmental authorities, the Washington Convention and its ICSID arbitration regime are among the prime options worth considering.

### 1. Introduction of ICSID

ICSID<sup>6</sup> is an autonomous international institution established under the Washington Convention with 156 member states as of September 30th, 2010, providing facilities for conciliation and arbitration of international investment disputes.<sup>7</sup> The Washington Convention originally got formulated by the World Bank intending to remove major obstacles to free international private investment imposed by non-commercial risks and the absence of specialized international methods for investment dispute settlement. ICSID plays an increasingly important role in the field of international investment and economic development and considers itself being today’s leading international arbitration institution devoted to investor-state dispute settlement.

ICSID itself does not conciliate or arbitrate disputes. Instead, it provides for the institutional and procedural framework for independent conciliation commissions and arbitral tribunals constituted in each case to resolve the dispute. The major procedural rules for initiating and conducting proceedings are the “ICSID Convention, Regulations and Rules” and the “ICSID Additional Facility Rules”, both available under <http://icsid.worldbank.org>. In contrast to other arbitral awards, awards obtained under the ICSID regime do not require recognition of national courts for becoming enforceable but are automatically considered as final, binding and enforceable in any contracting state of the Washington Convention.<sup>8</sup>

According to its annual report 2010, ICSID administered the total number of 154 cases and registered 27 new cases in 2010. Out of the 154 cases, 49% involved respondent states from South and Central America and the Caribbean Region, followed by further 25% involving respondent states from Central Asia and Eastern Europe. The majority of the cases currently administered have been filed by judicial persons. Pending disputes cover a variety of different economic sectors, ranging from

<sup>6</sup> Further information about ICSID can be taken from their website at <<http://icsid.worldbank.org>> visited September 7th, 2011.

<sup>7</sup> The ICSID rules do not provide for a definition of the term “Investment”. In practice, five criteria need to be fulfilled (certain duration of investment, expectation of constant income, risk for both parties related to the investment, considerable amount invested and significance for the economic development of the host state). However, the term “Investment” is often defined in BITs. Alternatively, a contractual definition of “Investment” may be agreed upon. cf. Christoph H. Schreuer, “Streitbeilegung im Rahmen des ICSID” in: Kronke/Melis/Schnyder, *Handbuch des Internationalen Wirtschaftsrechts*, page 2016/17.

<sup>8</sup> Cf. Art. 54 par. 1 ICSID.

public utilities, water and sewer services, power generation, electricity distribution, telecommunication services, natural resources, agricultural products/food industry, construction industry, financial services / debts and others.

As of June 30, 2010 the overall number of cases registered with ICSID since its establishment has reached 319, involving more than 80 different respondent states from all over the world including the United States of America, Canada, Germany, Spain, Mexico, Philippines, Turkey, South Africa, Indonesia, New Zealand and the United Arab Emirates.<sup>9</sup>

Concluding it can be judged that ICSID offers a sufficient framework for legal disputes between foreign investors and their host states. The question is, whether this can also be said for potential disputes involving the PR China or its governmental authorities. – Though recently the PR China for the first time became respondent to an investment dispute under the ICSID arbitration regime<sup>10</sup> there is only very little to learn from this case. The reason therefore lies in the fact that only two months after the request for instituting arbitration procedures got registered the proceedings already were suspended due to a respective parties agreement. Moreover, the case is based on the China-Malaysia BIT which came into force on 31.3.1990 at a time the PR China had not even ratified the Washington Convention. Hence, the uncertainty whether or not the ICSID regime can serve as a suitable tool for investment disputes involving the PR China remains.

<sup>9</sup> The following nations have been respondent states in ICSID cases: Argentina, Republic of Chile, Tanzania, Burundi, Egypt, Republic of Ecuador, Republic of Bulgaria, Republic of the Philippines, Republic of Peru, Islamic Republic of Pakistan, United Mexican States, Gabonese Republic, Democratic Republic of the Congo, Republic of Tunisia, Republic of Venezuela, Republic of Algeria, Republic of Zimbabwe, People's Republic of Bangladesh, Malaysia, Romania, Grenada, Republic of Kazakhstan, Georgia, Republic of Slovenia, Bolivia, Czech Republic, Republic of Togo, Kyrgyz Republic, Republic of Turkey, Slovak Republic, Republic of Azerbaijan, Ukraine, Republic of Panama, Republic of South Africa, Central African Republic, Republic of Costa Rica, Republic of Paraguay, Republic of Lebanon, Romania, Republic of Nigeria, Republic of Hungary, Republic of Albania, Republic of Guatemala, Republic of Ghana, Hashemite Kingdom of Jordan, Canada, Republic of Honduras, Republic of Senegal, Democratic Socialist Republic of Sri Lanka, Federal Republic of Germany, Republic of Yemen, Turkmenistan, Republic of El Salvador, Morocco, Jamaica, Republic of Indonesia, Republic of Madagascar, Iceland, Republic of Liberia, Trinidad and Tobago, People's Revolutionary Republic of Guinea, Republic of Korea, New Zealand, Papua New Guinea, Burkina Faso, Spain, United States of America, Republic of Estonia, Republic of Gambia, Republic of Kenya, United Arab Emirates, Republic of Mali, Republic of Guyana, Republic of Cameroon, Republic of Seychelles, Republic of Niger, Republic of Mongolia, Republic of Poland, Republic of Lithuania, Republic of Uzbekistan, Republic of Armenia and Bosnia Herzegovina, Republic of Moldova, People's Republic of China, Republic of Rwanda, Republic of Serbia..

<sup>10</sup> Ekran Berhad v. People's Republic of China (ICSID case no. ARB/11/15); the request got registered on May 24th, 2011 and the proceedings were suspended on June 22nd 2011.

## 2. The PR China joining the convention

The PR China joined ICSID as early as 1993. However, despite its increasing willingness to accept international business standards, the PR China on the one hand agreed in becoming a further contractual partner to this multinational treaty but on the other hand made several reservations worth to be noted and considered. Hence, though on paper the regulatory framework of ICSID seems to be a suitable mechanism for dispute resolution even with the PR China, such reservations – in practice – may constitute serious obstacles for foreign investors seeking for legal security for their investment in the PR China.

The gateway for reservations made by states joining ICSID can be found in Article 25 par. 4 of the ICSID convention. It reads:

“Any contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre.”

The PR China made use of this provision and notified ICSID of the following:

“Pursuant to Article 25 par. 4 of the Convention, the Chinese Government would only consider submitting to the jurisdiction of the International Centre for Settlement of Investment Disputes disputes over compensation from expropriation and nationalization.”

Hence, the application area available for a foreign investor being party to an investment dispute with the PR China is limited to disputes related to the compensation from expropriation and nationalization only unless otherwise agreed upon in applicable multilateral or bilateral agreements.

Apart from such limitation / reservation there is another obstacle worth mentioning which can be found in Article 25 par. 3 ICSID:

“Consent [to submit the dispute to ICSID] by a constituent subdivision or agency of a Contracting state shall require the approval of that State unless that State notifies the Centre that no such approval is required.” (comment by author)

Thus, an investor will need to review whether his contractual Chinese governmental authority has been notified to ICSID as potential party to a dispute under ICSID regulations or whether the PR China would give its consent in letting the respective governmental authority participate in such procedures. In the absence of such notification / consent ICSID will not be competent to handle the

investment dispute. In such case, an agreement to submit an investment dispute between a Chinese administrative/governmental authority and a foreign investor to international arbitration under ICSID will only be binding for the respective administrative/governmental authority concerned but not for the PR China as a state.<sup>11</sup>

### 3. Impact of bilateral investment treaties on PR China's ICSID reservations

The competence of ICSID to handle an investment dispute needs to be fixed in a respective contractual agreement. The offer for such agreement is mostly contained in BITs whereby the host state submits itself to the competence of ICSID and the investor (conclusively) accepts such submission by filing an application for initiating arbitration procedures.

The PR China joined ICSID in a period where it had just begun to speed up its "socialist market economy with Chinese characteristics" and when it was by far not as open to foreign investors as it is now. Since then, the demand for foreign investors to safeguard their investments in the PR China is ever increasing. On the other hand, as a result of the PR China's impressive economic development, more and more Chinese multinational companies are themselves investing abroad at a large scale and in many different fields of industry (e.g. automotive, raw materials, etc.). Hence, the protection of foreign investment is no longer a "one-way street" but has become of increasing importance for the PR China as well.

As a result, it can be discovered that since the year 1999 approximately the PR China has ratified a "new generation" of BITs. The turning point for such new development has been the implementation of the Chinese Administrative Reconsideration Law which came into force on October 1st, 1999<sup>12</sup>. While the so called "First Generation" BITs were highly affected by Chinese protectionism, the latest "Second Generation" BITs signed thereafter more and more reflect the Chinese open door policy towards foreign investors and many new BIT do make explicit reference to ICSID arbitration.

However, it would go beyond the scope of this article to introduce each and every BIT the PR China has entered into. Instead, for the purpose of this article we have analyzed several selective

BITs<sup>13</sup> with regard to ICSID arbitration which may serve as an example for other BITs with usually similar (if not identical) provisions regarding dispute resolution. In general, the BITs can be classified in two groups, "First" and "Second Generation" BITs.

#### a) "First Generation" BITs

The provisions regarding dispute resolution contained in the so called "First Generation" BITs reflect the limited application area as demanded by the PR China with its reservations when joining the Washington Convention. Only investment disputes involving the amount of compensation resulting from expropriation, nationalization or other measures having equivalent effect may be submitted to an international arbitration tribunal established by both parties and only if an amicable settlement through negotiations has failed. Other application areas for investment disputes are excluded from international arbitration and will be subject to the jurisdiction of the state in which the investment is located.<sup>14</sup> This will also be true, should any of the "First Generation" BITs provide for a clause whereby an investor's investment shall enjoy equal treatment to other third countries' investments.<sup>15</sup> From our point of view it is highly arguable whether or not such "Most Favorable Nation Clause" would allow a foreign investor to do "Treaty Shopping" by searching for the most beneficial provision in BITs the PR China has signed (or will sign) with any other country. Currently, the PR China is party to 128 of such treaties with varying content reflecting the specific bilateral relationship of the two countries concerned and the negotiations they had when reaching the agreement.<sup>16</sup> It does not appear to be convincing that provisions being the result of intensive negotiations with one country should become an integral part of other BITs without even considering the respective relationship to such countries.

Arbitral proceedings - when initiated - shall be determined with reference to the Washington Convention<sup>17</sup> or the Arbitration Rules of the UNCI-

<sup>11</sup> Cf. Christoph H. Schreuer, loc.cit., page 2016/17.

<sup>12</sup> The Chinese Administrative Reconsideration Law can be found at <<http://vip.chinalawinfo.com/newlaw2002/slc/slc.asp?db=chl&gid=22100>> visited September 7th, 2011 (Chinese version) or <<http://lehrstuhl.jura.uni-goettingen.de/chinarecht/990429.htm>> visited September 7th, 2011 (German version).

<sup>13</sup> Such selective BITs do cover the following nations: Austria, Bahrain, Belgium and Luxembourg, Bosnia and Herzegovina, Botswana, Brunei, Chile, Czech Republic, Denmark, Finland, Germany, Japan, Korea, Peru, Portugal, Singapore, Spain, United Kingdom.

<sup>14</sup> Should the investment be located in CHINA, conflicts between foreign entities/nationals and a Chinese governmental authority will usually be handled by the Intermediate People's Courts, cf. Art. 19 Chinese Civil Procedure Law available at <<http://vip.chinalawinfo.com/newlaw2002/slc/slc.asp?db=chl&gid=98761>> visited September 7th, 2011 (Chinese version) or <<http://lehrstuhl.jura.uni-goettingen.de/chinarecht/910409.htm>> visited September 7th, 2011 (German version).

<sup>15</sup> E.g. such provision can be found in Art. III A (c) of the CHINA/Australia-BIT available at <[www.unctad.org/sections/dite/ia/docs/bits/australia\\_china.pdf](http://www.unctad.org/sections/dite/ia/docs/bits/australia_china.pdf)> visited September 7th, 2011.

<sup>16</sup> Cf. footnote no. 3 above.

TRAL United Nations Commission on International Trade Law<sup>18</sup>.

These “First Generation” BITs do provide for very little security for a foreign investor only. For the majority of issues which might become subject of an investment dispute he will need to seek for the assistance of the Chinese national courts who – at least in the past – have not been “over-enthusiastic” (see our comments under no. II. above) when handling cases against governmental authorities or making decisions in favor of foreign investors respectively.

### b) “Second Generation” BITs

According to “Second Generation BITs” an investor may submit any investment dispute to ICSID whose arbitral awards shall be final and binding upon both parties to the dispute. Awards shall be executed by both contracting parties. Hence, should the PR China (or its national courts respectively) refuse to accept and enforce such arbitral award, it would breach its obligations under the BIT with the contracting state concerned which – most likely - would result in serious international consequences and damage the reputation of both the PR China and the governmental body being party to the investment agreement in question.<sup>19</sup>

The “Second Generation” BITs do not make any reference to a limited application area or to the PR China’s reservations made when joining the Washington Convention respectively (expropriation and nationalization). The question to be answered is, whether the absence of such limitations / reservations can automatically be interpreted in a way that the PR China in the “Second Generation” BITs did agree to broaden the scope for settling investment disputes by way of international arbitration or whether the former, conflicting reservations notified to ICSID do still apply.

Some authors<sup>20</sup> have argued that the wording of the PR China’s reservations when joining the Washington Convention reflects the intention of a non-mandatory and preliminary estimation at the time of declaration only (“... would only consider

submitting”) which, hence, cannot be considered being in conflict with “Second Generation” BITs. However, we doubt such argumentation to be convincing. The wording of the reservations was taken from Art. 24 par. 4 ICSID Convention and not an “invention” of the PR China. Thus, the wording alone must not be interpreted in a way that the PR China did not really mean to limit the application area. Instead, we believe that the wording of the “Second Generation” BITs and the reservations made by the PR China when joining the Washington Convention are in conflict with each other and that such conflict needs to be solved by way of legal interpretation.

### c) Conflict of ICSID Reservations and “Second Generation” BITs

The most obvious indication for arguing that with its “Second Generation” BITs the PR China voluntarily decided to submit each and any investment dispute governed by such treaties to ICSID arbitration can be taken from the wording of these BITs which, in contrast to “First Generation” BITs, do not make any reference to a limitation/restriction to the application area. However, on the other hand one may say that the PR China would have explicitly given up its reservations to ICSID if this had been intended when signing the BIT in question and that any reference to ICSID arbitration can only be understood as arbitration according to the former reservations of the PR China made when joining the Washington Convention. The latter argument, though plausible at the first glance, does not seem to be a strong argument to us as it would mean that the provisions for dispute resolution under the ICSID arbitration regime contained in the “Second Generation” BITs would be a mere repetition only and could just as well be deleted from such treaties without making any difference. Hence, it seems more favorable to interpret the wording of the “Second Generation” BITs in a way that the PR China really intended to broaden the application area.

This result/interpretation appears to be even more realistic when considering the China-Australia BIT effective since 1988 (“First Generation” BIT).<sup>21</sup> Art. XII par. 4 states as follows:

“In the event that both the People’s Republic of China and Australia become party to the 1965 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, a dispute may be submitted to the International Centre for the Settlement of Investment

<sup>17</sup> E.g. in the following BITs: Belgium and Luxembourg 1984 (Art. 10 par. 3 including protocol Art. 6 par. 1 - 3), Denmark 1985 (Art. 8 par. 3 and 4), Singapore 1986 (Art. 13 par. 3 and 6), Austria 1986 (Art. 4 par. 5 including protocol), Japan 1989 (Art. 11 par. 2), Chile 1994 (Art. 9 par. 3), Peru 1995 (Art. 8 par. 3) and Bahrain 1999 (Art. 9 par. 3).

<sup>18</sup> E.g. in the BIT with the United Kingdom 1986 (Art. 7, par. 1 - 3).

<sup>19</sup> Additionally, the refusal to enforce an arbitral award would constitute a breach of the ICSID convention whereby each contracting state shall recognize and enforce such award as if it were a final judgment of one of its national courts (Art. 54 par. 1 ICSID). Moreover, in such cases the foreign investor concerned would be entitled to ask for diplomatic protection (Art. 27 par. 1 ICSID).

<sup>20</sup> E.g. Tillman Rudolf Braun/ Pascal Schonard in: RIW Recht der Internationalen Wirtschaft, page 561 (569).

<sup>21</sup> English version available at <[www.unctad.org/sections/dite/iaa/docs/bits/australia\\_china.pdf](http://www.unctad.org/sections/dite/iaa/docs/bits/australia_china.pdf)> visited September 7th, 2011.

Disputes for resolution in accordance with the terms on which the Contracting Party which has admitted the investment is a party to the Convention.”

(highlighting by authors)

The above quotation shows that already in 1988 the PR China has been aware of the possibility of explicitly making reference to its reservations regarding the application area in the BITs signed with other states. Therefore, as the PR China did not include any such explicit reference in its “Second Generation” BITs it obviously opted for broadening the application area to each and any investment dispute.

Such understanding can be supported by a general rule for legal interpretation whereby new regulations shall prevail older ones (“lex posterior derogat leges anteriori”) and which can also be found in Art. 30 par. 3, 4 a) of the Vienna Convention on the Law of Treaties (1969), an international treaty dealing with disputes concerning treaties and their interpretation which got signed and ratified by more than 100 states (including the PR China):<sup>22</sup>

“Art. 30

(...) 3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.

(...) 4. When parties to the later treaty do not include all the parties to the earlier one:

a) as between States Parties to both treaties the same rule applies as in paragraph 3; (...).”

Hence, as the application area of the Washington Convention (when considering the PR China’s reservations) and the “Second Generation” BIT’s signed by the PR China are not compatible, the latter new and bilateral treaty shall prevail.

Furthermore, the above interpretation cannot be challenged by arguing that the former reservations of the PR China when joining the Washington Convention would not make any sense, if the “Second Generation” BITs are interpreted in a way that the application area for ICSID arbitration has been broadened. Such understanding misses noticing that from the PR China’s perspective it does make sense to keep different levels of protection for for-

ign investment and at the same time not to notify ICSID about waiving the reservations as a whole. Actually there are currently 156 states having signed and ratified the Washington Convention not all of which the PR China has signed a (“Second Generation”) BIT with.

Last but not least, there is one more argument worth mentioning why we are of the opinion that the PR China voluntarily opted for broadening the application area with its “Second Generation” BITs. Within such BITs the PR China did not only offer the opportunity for a foreign investor to submit each and any investment dispute to arbitration under the ICSID regime but also introduced a further (mandatory) requirement whereby an investor will need to refer the dispute to an administrative review procedure according to Chinese law prior before being entitled to file an application for international arbitration under ICSID.<sup>23</sup> Such additional requirement serves as new “protective barrier” in order to safeguard Chinese public interests in disputes with foreign investors and can be found with different characteristics in every “Second Generation” BIT.<sup>24</sup> While some of these BITs require the investor concerned to “exhaust” the domestic administrative review procedure<sup>25</sup> others do only require submitting the dispute to such procedure<sup>26</sup>. In some of the latter BITs it is even stated that the investor may submit the dispute for arbitration under ICSID should the administrative procedure not be finished within three months.<sup>27</sup>

Hence, even when arguing that the PR China would not voluntarily put itself or its governmental authorities under the control of some independent international arbitration tribunal, the requirement for an additional administrative procedure and its protection provided for Chinese public interests serves as a counter-argument. In BITs requiring an investor to “exhaust” the Chinese domestic administrative review procedure, the public authority in charge may delay the procedures arguing it has yet not been “exhausted”. Additionally it needs to be mentioned that though Chinese law provides for “proceedings for failure to act” against a public

<sup>23</sup> Art. 6 of the relevant Chinese Administrative Reconsideration Law contains a (comprehensive) catalogue of circumstances for which an application is admissible.

<sup>24</sup> The administrative review procedure serves as a tool of administrative self-control and provides a chance for CHINA to settle investment disputes even before becoming subject of international arbitration proceedings.

<sup>25</sup> E.g. Botswana 2000 (Art. 9 par. 3), Brunei 2000 (Art. 9 par. 2), Bosnia and Herzegovina 2002 (Art. 8, par. 2 b)), Finland 2004 (Art. 9, par. 3)) and Spain 2005 (protocol about Art. 9).

<sup>26</sup> E.g. Germany 2003 (protocol about Art. 9), Portugal 2005 (protocol about Art. 9), Czech Republic 2005 (Art. 9, par. 3) and Korea 2007 (Art. 9, par. 3 b).

<sup>27</sup> E.g. Germany 2003 (protocol about Art. 9), Czech Republic 2005 (Art. 9 par. 3) and Korea 2007 ((four months) Art. 9 par. 3).

<sup>22</sup> Hans-Jürgen Sonnenberger in: Münchener Kommentar zum BGB, 5th Edition 2009, volume 10 (EGBGB), introduction, margin no. 305; full version of the Vienna Convention on the Law of Treaties available at <http://treaties.un.org> visited September 7th, 2011.

authority<sup>28</sup>, a foreign investor cannot force a Chinese administrative agency (or a Chinese People's court respectively) to initiate administrative review/court procedures. Hence, at least for those "Second Generation" BITs not providing for a time frame within which the administrative review proceedings have to be completed, a foreign investor may face problems in fulfilling the requirement of referring the dispute in question to the administrative review procedures prior to having his case submitted for international arbitration.

#### d) Preliminary conclusions

Considering the above there is room for a preliminary conclusion:

(i) To those investors from countries who have not entered a "Second Generation" BIT with the PR China so far but have either joined the Washington Convention or signed "First Generation" BITs with the PR China only, the protection for their investment when submitting an investment dispute to international arbitration under the ICSID arbitration regime will be limited to the application area of expropriation and nationalization. Other application areas for investment disputes are excluded from arbitration.

(ii) Hence only to those investors, whose national state has signed a "Second Generation" BIT with the PR China, ICSID might become an option for settling investment disputes with the PR China or one of its governmental authorities. Though, as we have described in detail, good arguments can be found that the PR China has intentionally broadened the application area for arbitration under the ICSID regime, it needs to be considered that until today only one case - be it for expropriation and nationalization or other grounds - has been reported where the PR China has been respondent to arbitration proceedings under the ICSID regime and that such case has been suspended shortly after being registered by the secretary general.<sup>29</sup> Moreover, it needs to be considered that the applicant of such case is a Malaysian company. The PR China and Malaysia did only sign a "First Generation" BIT which came into force on 31.3.1990. As by that time the PR China had not

even ratified the Washington Convention, ICSID's jurisdiction will be limited to the scope given in the BIT, limiting it to "disputes relating to the amount of compensation" and "any other disputes agreed upon by the parties".<sup>30</sup>

Thus, there remains some uncertainty that our above interpretation may not be followed by an arbitral tribunal or that a Chinese national court may accept a case which - according to our opinion - would be subject to international arbitration only.

(iii) Moreover, "Second Generation" BITs do make reference to an administrative procedure review which needs to be initiated prior to submitting an investment dispute for international arbitration under ICSID. Such requirement serves as a new protective barrier to safeguard Chinese public interests.

(iv) Irrespective whether a "First" or "Second Generation" BIT has been signed, Article 25 par. 3 ICSID and the question whether or not the contractual Chinese governmental authority can participate in ICSID procedures must be considered (i.e. prior notification or consent by the PR China).

(v) Summarizing, also for foreign investors whose states are party to a "Second Generation" BIT with the PR China there are several uncertainties when deciding to submit an investment dispute for arbitration under the ICSID rules and regulations. It should thus be reviewed whether apart from ICSID there is any alternative available for foreign investors seeking for a suitable tool for dispute resolution.

#### IV. Other options for clauses regarding dispute resolution

In the following we would like to introduce and discuss alternative options available for the settlement of investment disputes between foreign investors and Chinese governmental authorities.

##### 1. National courts

Choosing either a Chinese national court or a court of the state where the investor domiciles will not serve as a suitable solution for dispute resolution.

Even though the PR China has undertaken numerous measures to modernize its legal system, still legal proceedings (at least in rural areas) may not comply with "Western standards" making decisions sometimes unpredictable and vulnerable for protectionism. While this situation can already be

<sup>28</sup> Art. 11 no. 4 and 5 of the Chinese Administrative Procedure Law, <<http://vip.chinalawinfo.com/newlaw2002/slc/slc.asp?db=chl&gid=4274>> visited September 7th, 2011 (Chinese Version) or <<http://lehrstuhl.jura.uni-goettingen.de/chinarecht/890404.htm>> visited September 7th, 2011 (German Version).

<sup>29</sup> Ekran Berhad v. People's Republic of China (ICSID case no. ARB/11/15); the request got registered on 24. 5.2011 and the proceedings were suspended on 22. 7.2011; vice versa a Chinese national has applied for submitting an investment dispute for arbitration under the ICSID regime in a case against Peru in 2007 (ICSID case no. ARB/07/06). However, the subject matter of such dispute refers to "expropriation". The tribunal rendered its award on 7. 7.2011.

<sup>30</sup> Please also refer to <http://www.wunscharb.com/content/first-icsid-case-against-china> visited on September 7th, 2011..

experienced in conflicts with Chinese corporate entities, it does not take much to predict that legal proceedings under participation of a Chinese governmental authority will be a much more sensitive matter giving room for various opportunities of governmental bodies to take influence. Besides openly arguing that the motion will be contrary to the “public interests” of the PR China, the Chinese government might legally also use ways less transparent to the foreign investor “to bring the court back on track”: In practice, the government is authorized to supervise and give directions to the courts.

However, national courts from the jurisdiction of the foreign investor will also be no option for dispute resolution. Even when achieving a judgment in favor of the foreign investor there will follow the problem of how to get acknowledged such judgment and get it enforced in the PR China. Anyway as practical matter, it is hard to imagine that a Chinese governmental party would submit itself to the jurisdiction of a foreign state.

## 2. Arbitration Institution

Whereas putting disputes arising from and in connection with a foreign investment contract under the exclusive jurisdiction of Chinese or foreign national courts will not be an option, it might be considered to agree on an arbitration clause whereby any such dispute would be submitted to an arbitration institution<sup>31</sup> or an ad hoc arbitral tribunal.

As for hoc arbitral tribunals it is important to know Article 16 par. 3 Chinese Arbitration Law:<sup>32</sup>

“An arbitration agreement shall contain the following particulars:

(...)

par. 3 a designated arbitration commission.”

(highlighting by authors)

Hence, this provision relates to an institutional arbitration organization rather than an ad-hoc tribunal. Therefore, it is common sense in the PR China that ad hoc arbitration procedures within the PR China are not permissible.<sup>33</sup> Should the parties to a foreign related investment agreement wish to

agree on an ad hoc arbitral tribunal they should at the same time agree (in writing) that the place of arbitration will not be within the PR China. If so, the arbitration procedures will be governed by the applicable laws and regulations at the place of arbitration and Article 16 par. 3 of the Chinese Arbitration Law will not apply. Additionally, the arbitration clause should not only make reference to the applicable arbitration rules but should also explicitly name the competent arbitration commission which the dispute will be submitted to.<sup>34</sup>

Having obtained an arbitral award in his favor the foreign investor may have to enforce such award in the PR China. However, the enforcement of an arbitral award (be it issued by an arbitration commission or by an ad hoc arbitral tribunal) will be subject to the prior recognition of a Chinese national court in accordance with the UN Convention on the Recognition and Enforcement on Foreign Arbitral Awards of 1958 (the “New York Convention”)<sup>35,36</sup> the PR China is a signatory state to this convention.<sup>37</sup>

As stated above it must be doubted that a Chinese national court will be very “supportive” in reaching a decision in favor of a foreign investor who wishes to enforce such award against the PR China or one of its governmental authorities. Especially Article 58 par. 2 of the Chinese Arbitration Law and Article 260 par. 2 of the Chinese Civil Procedure Law may serve as an argument for refusing an application handed in by a foreign investor. These regulations allow the court to refuse an application if the enforcement of the arbitral award would go

“against the social and public interest of the country”.

Although the PR China implemented a reporting and approval system ultimately to the Supreme Court, before foreign awards can be rejected by Chinese courts<sup>38</sup>, it is very likely that the appellate courts will take the very same stance. Moreover, the PR China made a reservation when joining the New York Convention by stating that it would only

<sup>31</sup> E.g. CIETAC (China International Economic and Trade Arbitration Commission in Beijing) or ICC (International Chamber of Commerce in Paris).

<sup>32</sup> Chinese Version available at <<http://vip.chinalawinfo.com/newlaw2002/slc/slc.asp?db=chl&gid=9590>> visited September 7th, 2011, and German version available at <<http://lehrstuhl.jura.uni-goettingen.de/chinarecht/inhalt.htm>> visited September 7th, 2011.

<sup>33</sup> Marcel Barth/Graeme Johnston in: SchiedsVZ Zeitschrift für Schiedsverfahren 2007, 300 (302); Dietmar Hantke in: SchiedsVZ Zeitschrift für Schiedsverfahren 2007, 36 (37).

<sup>34</sup> Dietmar Hantke in: SchiedsVZ Zeitschrift für Schiedsverfahren 2007, 36 (37).

<sup>35</sup> Full version available at <[www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html)> visited September 7th, 2011.

<sup>36</sup> An exemption has to be made for arbitral awards under ICSID. According to Art. 54 par. 1 ICSID such awards shall automatically be regarded as final and binding (in any contracting state of the Washington Convention) without the necessity of prior recognition by Chinese national courts; cf. Christoph H. Schreuer, loc. cit., page 2034.

<sup>37</sup> As of October 1st, 2010, 148 nations have signed the New York Convention.

<sup>38</sup> Cf. Johannes Trappe in: SchiedsVZ Zeitschrift für Schiedsverfahren 2006, 258 (269) with further references.



acknowledge foreign arbitral awards when the respective dispute had been related to a

“commercial legal relationship of a contractual nature or non-contractual nature”.  
(highlighting by authors)

Thus, for the majority of investment agreements a Chinese court may take the position that the nature and content of the contract (e.g. grant of land use rights, preferential tax treatment) is not a commercial but a public-law contract and, thus, refuse to declare the arbitral award enforceable.

### 3. International arbitration under UNCITRAL

Finally we would like to introduce a further option for dispute resolution which is to agree on submitting a dispute arising from an investment agreement to an ad hoc arbitral tribunal to be established under the United Nations Commission on International Trade Law (the “UNCITRAL”).<sup>39</sup>

#### a) Introduction of UNCITRAL

International arbitration procedures in accordance with the UNCITRAL terms<sup>40</sup> are - apart from ICSID - frequently agreed for contracts where one contracting party is a state or governmental authority respectively. Especially in the field of investment related arbitration, UNCITRAL terms are commonly referred to. The UNCITRAL arbitration rules were passed in 1976 by the United Nations Committee for International Trade Law and were recommended by the United Nations plenary assembly for the settlement of international business disputes on 15.12.1976.<sup>41</sup> The reason for formulating the UNCITRAL arbitration rules was that - by then - existing arbitration rules had been regulatory frameworks almost exclusively considering the needs of industrialized nations. By contrast, the UNCITRAL terms were designed for the attempt of offering arbitration rules suitable also for business relations with developing countries.<sup>42</sup>

As UNCITRAL is a regulatory framework and not an international agreement, states do not “join” such “agreement” and, thus, can only bilaterally declare reservations as for the application area.

As an UNCITRAL clause for dispute resolution would provide for an ad hoc arbitral tribunal to decide upon potential claims arising from or in connection with an investment agreement, it will be

essential to agree on a place of arbitration outside the PR China.<sup>43</sup> Since it must be expected that the Chinese partner to the investment agreement will not accept any location within the state the foreign investor is domiciled in, a “neutral location” within a third country should be chosen.

#### b) Impact of BITs on arbitration procedures under UNCITRAL

While “First Generation” BITs provided for certain reservations regarding the application area when submitting an investment dispute for international arbitration, under the “Second Generation” BITs such reservations have been waived making international arbitration available for each and every investment dispute irrespective of the subject matter in conflict. However, there remain the uncertainties described under no. III 3 c) above regarding the newly introduced requirement of undergoing administrative review procedures in accordance with applicable Chinese laws and regulations prior to submitting an investment dispute for arbitration under UNCITRAL.

#### c) Enforcing an UNCITRAL arbitral award

Additionally, there remains the problem of how to enforce an arbitral award in the PR China which was obtained under the UNCITRAL.<sup>44</sup> Unfortunately, these risks cannot be avoided but, instead, must be accepted by the foreign investor.

### V. Summary

1. Considering the PR China’s reservations when joining the Washington Convention, ICSID will not be a comprehensive option as only disputes regarding expropriation and nationalization would be available for arbitration.

2. When drafting an investment contract with a Chinese governmental authority a close look should be taken at the applicable Bilateral Investment Treaties and the options contained in such agreement for dispute resolution.

a) Where there is no BIT with the PR China or a “First Generation” BIT only, an ad hoc arbitral tribunal under the UNCITRAL arbitration rules (having its place of arbitration outside the PR China) will be the only choice to be considered.

b) Where there is a “Second Generation” BIT the following distinction should be made:

In case the contractual party of the foreign investor concerned is either the PR China, one of its

<sup>39</sup> For detailed information on UNCITRAL please visit their website at <www.uncitral.org> visited September 7th, 2011.

<sup>40</sup> Available at <www.uncitral.org/uncitral/en/uncitral\_texts/arbitration.html> visited September 7th, 2011.

<sup>41</sup> The UNCITRAL arbitration rules got revised on June 25th, 2010.

<sup>42</sup> Karl Heinz Schwab/ Gerhard Walter in: Schiedsgerichtsbarkeit, 7th, edition 2005, chapter 41, margin no. 10.

<sup>43</sup> Please refer to our comments under no. IV: 2 above.

<sup>44</sup> Please refer to our comments under no. IV. 2 above.

governmental authorities notified to ICSID or the PR China has given its consent in letting the respective governmental authority participate in a dispute under the ICSID arbitration regime (Art 25 par. 3 ICSID), the foreign investor should opt for ICSID as according to Art. 54 par. 1 ICSID its awards do not have to be declared enforceable by Chinese national courts but will directly be enforceable in any contracting state of the Washington Convention.

In other cases the agreement to submit disputes for arbitration in accordance with the ICSID regime would only be binding for the contracting administrative governmental authority concerned but not for the PR China as a state. Therefore, considering the remaining uncertainty that either an arbitral tribunal will not follow our above argumentation whereby the application scope has been broadened by "Second Generation" BITs or a Chinese national court may accept handling a case which – according to our opinion – should be subject to arbitration only, choosing UNCITRAL will be (slightly) preferential for a foreign investor.

Foreign investors should request written evidence from their contractual partners that they have been notified by the PR China as a potential party for arbitration proceedings under the ICSID regime.

3. A refusal of the PR China to accept and execute an (ICSID or UNCITRAL) arbitral award in favor of a foreign investor might be deemed a breach of either the Washington Convention or a BIT by the international political and media audience. It might thus harm the reputation of both the PR China and the governmental body being party to the investment agreement in question.