The Future of Investor-State Dispute Settlement: Exploring China's Changing Attitude

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Abstract

The legitimacy of investor-state dispute settlement (ISDS) system has come under fire in recent years and the call for reform or even transformation of global foreign direct investment governance is in vogue, with proposals ranging from incremental improvement of the current system to a radical paradigm shift for a wholesale replacement. Given its economic scale, China's position in ISDS reform will undoubtedly carry considerable weight in shaping the future of the ISDS system. This chapter intends to map out China's interaction with the ISDS over the past thirty years as well as explain China' attitude towards the ongoing ISDS reform. We argue that China's switch from "light" to more strategic "heavy" engagement with the ISDS goes hand in hand with China's shifting role from a major capital importing state to a key hybrid regime of capital importing and exporting state. This switching position also matches China's more ambitious stance to be part of the global economic governance system reform. ISDS reform can be a good opportunity or window for China to voice its ideals in the international investment sphere.

Key words: ISDS reform, legitimacy crisis, China, belt & road initiative

I. Introduction

As an essential part of its government-directed development model, China has adopted a government-mandated 'Go Global' policy since 2000. The essence of the 'Go Global' policy is to promote the international operations of capable Chinese firms through outbound direct investment (ODI) with a view to enhancing their international competitiveness.[1] This policy has been very successful, with the world witnessing a dramatic increase in Chinese ODI and an even larger potential for growth over the years.[2] In 2008, while global ODI fell by 15% as a consequence of the global financial crisis, Chinese ODI flows more than doubled.[3] In 2012, global ODI slid 17 percent amid uncertainties facing the world economy, whereas Chinese ODI rose 17.6 percent and hit a record high of USD87.8 billion, compared to USD12.3 billion in 2005.[4]

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[1] Wayne M. Morrison, *China's Economic Conditions*, Congressional Research Service (May 4, 2013), at 20.

[2] Nargiza Salidjanova, *Going Out: An Overview of China's Outward Foreign Direct Investment*, U.S.-China Economic & Security Review Commission Staff Research Report (March 30, 2011), at 3.

[3] Ken Davies, *Outward FDI from China and Its Policy Context*, Columbia FDI Profiles (October 18, 2010), at 5.

[4] UNCTAD, *World Investment Report 2013* (New York and Geneva, 2013), at 4

UNCTAD ranked China 3rd in the world in term of ODI in 2017, right after the United States and Japan.[5] In 2018, global FDI fell by 40% whilst China's ODI rose 4.2% to reach $130 billion.[6]

With the introduction of China's ambitious Belt and Road Initiative (BRI), Chinese ODI has reached a new level. As one of the most ambitious infrastructure projects ever conceived, BRI includes a vast network of railways, energy pipelines, highways and streamlined border crossings both westward and southward, as well as invests in port development along the Indian Ocean, from Southeast Asia all the way to East Africa.[7] It is estimated that the BRI has resulted in US$450 billion worth of investments in the five years since its inception in 2013. China's ODI stood at $15.66 billion in the first two months of 2019, among which $2.3 billion invested in 48 countries participating in the Belt and Road Initiative, rising 7 percent compared to 2018.[8]

Despite all the rhetoric, however, China's BRI represents an inherently risky endeavor, given the severe political instability and the lack of rule of law in many countries expected to participate in the BRI.[9] Therefore, the protection of China's ODI from investment risks in BRI countries figures prominently in Chinese government's approach to international investment law.[10] In particular, consistent with the rise of Chinese ODI and the development of BRI, Chinese investors may increasingly choose to take advantage of investor-state dispute settlement (ISDS) mechanisms in Chinese bilateral investment treaties (BITs) and free trade agreements (FTAs) to resolve investment disputes.[11] The unilateral and direct access to international investment arbitration bypasses the national court system and its effectiveness in delocalizing and depoliticizing investment disputes has long been acknowledged. For decades, ISDS has been the preferred means for capital exporting countries to protect the interests of their investors as they invested abroad and to enforce the terms of investment agreements. Likewise, ISDS has been a favored means used by capital importing countries to encourage investment.[12]

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[5] UNCTAD, World Investment Report 2018: Investment and New Industrial Policies (United Nations, 2018), at 4.

[6] Chinese Ministry of Commerce, China's Outbound Foreign Investment Remains Stable, http://www.xinhuanet.com/english/2019-03/21/c_137913265.htm (21 March 2019).

[7] Julien Chaisse and Mitsuo Matsushita 'China's "Belt and Road" Initiative-- Mapping the World Trade Normative and Strategic Implications' (2018) 52(1) *Journal of World Trade* 163-186. See also Andrew Chatzky and James McBride, 'China's Massive Belt and Road Initiative Backgrounder', Council on Foreign Relations Report (May 21, 2019).

[8] Chinese Ministry of Commerce, above n 6.

[9] Xiaojun Li and Ke Zeng, 'Beijing is Counting on its Massive Belt and Road Initiative, But are Chinese Firms on Board?' Washington Post (14 May, 2019).

[10] Julien Chaisse, 'China's International Investment Policy: Formation, Evolution, and Transformation', in Julien Chaisse and Luke Nottage, *International Investment Treaties and Arbitration Across Asia* 544 (Brill, 2018), 568-570.

[11] Guo Shining, Edwina Kwan and Josephine Lao, 'The Rise of Chinese Investors as Claimants: What are the Likely Impact of International Arbitration', China Law Insight, King & Wood Mallesons (June 25, 2018).

[12] Kate Miles, *The Origins of International Investment Law: Empire, Environment, and the Safeguarding of Capital* (CUP 2013), at 86-88; Rafael Leal-Arcas, *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar, 2010), at 69-86.

China has entered into an extensive network of international investment treaties (IIAs) over the past three decades. According to UNCTAD, China has signed 129 BITs (109 in force) and 22 other treaties (19 in force) with investment provisions by 2019, the second most prolific signatory state in the world only behind Germany.[13] Moreover, whilst China's earliest BITs rejected ISDS in favor of state-to-state adjudication (such as the 1982 China-Sweden BIT) due to its skepticism of international law and strong emphasis on the primacy of state sovereignty[14], unobstructed access to ISDS clause has become a standard feature in most of China's BITs since 1998.[15] Concurrently, China's presence in ISDS proceedings has also been slowing rising, with both claims raised by Chinese investors and Chinese government as a respondent. Given China's economic scale, some predicted that China will soon be a 'global ISDS power'.[16]

It is against this background that an exploration of China's attitude towards ISDS and its future reforms is a valuable exercise. The legitimacy of ISDS has come under fire in recent years and the call for reform or even transformation of global foreign direct investment governance is on the way, with proposals ranging from incremental improvement of the current system to a radical paradigm shift for a wholesale replacement rival for prominence.[17] Given China's economic scale, China's position in this heated debate will undoubtedly carry considerable weight. Part II of the chapter reviews China's existing experience, or "light" engagement, with ISDS, highlighting some distinctive legal issues in investment arbitration claims involving China and China's BITs. Part III evaluates critically China's approach to, or more strategic engagement with, the ongoing ISDS reform. Part IV concludes the chapter.

II. China's Limited Experience with ISDS

There is a puzzling so-called "China disequilibrium" in international investment arbitration.[18] Despite China is a signatory of almost 150 international investment treaties (IIAs) in which the ISDS clause is a common feature, there were very few investor-state arbitration cases involving China or Chinese BITs, Chinese investor or Chinese BITs. Under current records, Chinese companies were claimants in five cases before the ICSID and other international arbitration forums, including *Tza Yap Shum v. Republic of Peru* (2007), *China Heilongjiang International Economic & Technical*

[13] UNCTAD, Investment Policy Hub, available at http://investmentpolicyhub.unctad.org/IIA
[14] Kong Qingjiang, 'Bilateral Investment Treaties: The Chinese Approach and Practice', 8 Asian Yearbook of International Law (1998/1999), at 105.
[15] Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policies and Practice* (OUP, 2009), at 41-42.
[16] Diane A. Desierto, 'China as a Global ISDS Power', https://oxia.ouplaw.com/page/715 (24 August 2018).
[17] Anthea Roberts, 'Incremental, Systemic, and Paradigmatic Reform of Investor-State Arbitration', 112(3) AJIL 410 (2018), at 410.
[18] Wei Shen, 'The Good, The Bad, or The Ugly? A Critique of the Decision on Jurisdiction and Competence in Tza Yap Shum v. The Republic of Peru', 10(1) Chinese Journal of International Law 55 (2011), 55.

Cooperative Corp. v. Mongolia (2010), *Ping An Insurance (Group) Company of China, Limited v. Kingdom of Belgium* (2012), *Sanum Investments Limited v Lao Peoples' Democratic Republic* (2013), and *Beijing Urban Construction Group Co., Ltd. v. Republic of Yemen* (2014). China was the respondent in only three cases, that is, *Ekran Berhad v. People's Republic of China* (2011), *Ansung Housing Co., Ltd. v. China* (2014) and *Hela Schwarz GmbH v. China* (2017). It is important to note that almost all of these Chinese BITs-related investor-state arbitration cases are concerned with old-generation BITs with restrictive terms of investor, investment, dispute and fork-in-the road clauses.

There are a number of explanations to this "China disequilibrium" phenomenon. One explanation is to argue that the Chinese government has already been offering sufficient investment protection to foreign investors.[19] For example, China often accords foreign investors better than "national treatment".[20] As a result, there were few cases involving the Chinese government as a respondent. In contrast to this explanation, a competing argument holds essentially that a dearth of claims against China is due to lack of rule of law in China. Foreign investors may fear that their claim could jeopardize their relationship with the Chinese government and in turn put their business dealings in China at risk. As the European Union Report pointed out, initiating arbitration against China is likely to be "a last resort", due to fear of retaliation.[21] Yet another school of thought attributes the low utility rate of Chinese BITs to the fact that the early-generation Chinese BITs often incorporate restrictive terms, especially such terms as investor, investment, dispute, fork-in-the road, among others. A typical example is that early Chinese BITs provide only that disputes "involving the amount of compensation for expropriation' may be submitted for arbitration. These narrow BIT terms in effect disallow foreign investors to easily initiate investor-state arbitration against the Chinese government even if the Chinese government or its local governments did harm foreign investors' interests.[22]

The last explanation of restrictive BIT terms may also justify the small number of investor-state arbitration cases in which Chinese investors are claimants especially in the context that China has become the second capital exporting state while Chinese outbound investment often encounters legal, political and economic difficulties in host states. Moreover, Chinese traditional culture may also play a role here. In Chinese culture and tradition, the optimal resolution of most disputes should be achieved not by the exercise of legal power but by moral persuasion.[23] Therefore, Chinese investors

[19] Yuqing Zhang, 'The Case of China' in Michael Moser (ed), *Investor-State Arbitration – Lessons for Asia* (Juris Publishing 2008) 159.
[20] Wenhua Shan, Norah Gallagher and Sheng Zhang, 'National Treatment for Foreign Investment in China: A Changing Landscape', 27 ICSID Review 120 (2012), at 141.
[21] Leon E. Trakman, 'Geopolitics, China, and Investor-State Arbitration', in Lisa Toohey, Colin B. Picker and Jonathan Greenacre, *China in the International Economic Order* 268 (CUP, 2015), at 279.
[22] Stephan W. Schill, 'Tearing Down the Great Wall: The New Generation Investment Treaties of the People's Republic of China',15(1) Cardozo Journal of International and Comparative Law 73 (2007), 73-118.
[23] Xue Hanqin, 'Cultural Element in International Law', Melland Schill Lecture, University of Manchester (May 5, 2016), at 12-13.

may prefer non-adversarial methods such as negotiation and mediation to resolve their disputes with host countries.

The first ICSID arbitration under a China BIT was *Tza Yap Shum v. Republic of Peru* that concerned Tza Yap Shum, a Hong Kong resident and PRC national, and his dispute arising out of taxes imposed by the Peruvian authorities on a fish flour manufacturing and export company owned by Tza. Tza initiated arbitration under the 1994 China-Peru BIT alleging that measures adopted by the Peruvian authorities were tantamount to indirect expropriation of his investments and violated fair and equitable treatment and full protection and security. The award on merits supported Tza's claim and granted Tza compensation in the amount of US$ 786,000 in July 2011.[24] A hearing on Peru's application for annulment of the award was held in March 2014 and the annulment committee affirmed the decision.[25]

The second known case *China Heilongjiang International Economic & Technical Cooperative Corp. v. Mongolia* is an international investment arbitration case in which three Chinese investors brought investment claims into *ad hoc* proceedings administered by the Permanent Court of Arbitration (the PCA) pursuant to the 1991 China-Mongolia BIT. Three Chinese companies invested in a joint venture called Tumturei Ltd. with BLT LLC, a Mongolian company holding a license to exploit certain iron ore deposits, to commercially develop an iron ore mine in Mongolia. This license was duly transferred from BLT LLC to Tumturei in 2005 and iron ore production commenced in early 2006. Largely due to the then-higher price of iron ore, the new Mongolia government began efforts in 2006 to find a way to take back their now-valuable mining concession. The license was later revoked and claimed by Mongolia to belong to a domestic SOE. Three Chinese companies claimed that Mongolia unlawfully expropriated their investment. The claim was rejected by the tribunal due to the lack of jurisdiction in an award rendered on 30 June 2017.[26] Three Chinese companies later brought the case to the District Court of Southern New York petitioning for an order to vacate the award.

The third arbitration under a China BIT was *Ping An Life Insurance Company of China v. Kingdom of Belgium*. Ping An, a major Chinese insurance and financial services company, acquired approximately 4.81 percent of shares in Fortis, a Belgian-Dutch company active in banking and insurance sectors, for an aggregate sum of more than 2 billion Euros in 2017 and 2018. Later Belgium acquired all the shares in Fortis Bank (FBB), a Fortis's banking subdivision because it was hit by the international financial crisis in 2008. Ping An was dissatisfied over Belgium's nationalization of FBB and the extremely low compensation and sought compensation in relation to a US$ 2.3 billion write off on its investment in Fortis. Ping An based their claim on breaches of the 1986

[24] *Tza Yap Shum v The Republic of Peru*, ICSID Case No ARB/07/6.
[25] *Tza Yap Shum v Peru*, Decision on Annulment, ICSID Case No ARB/07/06. IIC 677 (2015).
[26] *China Heilongjiang International Economic and Technical Cooperative Corp, Beijing Shougang Mining Investment Company Ltd, and Qinhuangdaoshi Qinlong International Industrial Co. Ltd v Mongolia* (Award 30 June 2017), UNCITRAL, PCA Case No 2010-20.

China – Belgium BIT but relied on the 2009 China -Belgium BIT for jurisdiction.[27] The tribunal rejected Ping An's claim due to a lack of jurisdiction.[28]

The fourth case is *Sanum Investments Limited v. Lao People's Democratic Republic*, in which the Macao-based investor Sanum alleged that taxes imposed by Laos deprived her investment in Laos' gaming industry of several standards guaranteed by the 1993 China-Laos BIT. An *ad hoc* UNCITRAL tribunal seated in Singapore held that it had jurisdiction to hear Sanum's expropriation claims.[29] The Lao Government filed a successful jurisdictional challenge to the Singapore High Court, which overturned the tribunal's ruling and halted the arbitration. However, the high court decision was reversed by the Appellate Court of Singapore. The investor and Laos eventually agreed to an amicable settlement, only to see Sanum initiating a fresh arbitration proceeding against Laos before ICSID in 2017.[30]

In the most recent case of *Beijing Urban Construction Group Co., Ltd. v. Republic of Yemen*, Beijing Urban Construction Group (BUCG), a state-owned enterprise (SOE) in China, won a tender process for the selection of a construction contractor for a new international terminal at Sana's International Airport in Yemen, and entered into a construction contract (in the value of more than US$110 million) with the Yemen Civil Aviation and Meteorology Authority (CAMA) in 2006. The Claimant commenced ICSID arbitration proceedings based on the 2002 China-Yemen BIT alleging that Yemen had unlawfully expropriated its investment by employing military forces and security apparatus to assault and detain the Claimant's employees and to forcibly deny its access to the construction site. The tribunal ruled that it has jurisdiction on the dispute and the case is currently at its merit phase.[31]

The first publicly-known investment claim against China was brought by a Malaysian construction and development company under the 1990 Malaysia-China BIT in May 2011. In the case of *Ekran Berhad v. People's Republic of China*, the dispute concerned the revocation of Ekran Berhad's Chinese subsidiary's 70-year lease of 900 hectares of land in China's Hainan province on the grounds that the investor had failed to develop the land as stipulated in the pertinent local legislation. The arbitration was suspended by agreement a month after being registered and discontinued on unknown terms.[32]

Ansung Housing Co., Ltd. v. China is the second registered case and the first published ICSID case involving China as a respondent State that has proceeded to a substantive

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[27] Qing Ren, "*Ping An v Belgium*: Temporal Jurisdiction of Successive BITs", 31(1) ICISD Review 129 (2016), at 131-132.

[28] *Ping An Life Insurance Company, Limited and Ping An Insurance (Group) Company, Limited v Government of Belgium*, ICSID Case No ARB/12/29.

[29] *Sanum Investments Limited v Lao People's Democratic Republic*, UNCITRAL, PCA Case No 2013-13, Award on Jurisdiction, paras 239-242.

[30] *Sanum Investments Limited v. Lao People's Democratic Republic*, ICSID Case No. ADHOC/17/1.

[31] *Beijing Urban Construction Group Co., Ltd. v. Republic of Yemen*, ICSID Case No. ARB/14/30. The Decision on Jurisdiction, 31 May 2017.

[32] *Ekran Berhad v People's Republic of China*, ICSID Case No ARB/11/15.

hearing and led to an award.[33] The Claimant, a South Korea company Ansung Housing Co Ltd, entered into an investment agreement in 2016 with the Sheyang Harbor Industrial Zone Administration Committee (the Committee) in Sheyang County, Jiangsu Province relating to a golf course and condominium development project. Ansung was unable to start its construction work due to the committee's failure to transfer all the land needed for the construction of the project under the investment agreement. Ansung had no alternative options but to dispose of all its assets in the golf business to a Chinese purchaser at a price significantly lower than the amount Ansung had invested in October 2011. Ansung filed a claim against China for serious financial losses and damages of more than Renminbi 100 million on the basis of the 2007 China-Korea BIT on 7 October 2014.

China's objection on jurisdiction was based on Article 9(7) of the China-Korea BIT (2007) which states that "an investor may not make a claim … if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge that the investor had incurred loss or damage." The key issue before the tribunal was how to calculate the three-year limitation period. The tribunal held that the limitation period began with the investor's first knowledge of the fact that it had incurred loss or damage, not at the date on which it gained knowledge of the quantum of that loss or damage.[34] Based on the facts, the tribunal concluded that the start date is before October 2011, the date on which Ansung "necessarily knew of the fact that it had incurred loss or damage and sold its investment "in order to avoid further losses", and rejected Ansung's argument that the temporal limitation period does not start until it could ascertain its loss or damage after its expectations and plan for the construction had been completely frustrated. The tribunal also found that the ending date was 7 October 2014, the date on which an investor deposits its request for arbitration with ICSID. Therefore, the Tribunal held that Ansung's claim was time-barred and, as such, was manifestly without legal merit since the Claimant submitted its dispute before the ICSID and made its claim after more than three years had elapsed from the date on which the Claimant first acquired knowledge of loss or damage.[35]

On June 21, 2017, a German company Hela Schwarz GmbH initiated a third known ICSID claim against China under the 2003 China– Germany BIT. The case was concerned with the expropriation of its subsidiary Ji'nan Hela Schwarz Food Co. Ltd's legal right to use a parcel of state-owned industrial land in Shandong province for 50 years. Chinse authorities announced in September 2014 that they were taking the land as part of a larger plan to renovate the region and offered to pay roughly $5 million in exchange for the property and buildings. Hela argued that the Chinese authorities

[33] *Ansung Housing Co., Ltd. v. People's Republic of China*, ICSID Case No. ARB/14/25.
[34] *Ansung v China* Award, Para. 110.
[35] Ibid, para. 115.

grossly undervalued their property.[36] In 2018, the ICSID tribunal refused to issue emergency provisions protecting Hela from an expropriation order because China had already carried out the measures.[37]

Despite limited sample of known ISDS cases involving China, certain distinctive legal issues can be identified in the arbitration claims that reached the award stage.

A. Are Chinese State-owned Enterprises Qualifying Investors?

In *Beijing Urban Construction Group Co., Ltd. v. Republic of Yemen,* one of the jurisdictional objections raised by Yemen was that BUCG, being an Chinese SOE, should not be regarded as a "national of another Contracting State" as required by Article 25(1) of the ICSID Convention for the reasons: (i) BUCG was under the direction and control of the Chinese government in carrying out its activities, and (ii) BUCG was empowered to exercise elements of governmental authority in China.[38] BUCG contended that the question of whether or not it qualified under Article 25(1) must be considered in the specific context of the investment that had given rise to the dispute. It argued that its investment in Yemen was made while acting as a commercial enterprise, after participating in a competitive tender, and did not involve the exercise of governmental or public powers. According to BUCG, its structural links to the Chinese government and public functions inside China were irrelevant to its standing as an investor under the ICSID Convention.[39]

The tribunal held that, notwithstanding the fact that BUCG was an SOE, the evidence demonstrated that the Claimant was, in carrying out this work, acting as a commercial contractor and was neither an agent of the Chinese government nor fulfilling governmental functions in the fact-specific context.[40] In this regard, the tribunal found it particularly noteworthy that "BUCG participated in the airport project as a general contractor following an open tender in competition with other contractors. Its bid was selected on its commercial merits. Its contract was terminated, Yemen contends, not for any reason associated with the PRC's decisions or policies but because of BUCG's failure to perform its commercial services on the airport site to a commercially acceptable standard".[41]

Yemen further argued that, under Chinese law, SOEs act effectively under the direction and control of the Chinese government and the Chinese Communist Party (the CCP),

[36] *Hela Schwarz GmbH v People's Republic of China*, ICSID Case No ARB/17/19.
[37] Ibid, Procedural Order 2 (10 August 2018).
[38] *BUCG v. Yemen*, above n 31, para. 29.
[39] Ibid, para. 31.
[40] Ibid, para. 39. The tribunal approach in the BUCG case is perfectly in line with earlier cases that had to deal with the question of state-controlled entities legal standing before investment tribunals. See Julien Chaisse 'State Capitalism on the Ascent-- Stress, Shock, and Adaptation of The International Law on Foreign Investment' (2018) 27(2) *Minnesota Journal of International Law* 339-419.
[41] Ibid. para. 40.

and that this meant that the Chinese government was the ultimate decision-maker for BUCG's operational, management and strategic decisions. In support of its position, Yemen invoked certain features of Chinese law applicable to SOEs generally and BUCG specifically. The tribunal further found that "the assertion that 'the Chinese State is the ultimate decision maker' for BUCG is too remote from the facts of the Sana'a International Airport project to be relevant".[42]

In the case of *China Heilongjiang International Economic & Technical Cooperative Corp. v. Mongolia* , the claimants asserted that they are "qualifying investors" under Article 1(2) of the BIT because they are "economic entities" that are "established and domiciled in the territory of the PRC in accordance with the PRC's laws".[43] In denying Beijing Shougang and China Heilongjiang are "agencies" of the Chinese government or exercise "any element of governmental authority",[44] the claimants made an emphasis on the fact that the BIT does not exclude SOEs from qualifying as investors.[45] Mongolia, however, claimed that Beijing Shougang and China Heilongjiang are not investors as they cannot be classified as "economic entities" under Article 1(2) of the BIT.[46] Mongolia suggested applying a narrow formulation of "economic entities". As the tribunal focused on the "involving" formulation and fork-in-the-road provision to deny jurisdiction, it did not elaborate on the standing of SOEs in the BIT.

B. The Application of Chinese BITs to Investors from Hong Kong or Macau

One recurrent issue in China-related investment disputes is whether individuals or companies from "special administrative regions" of China, Hong Kong and Macau, should qualify as a "Chinese investor" under Chinese BITs. The wording of PRC investment treaties typically protects PRC nationals or companies, without elaborating on the criteria for establishing nationality of individual and corporate investors in Hong Kong and Macau. The issue is further complicated by the fact that Macau and Hong Kong still have their own independent investment treaties with some countries - as highlighted recently by *Philip Morris v. Australia*, in which Philip Morris Asia Limited, the claimant, attempted to use the Hong Kong-Australia BIT as a basis for challenging Australia's Tobacco Plain Packaging Act.[47]

Two arbitral tribunals have answered this question in the affirmative. In *Tza Yap Shum v. Peru*, Peru argued that, by virtue of Tza's residency in Hong Kong, he lacked standing to assert a claim under the Peru-China BIT. Peru made two objections to Tza's nationality. First, the Claimant failed to prove his Chinese nationality. Second, a copy

[42] Ibid. para. 43.
[43] *China Heilongjiang International Economic and Technical Cooperative Corp v Mongolia,* above n 26, para. 228.
[44] Ibid, Para. 276.
[45] Ibid, Para. 274.
[46] Ibid, Para. 269.
[47] Christopher Knaus, 'Philip Morris Cigarettes charged millions after losing plain packaging case against Australia', The Guardian (10 July 2017).

of the passport issued by the government of the Hong Kong Special Administrative Region, as Peru claimed, was not sufficient evidence of the Claimant's nationality.[48]

The Tribunal technically relied upon both Article 25 of the ICSID Convention and the Peru-China BIT to establish its jurisdiction for "disputes arising out of an investment between a Contracting State and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the ICSID."[49] As Article 25 does not explicitly exclude Chinese nationals resident in Hong Kong, and "China has not excluded Hong Kong by written notice from the application of the ICSID Convention" in accordance with Article 70 therein,[50] all Chinese nationals including Hong Kong residents are therefore included in the scope of Article 25 of the ICSID Convention. In connection with the Peru-China BIT, the definition of "investor" in respect to China refers to "natural persons who have nationality of the PRC in accordance with its laws …". Neither this definition nor any other provisions exclude Hong Kong residents from the scope of application thereof. In applying Article 31 of the Vienna Convention on the Law of Treaties (the "Vienna Convention"), the Tribunal is bound to interpret the Peru-China BIT "in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in its context and in the light of its object and purpose." In other words, the Tribunal underscores the explicit intention expressed by China and Peru in the BIT which did not impose any additional requirements to the term "investor."[51] The Tribunal's position is clear that the nationality is fundamentally a question of domestic law and the Tribunal must strictly apply domestic laws.

The Tribunal's ultimate dismissal of Peru's objections to the Claimant's Chinese nationality effectively established the jurisprudence that a Hong Kong resident holding Chinese nationality, depending on the language of the BIT in question, is not only able to bring an investment treaty claim under a Hong Kong BIT but also a Chinese BIT. By contrast, a Hong Kong resident who is not a Chinese national would not be able to invoke Chinese BITs, while a Chinese national who is not a resident of Hong Kong could not invoke Hong Kong BITs. This is confirmed by the Hong Kong BIT which usually protects "physical persons who have the right of abode in its area."[52]

More recently, in the case of *Sanum v. Lao Republic*, an UNCITRAL tribunal held in 2013 that a Macau-incorporated company could take advantage of the China-Laos BIT. The tribunal found that allowing Macanese investors to benefit from the 1993 China-Laos BIT by extending its application to the Macau SAR was compatible with the object and purpose of the treaty. This holding, according to tribunal, was further reinforced by the fact that this extension does not impose communist values to Macau

[48] *Tza Yap Shum v The Republic of Peru* Award, above n 24, para. 44.
[49] Ibid, para. 70.
[50] Ibid, footnote 29.
[51] Odysseas G. Repousis, 'On Territoriality and International Investment Law: Applying China's Investment Treaties to Hong Kong and Macau', (2015) Michigan Journal of International Law 113.
[52] Thailand-Hong Kong BIT, Article 1(4)(b)(i).

as the latter is protected by the "one country, two systems" principle.[53] The ruling was the subject of a main challenge by the Laos government in the courts of Singapore where the arbitration was based. In 2015, a single judge of the Singapore High Court annulled the jurisdictional ruling, holding that Macau investors could not avail themselves of the BIT because the PRC-Laos BIT does not apply to Macau. But on 29 September 2016, Sanum prevailed in its appeal against the High Court's decision before a 5-judge Court of Appeal of Singapore (SGCA), Singapore's highest court.

The question the SGCA had to struggle with was whether the PRC-Laos BIT became applicable to Macau following the handover from Portugal to PRC in 1999. After an extensive review of the evidence, including the 1987 PRC-Portugal Joint Declaration on the question of Macau, the PRC's dealings with the UK in relation to Hong Kong, and various publications from the United Nations and the WTO, The SGCA found that there was "nothing in the text, the objects and the purposes of the PRC-Laos BIT, or in the circumstances of its conclusion that points to an intention to displace the "moving treaty frontier" rule such that it would lead to the conclusion that the BIT does not apply to Macau". The SGCA therefore held that "the PRC-Laos BIT will be presumed to automatically apply to the territory of Macau upon restoration of Chinese sovereignty with effect from 20 December 1999".[54] Notably, even though the Lao Government produced formal diplomatic correspondence between itself and the PRC in 2014 and 2015 expressing both governments' views that the PRC-Laos BIT was not applicable to Macau, the Court declined to place any weight on such evidence, which was only adduced only after Sanum's commencement of the arbitration proceedings.[55]

The SGCA's ruling does not quell the controversy. In October 2016, the PRC's Ministry of Foreign Affairs reacted to the ruling by issuing a statement criticizing the judgment and reiterating its position that only mainland Chinese investors are entitled to treaty protection of PRC treaties and that Hong Kong and Macau investors should not be allowed to take advantage of Chinese nationality for such purposes. Given how much of the *Sanum* judgment was focused on the particular facts of the case, it remains unclear how future tribunals or courts will approach the territorial scope of different PRC treaties in different contexts. While clarifying that *post-hoc* documents that retroactively alter the scope of those treaties will be not be given effect, the Court also confined its findings to the features of the particular PRC-Laos BIT. The Court appeared to accept *obiter* that, had the PRC-Laos BIT, like NAFTA, permitted the States to issue binding interpretive statements, the 2014 NVs might have resulted in a different outcome. The effect of binding interpretive statements is far from noncontroversial, having on occasion sparked rebuke from Tribunals that have seen it as a way for Contracting States to avoid liability.[56] Commentators have also noted that some interpretative statements are tantamount to retroactive amendments, which may

[53] *Sanum vs Laos*, above n 29, paras 243-251.
[54] *Laos v Sanum* [2016] SGCA 100-121.
[55] Ibid.
[56] *Pope & Talbot v Canada*, Award in Respect of Damages, 31 May 2002.

undermine the rule of law.[57]

C. Broad or Narrow Interpretation of Restrictive ISDS Clauses

Early Chinse BITs limit international arbitration only to disputes involving the quantum of compensation payable in the event of an expropriation. The phrase "involving the amount of compensation for expropriation" was therefore a heavily contentious issue between Tza and Peru in the case of *Tza Yap Shum v. Peru*. Article 8(3) of the Peru-China BIT provides: "a dispute involving the amount of compensation for expropriation may be submitted at the request of either party to the international arbitration of the ICSID." Peru interpreted "involving" as meaning "limited to" or "exclusively." Based upon such a restrictive interpretation, the dispute that can be arbitrated merely covers "disputes related to the determination of the value of the investment" but excludes such "potentially important matters" as "whether expropriation has taken place" and "whether any compensation must be paid."[58] Therefore, Peru made the most significant challenge to jurisdiction: Tza's claims fell outside of the scope of Article 8(3) of the BIT; and the Tribunal did not have jurisdiction over liability of expropriation to determine if Peruvian tax authority's actions constitute an expropriation of Tza's investment in TSG. The Claimant, on the contrary, expanded to "the other end of the interpretation spectrum" so that "a determination of other important matters related to the alleged expropriation" is also allowed.[59]

In resolving such a core interpretation issue, the Tribunal adopted its ordinary meaning approach, relied upon the Oxford Dictionary, which defines the word "involving" as meaning "to enfold, envelope, entangle, include."[60] This led the Tribunal to endorse the Claimant's "broadest interpretation" as the "most appropriate" approach.[61] The Tribunal found that a narrow interpretation of "involving the amount of compensation" would invalidate the arbitration clause. This narrow interpretation, the Tribunal contended, would make the host state's consent to arbitration illusory since the investor could not actually have access to arbitration unless the host state agreed to allow it.[62] As a result, given the sub-elements (of expropriation) listed in Article 4 of the BIT and the inclusive nature of the phrase "involving," the Tribunal drew the broadest spectrum and permitted arbitration of claims concerning all aspects of expropriation.[63]

Similarly, in the case of *Sanum v. Laos*, one of Laos' major jurisdictional objections were that Sanum's claims fell outside the scope of the dispute resolution clause in Article 8(3) of the PRC-Laos BIT on the ground that the clause only permits arbitration

[57] Kaufmann-Kohler, 'Interpretive Powers of the Free Trade Commission and the Rule of Law' in Emmanuel Gaillard and Frederic Bachand, *Fifteen Years of NAFTA Chapter 11 Arbitration* (JurisNet LLC, 2011) 190-192.
[58] *Tza Yap Shum v The Republic of Peru* Award, above n 24, para. 150.
[59] Ibid, para. 150.
[60] Ibid, para. 151.
[61] Ibid, para. 150.
[62] Ibid, para. 148.
[63] Ibid, para. 152.

where the issue in dispute is the amount of compensation payable upon on expropriation but not the liability itself. The Tribunal concluded that the arbitration clause made the existence of an expropriation arbitrable based on similar reasons advanced in *Tza Yap Shum v. Peru*. In particular, the tribunal found that a limitation of the dispute settlement clause to arbitration of disputes solely over the amount of compensation for expropriation would leave the clause *effect utile*. This is because an investor who would have recourse to a competent national court to determination whether an expropriation has occurred would be precluded from submitting the dispute on the amount of compensation to international arbitration pursuant to the fork-in-the-road provision, as national court would have already determined the compensation.[64]

When Laos initiated proceedings to set aside the award on jurisdiction rendered in *Sanum v. Laos* in the high court of Singapore, the high court rejected the broad interpretation of the tribunal and advocated a restrictive meaning of the phrase 'a dispute involving the amount of compensation'.[65] The high court considered that it was not correct to conclude that an investor would be precluded from arbitration if Article 8(3) of the PRC-Laos BIT was interpreted restrictively. Essentially, the high court reasoned that the arbitration clause would still be useful in cases in which it is undisputed that an expropriation occurred.[66]Moreover, the high court pointed to the historical context of China's earlier BITs. In its view, the restrictive dispute settlement clause was a reflection of China's distrust of international arbitration at the time when the BIT was concluded. This is in sharp contrast to China's more recent BITs which allows any investor-state dispute to be arbitrated.[67]

On appeal, the SGCA overturned the high court and accepted the broad reading approach instead.[68] According to Article 31 of the VCLT, the SGCA considers the interpretation of Article 8(3) in light of its ordinary meaning, context, object and purpose. The Court held that "the Lao Government's interpretation of Art 8(3) of the PRC-Laos BIT is not tenable" in the context of the PRC-Laos BIT, which contained a "fork-in-the-road" provision to the effect that once an expropriation claim is referred to the national court, no aspect of that claim can then be brought to arbitration. In this regard, the Court was mindful that cases of direct expropriation were becoming increasingly rare, and even in those rare cases with only amounts of compensation being in dispute, host States could effectively avoid arbitration by simply denying that they had engaged in expropriation. Echoing the arbitral tribunal's sentiments in *Tza Yap Shum v. Peru*, the Court observed that this "would lead to an untenable conclusion – namely that the investor could never actually have access to arbitration".[69] In addition,

[64] *Sanum v Laos*, above n 29, paras 340-342.
[65] *Laos v Sanum Investments Ltd* [2015] SGHC 15, para 121.
[66] Ibid. para 122.
[67] Ibid, para 126.
[68] *Laos v Sanum* [2016] SGCA 57.
[69] *Tza Yap Shum v The Republic of Peru* Award, above n 24, para. 133.

the Court agreed with Sanum that the broad interpretation of Art 8(3) "is also consistent with the BIT's objective of promoting investments and protecting investors" [70]

The tribunal in the case of ***BUCG v. Yemen*** followed the suit of *Tza Yap Shum v. Peru* and *Sanum v. Laos*. In the award handed down on 31 May 2017, the tribunal held that it had jurisdiction on the basis that a clause in the China-Yemen BIT granting jurisdiction over "any dispute relating to the amount of compensation for expropriation" covered both quantum and liability issues arising out of alleged expropriation. The tribunal found that a narrow interpretation that excluded disputes over liability for expropriation would lead to an "internal contradiction" and allow the host state unilaterally to deny an investor's access to investment arbitration simply by refusing to concede liability.[71] The conclusion drawn by the tribunal is that the Contracting Parties intended to confer a real choice, not an illusory choice, on investors from their respective countries, and that the words 'relating to the amount of compensation for expropriation' must, in context, be read to include disputes relating to whether or not an expropriation has occurred.

By contrast, the Tribunal in *China Heilongjiang International Economic & Technical Cooperative Corp. v. Mongolia* rejected the broad interpretation and adopted a diametrically opposed approach when faced with the same interpretative question in connection with Article 8(3) of the China-Mongolia BIT.[72] The Tribunal in this case adopted an extremely narrow construction. In its view, the only matter that is arbitrable is the amount of compensation for an expropriation, and that it lacks jurisdiction with regard to an examination of the legal issues of whether an expropriation has actually occurred.[73]

The tribunal considered that conclusions reached by the three tribunals *Tza Yap Shum v. Peru*, *Sanum v. Laos,* and the ***BUCG v. Yemen*** and the SGCA are principally based on the grounds of *effect utile*.[74] However, the tribunal in *Heilongjiang v Mongolia* did not share this concern. It states that arbitration will be available in direct expropriation where the occurrence of expropriation is untested by the host state and the dispute is indeed limited to the amount to be paid by the host state to the investor for its expropriated investments, as well as in indirect expropriation where an investor, in host state's national courts, had expressly sought to reserve the question of compensation

[70] SGCA distinguished a number of arbitral awards relied upon by the Lao government, where arbitral tribunals had arrived at narrow interpretations of dispute resolution clauses that also referred to "the amount of compensation." SGCA paid particular attention to the differences in language and architecture of the various BITs under consideration, as well as the interpretative context, placing particular emphasis on whether the BITs under expressly demarcated the determination of the legitimacy of the expropriation from the amount of compensation, and whether there was a fork-in-the-road provision.

[71] *BUCG v. Yemen*, above n 31, paras 78-87.

[72] Bajar Scharaw, "The (provisional) end of debates on narrow dispute settlement clauses in PRC first-generation BITs?- *China Heilongjiang et al v Mongolia*", 34 Arbitration International 293 (2018), at 302-305.

[73] *China Heilongjiang International Economic and Technical Cooperative Corp v Mongolia,* above n 26, paras 435-454.

[74] Ibid, para 447.

for ad decision in arbitration.[75] While the tribunal recognized that these scenarios were uncommon, they support the argument that the restrictive ISDS clause will be not be rendered *effect utile* by adapting an exceptionally narrow interpretation, and that a narrow interpretation reflects what China and Mongolia agreed to when they concluded the BIT in 1991.[76]

D. MFN Treatment and ISDS Clauses in Other BITs

It has been argued that a MFN clause has a multilateralizing effect as it is operated in a way to extend the greatest protection offered by a state in a single BIT to the beneficiaries of all of its BITs.[77] As the MFN treatment clauses in the BITs usually grant investors, as regards 'management, maintenance, use, enjoyment or disposal of their investment', no less favourable treatment, it is always controversial if the investor can invoke the MFN obligation to enjoy the more favourable dispute resolution provisions in other BITs, which may include consent to ICSID arbitration as an option for all disputes. Arbitration practice indicates that the broader the language used, the more likely that the tribunal will extend the MFN standard to cover procedural rights. For instance, the investors may make use of the MFN treatment in some cases to bypass procedural impediments, *i.e.* the requirement to resolve the dispute in the local courts first.[78] It has been confirmed in other cases that the MFN treatment may be relied upon to broaden the tribunal's jurisdiction, from disputes relating to the amount or payment of compensation as under the basic treaty, to all disputes including the existence of expropriation under a third party BIT.[79] The case law in this respect, however, is highly divergent.[80]

Unlike these earlier inconsistent cases, the tribunals in China-BIT-related cases have decided consistently to reject the extension of MFN clause to procedural rights in other BITs. Moreover, the tribunals have employed the same interpretative techniques in their reasoning.

In *Tza Yap Shum v. Peru*, the tribunal was faced with the claimant attempts to extend the scope of jurisdiction to issues not covered by the arbitration clauses in the disputed

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[75] Ibid, paras 448-449.
[76] Ibid, para 451.
[77] Stephen Schill, *The Multilateralization of International Investment Law* (CUP, 2009) 65-106, 121-196.
[78] *Emilio Agustin Maffezini* v. *Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Objections to Jurisdiction of 25 January 2000.
[79] *RosInvestCo. UK Ltd v. Russian Federation*, SCC Case No. Arb. V079/2005. Matthew C. Porterfield, "Exhaustion of Local Remedies in Investor-State Dispute Settlement: An Idea Whose Time Has Come?, (2015) Yale Journal of International Law Online, Vol. 41, Fall 2015, available at https://ssrn.com/abstract=2735036.
[80] *Kilic Insaat Ithalat Ihracat Sanayi ve Ticaret Anonim Sirketi v. Turkmenistan,* ICSID Case No. ARB/10/1; *Joseph C. Lemire v Ukraine*, ICSID Case No. ARB/06/18; *Amboiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9.*; Plama v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005; *Maffezini v Spain*, ICSID Case No. ARB/97/7, Award on Jurisdiction, 25 January 2000; Salini et al v. Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001, 42 I.L.M. 609 (2003).

China-Peru BIT according to the Peru-Columbia BIT with a more liberal jurisdiction *ratione materiae*.[81] The MFN clause in the China-Peru BIT provides: "The treatment and protection referred to in Paragraph 1 of this Article [fair and equitable treatment] shall not be less favourable than that accorded to investments and activities associated with such investments of investors of a third State." It is clear from the text that the MFN clause merely applies to fair and equitable treatment and constant protection but not to all matters under the BIT. Further, the tribunal found that the submission to investor-state arbitration in Article 8(3) reflected the parties' agreement on two fundamental issues – agreement to submit expropriation disputes to ICSID arbitration and that specific agreement would be needed to submit other types of disputes to ICSID arbitration.[82] The tribunal therefore determined that the "specific wording of Article 8(3) should prevail over the general wording of the MFN clause in Article 3.[83] The tribunal was self-disciplined, largely by sticking to the "best indicator" of the "intention of the parties expressed in the text",[84] not to over exaggeratedly broaden its discretion without having any clear textual support in the disputed BIT.[85]

In *Beijing Urban Construction Group Co Ltd. v. Republic of Yemen*, one issue was whether the claimant was entitled to bypass the restrictive dispute clause confining international arbitration to "the amount of compensation for expropriation", and to import a broader dispute resolution clause from the Yemen-UK BIT to expand the scope of jurisdiction to include non-expropriation claims.[86] The tribunal held that the wording of the MFN clause is tied to activities that took place "in the territory" associated geographically with the investment. Thus the MFN clause could not be used by the tribunal to import jurisdiction over matters that are beyond the Yemen-China BIT.[87]

In *Ansung Housing Co., Ltd. v. China*, Ansung sought to invoke the MFN clause to save its claim from being time-barred as other Chinese BITs do not prescribe a three-year limitation period within which an investor is required to initiate an arbitration claim against the host state.[88] Relying upon a plain reading of the MFN clause,[89] the tribunal held that the MFN clause did not extend to a state's consent to arbitrate with investors

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[81] *Tza Yap Shum v. Republic of Peru*, ICSID Case No. ARB/07/6, Decision on Jurisdiction and Competence of June 19, 2009, paras. 189-190.

[82] Under Article 8(3) of the BIT, the tribunal's jurisdiction is limited to expropriation. Jurisdiction over all other matters is subject to specific agreement. Those "other matters" include the interpretation of the MFN clause in the first place. This means that the tribunal actually lacks the subject matter jurisdiction to consider whether MFN can be applied to expand subject matter jurisdiction.

[83] *Tza Yap Shum v. Republic of Peru*, Para. 216.

[84] Ibid. para. 206.

[85] However, the tribunal appeared to be mistaken in its reasoning. The tribunal took an effect utile approach by differentiating between the application of the MFN clause based on an a priori categorization of general and specific provisions. This is unsound as the purpose of the MFN clause is to establish and maintain at all times fundamental equality without discrimination among all the countries concerned.

[86] *BUCC v. Republic of Yemen*, ICSID Case No. ARB/14/30, Decision on Jurisdiction, para. 110.

[87] Ibid, para. 120.

[88] *Ansung Housing Co., Ltd. v. People's Republic of China*, ICSID Case No. ARB/14/25, paras. 125-126.

[89] China-Korea BIT (2007), Art. 3(3).

nor to the temporal limitation period for investor-state arbitration.[90] Further, the tribunal pointed out that the BIT offers specific MFN protection in relation to an investor's "access to courts of justice, administrative tribunals and authorities," without making any reference to international dispute resolution such as arbitration under the BIT.[91] Accordingly, the tribunal upheld the application of the limitation period in Article 9(7) of China-South Korea BIT.[92]

In response to the debate on the extension of MFN clause to dispute settlement clauses, recent Chinese BITs have tried to eliminate all potential controversies by making clear that the MFN treatment does not cover the procedural rights to dispute settlement. For example, the relevant provision in the New Zealand–China FTA reads:

> For greater certainty, the obligation in this Article does not encompass a requirement to extend to investors of the other Party dispute resolution procedures other than those set out in this Chapter.[93]

Similarly, there is a clarification in the EU-Canada CETA that MFN treatment will not be extended to dispute settlement provisions, which effectively avoids any *Maffezini*-like interpretations of the MFN clause.[94]

III. Understanding and Rationalizing China's Position on ISDS Reform

In recent years, ISDS has suffered a "legitimacy crisis" due to a number of reasons.[95] These include, but not limit to, the pro-investor interpretation of substantive treaty protections, inconsistency and unpredictability of decisions, chilling effects on state regulatory powers, lack of transparency, high costs that result in the diversion of public money from public goods and services, bypassing national judicial systems which might provide appropriate legal protection, self-interested arbitrators to overrule governments with no right of appeal.[96] Take inconsistent decisions as an example. The tribunals are found to be inconsistent in interpreting and applying the same clauses in the same investment treaty. A variety of investment arbitration cases such as the *CMS* case, *the LG & E* case, *the Continental Casualty* case were decided, which all related to the fundamental security exception clauses of the US-Argentina BIT. Although the

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[90] *Ansung Housing v China*, paras 140-141.
[91] China-Korea BIT (2007), Art. 3(5).
[92] *Ansung Housing v. China*, paras. 136-141.
[93] New Zealand–China FTA, Art. 139(2).
[94] Article X.8(4). *Maffezini v. Spain*, ICSID Case No ARB/97/7, Decision on Jurisdiction, 25 January 2000, paras. 38-64. See, among others, Martins Paparinskis, 'MFN Clauses and International Dispute Settlement: Moving Beyond Maffezini and Plama?' (2011) ICSID Review-Foreign Investment Law Journal 14-58; Yannick Radi, 'The Application of the Most-Favoured-Nation Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the "Trojan Horse"' (2007) 18 Eur. J. Int'I L. 757-774.
[95] Susan D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions', (2005) 73 Fordham Law Review 1521.
[96] Sergio Puig and Gregory Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law', 112 AJIL 361 (2018), at 366.

tribunals in these cases applied the same clause, the awards rendered in these cases were inconsistent on the issue whether Argentina can invoke the fundamental security exception.[97] Given the severity of these defects, states such as EU, US and China have put forward various proposals calling for a larger and deeper scale of reforms so that the efficiency and legitimacy of the investor-state arbitration system can be improved.[98]

A. Three Camps of Reformers

Before we delve into China's position paper, it is useful to offer a brief overview of the ISDS reform proposals made by other major powers. Based on a widely shared consensus that the traditional model of ISDS needs to be modernized in response to mounting criticisms by states and civil society alike, Roberts has identified three main camps, incrementalists, systemic reformers and paradigm shifters, that have emerged with distinct proposals.[99]

The main supporters of an incremental reform of the current ISDS are Japan and to some extent the United States.[100] This camp favors to retain the ISDS and downplays the criticisms levelled at it as 'perceptions rather than reality'.[101] Even though they recognized there are some outstanding problems to be addressed, they prefer to adopt small to moderate adjustments and more targeted reforms. For example, to address the problem of inconsistent rulings from different tribunals at different forums, incrementalists view it either as a natural and positive consequence of the bilateral nature of BITs or something can be rectified by adopting more precise and detailed treaty language or authoritative interpretations.[102] The typical example of such an approach is best represented by the recently negotiated Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The CPTTP includes ISDS provisions but limits claim for "indirect expropriation, allows governments to elect to deny the benefits of ISDS for any claims against tobacco control measures or on contracts foreign investors enter into with governments, and some CPTTP Parties have signed 'side letters' further restricting ISDS use.[103]

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[97] In CMS Gas Transmission Company v. The Republic of Argentine, (ICSID Case No. ARB/01/8), the Tribunal did not support Argentine defense of essential security exception. However, in LG&E Energy Corporation, LG&E Capital Corporation and LG&E International Inc. v. The Argentine Republic, (ICSID Case No. ARB/02/1) and Continental Casualty Company v. The Argentine Republic, (ICSID Case No. ARB/03/9), the Tribunal did support Argentine defense of essential security exception.

[98] Anthea Roberts, "The Shifting Landscape of Investor-State Arbitration: Loyalists, Reformists, Revolutionaries and Undecideds", (15 June 2017) available at www.ejiltalk.org/the-shifting-landscape-of-investor-state-arbitration-loyalists-reformists-revolutionaries-and-undecideds/

[99] Roberts, above n 17, at 410.

[100] Yuka Fukunaga, 'ISDS under the CPTPP and Beyond: Japanese Perspectives', Kluwer Arbitration Blog (May 30, 2018).

[101] Anthea Roberts & Zeineb Bouraoui, UNCTIRAL and ISDS Reform: What are States' concerns? EJIL:TALK! (June 5, 2018), available at:https://www.ejiltalk.org/uncitral-and-isds-reforms-what-are-states-concerns/

[102] Anthea Roberts and Zeineb Bouraoui, UNCITRAL and ISDS Reforms: Concerns about Consistency, Predictability and Correctness, EJIL:TALK! (5 June 2018), available at https://www.ejiltalk.org/uncitral-and-isds-reforms-concerns-about-consistency-predictability-and-correctness/

[103] New Zealand Foreign Affairs & Trade, Investment and ISDS.

The US position on ISDS reform is a mixed bag but largely falls into this camp. Many US international trade and investment agreements as well as the 1984, 2004 and 2012 Model Bilateral Investment Treaties have included ISDS mechanisms.[104]The USTR in Obama Administration expressly stated that it will expand the use of ISDS in negotiations because it is one element to achieve the US goal that American investors investing abroad are provided the same kinds of basic legal obligations that the US provides to both American and foreign investors within the US.[105] The current Trump Administration, however, seems to take a more cautious position. The USTR Robert Lighthizer lambasted ISDS in the context of United States-Mexico-Canada Agreement (USMCA) negotiations, even though the U.S. has an unbroken winning record of all 11 ISDS cases and there are currently no active claims against the U.S.[106] Similar to CPTTP, the USMCA has limited the application of ISDS provisions in its investment chapter.[107] Moreover, the US agreed with Canada that the ISDS clauses in the USMCA are not applicable to the investment disputes between them (but still apply between Mexico and these two countries). A prima facie reason for this exclusion is that Canada has been sued more often than either Mexico or the U.S under the investment provisions in USMCA's predecessor NAFTA.

Systemic reformers move one step further compared to incrementalists. They see merit in retaining the ISDS based on its oft-repeated advantages. However, they view the current ISDS as seriously flawed and argued for systematic and structural reforms. The key advocates for this camp are the EU and Canada. They highlight the legitimate concerns such as *ad hoc* arbitral appointments and inconsistent and unpredictable treaty interpretations and push for more systematic reforms. Take the EU as an example. In 2015, the European Commission proposed establishing a permanent multilateral investment court (ICS) to replace ISDS provisions. The new system retains the standing of private investors to file claims directly against states, but it effectively creates a tribunal of first instance and an appellate body, with the judges having fixed terms, paid a regular salary, and selected on a random basis from a roster designated by states.[108] The European Union has already concluded agreements containing such a system with Canada, Singapore, Vietnam and Mexico. In the CETA, while maintaining the

https://www.tpp.mfat.govt.nz/assets/docs/TPP_factsheet_Investment.pdf (last accessed on 25 September 2019).

[104] Christopher A. Casey, 'The End of Intra-EU Investor-State Dispute Settlement (ISDS): Implications for the United States', CRS Insight (13 February 2019).

[105] USTR, The Facts on Investor-State Dispute Settlement, available at: https://ustr.gov/about-us/policy-offices/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors (March, 2014).

[106] Scott Sinclair, "Canada's Track Record under NAFTA Chapter 11, North American Investor-State Disputes to January 2018", https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2018/01/NAFTA%20Dispute%20Table%20Report%202018.pdf (visited November 10, 2018).

[107] Ronald Labonte at al., 'USMCA (NAFTA 2.0): Tightening the Constraints on the Right to Regulate for Public Health', 15 Globalization and Health (2019), at 44.

[108] Colin M. Brown, 'A Multilateral Mechanism for the Settlement of Investment Dispute: Some Preliminary Sketches', 32 ICSID Review- Foreign Investment Law Journal 637 (2017),

investment arbitration under the ICSID and UNCITRAL arbitration rules, the EU establishes a standing arbitration tribunal that consists of fifteen members to conduct preliminary arbitration and appellate arbitration for the investor-state disputes. The CETA has made detailed provisions on the constitution of the standing arbitral tribunal, the appointment and term of service of an arbitrator, the application of law in the dispute settlement, the interim measure, the conditions for the appeal, the integrity of the arbitrator, and the recognition of the arbitral award.[109]

In addition, CETA has meticulous provisions addressing various problems such as handling possible parallel procedures under CETA and other international agreements, revealing third-party funding for arbitration, sharing of information, understanding of non-disputing parties, and the oppositions in early hearings.[110] It particularly entrusts the respondent state with the right to petition for a non-legal dispute, and the fast-track award by the tribunal if the claim involves no legal issue. These provisions help prevent the investor from abusing the proceeding and improve the efficiency of dispute resolution mechanisms.

Paradigm shifters hold the most critical view of the ISDS, dismissing it as irrevocably flawed and argue for the need for a fundamental overhaul of the current system. In practice, this mostly means going back to the past before the existence of ISDS. For example, Brazil championed investment facilitation agreement where an ombudsman is given powers to resolve disputes between investors and host states. If dispute persists, then pre-agreed state-to-state arbitration will come into play.[111] South Africa terminated most BITs and permit foreign investors to sue in domestic courts or bring mediation claims against the host government. If dispute cannot be resolved, South Africa may later consent to state-to-state arbitration.[112]

B. Analysis of China's Position on ISDS Reform

On 19 July 2019, China submitted a proposal on ISDS reform to UNCITRAL. In its proposal, China not only reaffirms its commitment to ISDS as an important mechanism for resolving investor-state disputes, but also suggests various pathways for reform of the ISDS.[113] This is the first time that China unveils its official attitude towards ISDS and its position on ISDS reform.

First, China makes it clear at the beginning of its submission that it supports the maintenance of the ISDS mechanism. China views the present ISDS as playing an

[109] CETA, Article 8.27.
[110] CETA, Articles 8.24, 8.26, 8.37, 8.38 and 8.36.
[111] Geraldo Vidigal and Beatriz Stevens, 'Brazil's New Model of Dispute Settlement for Investment: Return to the Past or Alternative for the Future?' 19 Journal of World Investment and Trade 475 (2018), 487-489.
[112] Roberts, above n 17, at 417.
[113] Note by the UN Secretariat, Possible Reform of Investor-State Dispute Settlement: Submission from the Government of China (July 8, 2019), A/CN.9/WG.III/WP.177.

important role in protecting the rights and interests of foreign investors and promoting cross-border investment. In addition, China stresses that role of ISDS in promoting rule of law in international investment governance and avoiding politicalisation of investment disputes.[114]

Second, China concurs with other countries that the current ISDS mechanism is deficient and requires reform. China points out the same problems that many have criticized extensively: lack of an appropriate error-correcting mechanism; lack of stability and predictability in arbitral awards; arbitrator's professionalism and independence; small pool of investment arbitration lawyers and arbitrators; third-party funding; lengthy and costly ISDS processes.[115] China's criticism of the current ISDS mechanism is partly based on China's experience viewed in part II of this chapter. The contradictory interpretation of the restrictive ISDS clause in China's first-generation BITs and China's disagreement with tribunals on the application of Chinese BITs to companies incorporated in Hong Kong and Macau are typical examples. Also notable are what China has not criticized at the current ISDS system: the pro-investor jurisprudence at the cost of state regulatory autonomy and chilling effect it may have on host state's social regulations that many other countries have complained about.

Finally, in view of the problems identified, China makes it clear that it supports a multilateral and flexible approach to ISDS reform. In particular, China has made 6 specific reform options. These include (1) permanent appellate mechanism with fixed procedures, institutions, and staff; (2) safeguarding the right of the parties to appoint an arbitrator; (3) improving rules governing the arbitrators' qualifications, conflicts of interest, and selection and removal procedures; (4) establishing alternative dispute resolution measures such as conciliation; (5) three to six months of compulsory consultation between the complainant investor and the central government of the host country prior to the commencement of arbitration proceedings; and (6) transparency disciplines for third-party funding.[116]

Our primary observation is that China's approach to ISDS reform must be understood from cultural, empirical and policy perspectives. But it is fair to say that China's publication of this position paper itself, regardless of the content therein, is reflective of China's gesture of its more strategic engagement with the ISDS, which is largely interconnected with China's more active outbound investment activities partially along with the Belt and Road. Having a fairer, more efficient and transparent ISDS at either global, regional or even bilateral level is in the best interest of China as a major capital importing and exporting state in the world.

To begin with, vast amount of Chinese ODI via the belt and road initiative, sometimes in countries with fragile rule of law systems, highlights the importance of foreign

[114] Ibid, at 2.
[115] Ibid, at 2-3.
[116] Ibid, 4-5.

investment protection and ISDS provides a useful international dispute settlement mechanism that China urgently needs. It promises to provide Chinese investors with an enforceable procedural remedy against infringing host states.[117] By taking this position, China distances itself from countries such as Brazil and South Africa that advocate a 'paradigm shifting' in ISDS reform. Furthermore, empirically, two trends have played a key role in China's formulation of its position. Firstly, ISDS clause has already become a standing feature of Chinese BITs since 1998. Secondly, China has up to date rarely been a defending party in ISDS disputes and has never lost a single case. We argue that it is precisely because China's limited exposure to ISDS proceedings that prompts China to take a more proactive attitude towards ISDS. It must be cautioned, however, that consistent with China's economic rise, the number of cases involving China looks set to rise in coming years.

Next, China's internal stress on the rule of law has led to its continuous expansion of the limited protection to investors[118] and liberalisation of previously restrictive rules China has made so much progress in the past thirty years that China's BIT rules are already closer to the Western practice. Consequently, the risk of Chinese government triggering ISDS mechanism is very low. This point is best illustrated through China's position on expropriation in its BIT practice. After amendment of Chinese constitutional law in 2004 and passing of the Chinese Property Rights Law in 2007, illegal expropriation is unlikely to happen in contemporary China.[119]

Finally, although China belong to the reformist camp, it is challenging to put China in either incrementalist or systemic reformers camp. It is probably fair to label China as an "aggressive incrementalist". On the one hand, though China supports the establishment of a permanent appellate mechanism, it does not go so far as to endorsing the EU's two-tier permanent multilateral investment court proposal and prefers to retain investors' right to appoint arbitrators. On the other hand, China has indeed pointed out structural problems of ISDS and prefers to reform the ISDS mechanism in some systemic ways. These include not only an appellate mechanism, but also alternative dispute settlement mechanism such as conciliation and compulsory consultation. China's preference for a permanent appellate mechanism is largely modelled on the WTO dispute settlement system. This is of course not surprising as China has long held a favorable view of the WTO and is a frequent user of the system. China's insistence on including alternative dispute settlement methods such as compulsory consultation and conciliation is partially motivated by its Confucius philosophy of resolving disputes in a negotiated and harmonious manner.

IV. Conclusion

[117] Dilini Pathirana, 'Making An Arbitration Claim under Chinese BITs: Some Inferences from Recent ISDS Cases', 5(2) The Chinese Journal of Comparative Law 420 (2017), at 422.
[118] Spencer S. Griffith, "US-China BIT Negotiations March On: The Road Ahead Is Challenging but Worthwhile", (2009) China Brief 13.
[119] Shen Wei, 'Expropriation in Transition: Evolving Chinese Investment Treaty Practices in Local and Global Contexts', 28 (3) Leiden JIL 579 (2015), at 600-601.

This chapter provides an overview of China's interaction with the ISDS over the past thirty years, as well as a critical assessment of China's attitude towards the ISDS reform in the context of its ambitious BRI. After review of the relevant case law involving Chinese BITs, this chapter identified four distinctive legal issues, i.e., Chinese SOEs can be 'investors' and enjoy the protection of BITs; Chinese BITs may be invoked by Hong Kong and Macao residents; the restrictive ISDS clause in early Chinese BITs may be interpreted either expansively or narrowly by tribunals while the majority of tribunals have adopted an expansive approach; and that MFN clause may not be invoked in order to have access to more liberal ISDS clauses in China's recent more liberal BITs. Moreover, this chapter sets out China's official position on ISDS reform and explains the underlying cultural, empirical and policy forces that help shape China's current stance.

China's switch from "light" to more strategic "heavy" engagement with the ISDS goes hand in hand with China's shifting role from a major capital importing state to a key hybrid regime of capital importing and exporting state. This switching position also matches China's more ambitious stance to be part of the global economic governance system reform, evidenced by its set-up of the Asian Infrastructure Investment Bank, BRICs New Development Bank, and, more proactively, the BRI. ISDS reform can be a good opportunity or window for China to voice its ideals in the international investment sphere.

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