Arbitration Under Foreign Investment In China*

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ABSTRACT

Despite the position of China as the 2nd largest investment destination for foreign direct investment, and the 6th largest outward investment country in the world, the number of arbitration or litigation cases conducted in China for settling the investment disputes between foreign parties and Chinese parties is very few. Foreign investors and the international community seem to have no confidence in the arbitration and court systems in China. Not only is it due to China's cultural skepticism towards the law, but also to its underdeveloped court system particularly in the enforcement of arbitration awards. Notwithstanding the efforts Chinese government has taken in improving its judicial and arbitrational scheme , it is still claimed by the foreign investors that the Chinese arbitration system is still locally protective. Therefore, for the purpose of attracting more foreign direct investment and also for preparing its investors "Going Global" for investor-state proceedings in the future, China has adopted a new attitude in concluding Bilateral Investment Treaties by including the investor-state arbitration in its Model Bilateral Investment Agreement and regional treaties, and accepting the jurisdiction of ICSID, or other third party institutions. However, China needs to weigh the advantages and disadvantages brought by these strategic changes. Attracting foreign investment without sacrificing its distinctive national interests and interest of Chinese parties including those of its investors abroad are an onerous task for Chinese leaders to accomplish.

Keywords: Foreign Investment, Arbitration in China, CIETAC, Bilateral Investment Treaties, Enforcement of Foreign Arbitration, Investor – state Dispute

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บทคัดย่อ

ถึงแม้ว่าประเทศจีนจะติดอันดับสองของโลกสำหรับการเป็นจุดหมายปลายทางของการลงทุนของต่างชาติโดยตรงและเป็นอันดับหกสำหรับประเทศที่มีการไปลงทุนในประเทศอื่นนั้น การอนุญาโตตุลาการหรือการพิจารณาคดีที่ดำเนินการในประเทศจีนเพื่อหาข้อยุติสำหรับข้อขัดแย้งที่เกี่ยวกับการลงทุนระหว่างคู่สัญญาที่เป็นชาวต่างชาติกับคู่สัญญาจีนยังถือได้ว่ามีจำนวนน้อยหากเทียบกับปริมาณของการลงทุน ซึ่งดูเหมือนว่านักลงทุนชาวต่างชาติไม่มีความมั่นใจต่อระบบศาลและการอนุญาโตตุลาการในประเทศจีนทั้งนี้มิใช่เพียงเพราะความกังขาในวัฒนธรรมจีนที่มีต่อกฎหมายแต่ความล้าหลังของระบบศาลโดยเฉพาะในการบังคับตามชี้ขาดของอนุญาโตตุลาการ ถึงแม้จะมีความพยายามในการเปลี่ยนแปลงกระบวนการยุติธรรมและการอนุญาโตตุลาการ นักลงทุนต่างชาติยังคงมีความเห็นว่าระบบอนุญาโตตุลาการของประเทศจีนไม่ได้ให้การปกป้องแก่นักลงทุนต่างชาติเท่าที่ควร ดังนั้นจุดประสงค์ที่จะดึงดูดการลงทุนของต่างชาติและเพื่อเป็นการเตรียมการลงทุนของรัฐในอนาคตภายใต้กรอบ “Going Global” ประเทศจีนได้รับแนวคิดใหม่ในการทำข้อตกลงด้านการลงทุนในระดับทวิภาคีและระดับภูมิภาคโดยนำการอนุญาโตตุลาการสำหรับการลงทุนภาครัฐบรรจุเข้าไปใน Model Bilateral Investment Agreement และยอมรับเขตอำนาจของ ICSID หรือสถาบันอนุญาโตตุลาการอื่น อย่างไรก็ตามประเทศจีนคงต้องพิจารณาถึงข้อดีและข้อเสียที่จะตามมาของการเปลี่ยนแปลงกลยุทธ์เหล่านี้ ซึ่งการดึงดูดการลงทุนจากต่างชาติโดยไม่ยอมสละผลประโยชน์ที่สำคัญของชาติไปบ้างและของคู่สัญญาชาวจีนย่อมเป็นความยากลำบากที่ผู้นำประเทศต้องทำให้สำเร็จ

คำสำคัญ: การลงทุนของชาวต่างชาติ, อนุญาโตตุลาการในประเทศจีน, CIETAC, ข้อตกลงพหุภาคีด้านการลงทุน, การบังคับตามการอนุญาโตตุลาการต่างชาติ, ข้อขัดแย้งระหว่างนักลงทุนและรัฐ

Introduction

Upon the inward investment remaining increasing in the last two decades, China has become one of the largest markets with the most foreign investments. Simultaneously, the Chinese dispute resolution mechanism was facing a significant challenge by the numerous foreign investment disputes brought along with the increased inward investment. Considering the fact that foreign investors prefer arbitration to resorting to litigation in the PRC's local courts, in order to attract more inward investment and establish the confidence and trust of foreign investors in China, for the past two decades, Chinese government has been taking actions and efforts in establishing internal international investment arbitration mechanism to solve foreign investment disputes. The efforts made by the Chinese government did explicitly show the attitude of China government's commitment in providing a stable and healthy economic and legal environment for inward investment.

However, it is claimed that the existing international arbitration mechanism of China may not be sophisticated to secure the positions and benefits of both foreign investor and China to achieve a win-win state of affairs, and satisfy the requirement of "Going Global" strategy adopted by Chinese government encouraging the overseas direct investment of Chinese entrepreneurs. China's "comprehensive consent" to ICSID and third party arbitration by 2nd generation BITs may not be that helpful in providing protection to investors and may result in the loss of benefits of China.

Overview of International Arbitration Mechanism in China

The specific law regulating the arbitration of China is the Arbitration Law of the People's Republic of China 1994 and came into force on 1 September 1995, (hereafter referred as the "Arbitration Law (1995)"). Civil Procedural Law of People's Republic of China, as amended in 2012, also provides the regulating provision in the enforcement or setting aside of arbitration awards.

Chinese law officially recognizes three types of arbitrations: international arbitration, foreign- related arbitration and domestic arbitration. China International

Economic and Trade Arbitration Commission ("the CIETAC") is one of the largest arbitration centers in the world. It is headquartered in Beijing, with Sub-Commissions in Shanghai (established in 1989), Shenzhen (established in 1990), Tianjin (established in 2008), and Chongqing (established in 2009).[1] Nowadays, China has up to about 190 arbitration institutions, and almost all of them may accept both domestic and foreign related arbitration cases. However, The CIETAC still maintains its leading position among these arbitration institutions within China in hearing international and foreign-related disputes. The CIETAC is made up of an official Chinese administrative body able to exercise its "delegated legislative power under the Chinese Constitution and the relevant regulations of the State Council."[2] The latest version of arbitration rules of CIETAC is the amended version in 2012 that came into effect on 1 May 2012. The rules of conducts of arbitrators are quite comparable to the international arbitration institute in developed countries. Although it is legally permitted to appoint foreign arbitrators to participate in the arbitration proceedings, the majority of arbitrators participating in the arbitration in the CIETAC and other Chinese Arbitration Institutions are still Chinese. It is worth noting that there are currently no foreign arbitral institutions operating in China and it is also rare for a foreign arbitral institution to administer an arbitration that has its seat in China.

The Chinese court system has many unpredictable problems in recognizing and enforcing foreign- related arbitrations and foreign arbitrations, such as; local protectionism, inexperienced judges, less independence of the courts from the local governments, etc.

Treaty Practice of China Regarding International Arbitration in Foreign Investment Disputes

China acceded to the Convention for the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter "the Washington

[1] Ulrike Glück & Falk Lichtenstein, Arbitration *In The People's Republic Of China*, CMS GUIDE TO ARBITRATION, Vol I, at 213.
[2] *Id*., at 69, cited John S. Mo, *Alternative Dispute Resolution*, in INTRODUCTION TO CHINESE LAW 368 (WangChenguang & Zhang Xianchu eds., Sweet & Maxwell Asia 1997).

Convention" or "the ICSID Convention") in 1993. In addition to joining the ICSID, China has been trying to conclude numerous bilateral investment agreements, most of which grant jurisdiction to the ICSID tribunals. Furthermore, in 2001, China accepted the jurisdiction of "the Dispute Settlement Body of the World Trade Organization". Thus, joining the ICSID Convention "represented an important milestone in China's engagement with mechanisms of international adjudication"[3].

So far, China has concluded 139 BITs. In fact, when China began its BIT practice, it was deemed not investor-friendly. For China's first generation BITs which are "viewed as concluded before 1997, investor-state arbitration clauses were either non-existent or much restricted in scope".[4] It limited investor-state arbitration disputes over the amount of compensation resulting from expropriation and nationalization.[5] Subsequent BITs contained a similar limitation on the subject-matter of arbitrations to questions of the "amount of compensation resulting from expropriation and nationalization."[6] "The very limited dispute resolution clause was later on replaced by the broad dispute resolution clause characterized by China's second generation BITs"[7], which provides an "comprehensive consent" for all kinds of disputes to be submitted to the jurisdiction of the ICSID or third party arbitration institution. It is viewed that "since the conclusion of the 1998 BIT between China and Barbados, most PRC BITs have granted ICSID jurisdiction without the limitation on the nature of the investment dispute". [8]

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[3] *Id.*

[4] Elodie Dulac, *The Emerging Third Generation of Chinese Investment Treaties*, TDM 4 (2010), http://www.transnational-dispute-management.com/ article.asp?key=1636.

[5] Agreement Between the People's Republic of China and the Kingdom of Spain on the Promotion and Reciprocal Protection of Investment, art. **9,** P.R.C.-Spain, Feb. 6, 1992

[6] see China-Norway BIT (1984), China-Denmark BIT (1985), China-Kuwait BIT (1985), China-Australia BIT (1988), Chi-na-Kazakhstan BIT (1992), China-Argentina (1992), China-Viet Nam BIT (1992), China-United Arab Emirates BIT (1994), Chi-na-Indonesia BIT (1994), China-Egypt BIT (1994), China-Peru BIT (1994), China-Syrian Arab Republic (1996),China-Sudan BIT (1997).

[7] Dulac, Supra note 4.

[8] Julian Ku, *The Enforcement Of Icsid Awards In The People's Republic Of China*, 6(1) CONTEMP. ASIA ARB. J. 31, 2013. at 32. See also Yu Jingsong & Zhan Xiaoning, Lun Tou Zi Zhe Yu Dong Dao Guo Jian Zheng Duan Jie Jue Ji Zhi Ji Qi

The reason resulting in a shift of attitude of China to ICSID or third party arbitration institution in BITs are claimed for preparation of "Going Global" by Chinese enterprises. In 1998, the Chinese government announced a "Going Global" strategy which aims at encouraging Chinese enterprises' outward investments. This strategy has been "embedded in the Tenth Five-Year Plan for National Economy and Social Development in 2001, marked the transition of Beijing's outward FDI policy from *regulations* to *encouragement*." [9] The current government gives priority to "resource exploration projects, the export promotion of domestic technologies, overseas research and development as well as M&A enhancing the international competitiveness of Chinese enterprises, accelerating their foreign market presence."[10] Though outward FDI is still surpassed by the volume of inward FDI, "the outward/inward FDI ratio – an indicator which refers to what Dunning has called a 'country's net international direct investment position'[11] – shows that outflows from China grew more rapidly than inflows during the last years, demonstrating that China's overall importance as an FDI-exporting economy is evolving."[12]

As a result of the less restrictive BIT terms, "arbitral investment disputes against China have expanded to the disputes involving investment treatment, transfer and other issues."[13] Such broad clauses thus allow investors "not only to resolve disputes

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Ying Xiang, *On the Dispute Settlement Mechanics Between Investors and Relative States and Its Influences*, 5 **CHINA LEGAL SCIENCE** 175, 176-177 (2005).

[9] *See Cai, C.* (2006): Outward Foreign Direct Investment Protection and the Effectiveness of Chinese BIT Practice, in: *Journal of World Investment and Trade* 7 (5), at 626.

[10] See World Investment Report 2006. FDI from Developing and Transition Economies: Implications for Development, New York, Geneva: United Nations, at 210.

[11] *Id. at 6*, see also UNCTAD (2007a): 299-306

[12] Axel Berger, *China's new bilateral investment treaty programme: Substance, rational and implications for international investment law making*, Paper prepared for the American Society of International Law International Economic Law Interest Group (ASIL IELIG) 2008 biennial conference "The Politics of International Economic Law: The Next Four Years", Washington, D.C., November 14-15, 2008, at 5

[13] Ku, *Supra* note 8, at 32

concerning the amount of compensation in expropriation cases, but also to invoke all substantive rights granted in the applicable BIT."[14]

Limitation of Protection to Foreign Investors under Existing International Arbitration Mechanism in China

It is notable that there are very few cases of foreign investment disputes being arbitrated in the arbitration institutions in China. There was only one case in which the BIT was invoked against China, but the case was withdrawn before the commencement of arbitration proceedings. Foreign investors may feel that there is insufficient protection for them when a dispute against Chinese interests occurs. At first, the market for international arbitration within China's territory is not open to foreign arbitration institutions. Secondly, there are strict requirements of validity of arbitration agreements under Chinese law to enable arbitration awards to be enforced in China. Thirdly, no ad hoc arbitration in China is recognized unless it is done outside of China in the country which is a member of New York Convention. Fourthly, it is not surprised to see the local government's interference in arbitration institutions and the courts. However, the most difficulty obstacle lies in the enforcement of foreign arbitral awards, especially in investment disputes.

Foreign awards were often refused recognition, estimated to be approximately 50% during the 1990s. [15] After the issuance of the Notice on Handling of Arbitration Involving Foreign Elements by the Supreme People's Court on 28 August 1995, with a view of applying the New York Convention and guaranteeing enforcement of arbitral awards, a reporting mechanism was set up to prevent local courts from abusing their powers to refuse enforcement of foreign- related arbitral awards rendered within China, or foreign arbitral awards ,without prudent check and reasonable ground in order to protect local interests, the refusal of enforcing foreign arbitral award has been significantly reduced. Between 2000 and 2007, a total of 12

[14] *Id.*
[15] Glück and Lichtenstein, *supra* note 1, at 233. see also Peerenboom, supra note 73, at 254

foreign awards were not enforced by PRC People's Courts. [16]Does it mean China has established a consummate mechanism in recognizing and enforcing foreign arbitral awards? The answer is still doubtful. But one thing is certain and that is the reporting mechanism takes too long to process and lacks transparency.

The foreign party of a foreign award often has to confront local protectionism. In the event that the judges would like to protect the local Chinese parties against enforcement on their assets, there are many 'legitimate' methods the judges could employ to achieve this purpose. This indirectly helps the Chinese party to obtain the opportunity and time to transfer its assets to escape enforcement. The foreign party may not be able to recover the award though enforcement has been granted by the Chinese court since there is no asset preservation procedure in enforcing the arbitration award in China.

In addition, applicants are responsible to identify and locate the respondent's assets for enforcement. Article 272 of Civil Procedure Law (2012) provides a legal ground for the applicant's responsibility to locate the respondent's assets when applying for the enforcement at the Chinese court.

Apart from aforementioned factors, shortage of qualified and experienced judges and lack of transparency in judicial process of enforcement also reduce the foreign investors' confidence in the Chinese Arbitration Mechanism.

Conclusion and Suggestions

Firstly, the deficiencies in internal foreign investment arbitration mechanism of China put the foreign investment awards in a dilemma. Foreign investors have to incur more time and cost to resort to overseas foreign arbitration institutions due to too strict and less than satisfactory legislation in China. China has many arbitration institutions that may conduct the foreign-related arbitrations. It is suggested that China should endeavor to improve and perfect the local foreign investment arbitration mechanism and make them trustable from foreign investors and

[16] *Id.*

build up an increasingly sound legal environment.[17] Secondly, it is understandable that China took a more liberal approach on the international arbitration for the investor-state dispute due to the consideration of the emerging of outward FDI of Chinese enterprises. It may be too early to say whether such approach will definitely bring a positive or negative impact to the benefits of China. However, abandoning "the right of case-by-case approval or consent" and "the priority of local remedies", "the right of significant security exception" and other relevant rights, and not excluding the disputes involving public safety, national economy and other important matters from ICSID or third party arbitration jurisdiction is apparently too risky and not worth doing only just for the purpose of protecting Chinese "Going Global" enterprises, especially during the stage that the inward investment of China still surpasses the outward investment.

What positions shall China take for the arbitration of foreign investment in the future?

It is suggested that China should build up an increasingly sound legal environment to gain the investors' confidence and trust in the international arbitration within China. The Chinese government should take a more prudent and careful attitude in the negotiation of future BITs instead of granting "comprehensive consent" in order to balance the protection of investors under BITs and the sovereignty and benefits of China.

a. Consummate the internal foreign investment arbitration mechanism

In order to enhance the confidence of the foreign investors to be more comfortable with the legal investment environment, and seek the arbitration within China as their first choice of dispute resolution instead of seeking arbitration under foreign arbitration institutions, China needs to make more effort in improving its internal legislation of arbitration mechanism, including a) enact or revise the relevant laws to loosen up the strict requirement on the elements of validity of arbitration

[17] Yang Shu-dong, *Investment Arbitration and China: Investor or Host State?*, Op. J., Vol. 2/2011, Paper n. 6, pp. 1 - 19, http://lider-lab.sssup.it/opinio, online publication December 2011, at 14

agreement, and to recognize ad hoc arbitration; b) open international arbitration market in China for foreign arbitration institutions; c) promote the use of arbitration institutions in China to hear the international investment disputes; d) improve the efficiencies of the court in examining and deciding whether to enforce the international arbitration awards; e) remedying the setting aside of arbitration awards by enacting relevant rules concerning conditions and procedures for re-arbitration.

b. Should China Be Hospitable or Hostile to Investor-State Arbitration in Future?

In spite of its weaknesses of Investor-State Arbitration that may cause China to lose its sovereignty and benefits, it is less likely that China will withdraw from the Investor – State arbitration like what Australia and South Africa did. To be more objective, China is not yet ready to withdraw from the Investor – State Arbitration. In consideration of the distinct situation of China that have both large inbound investments and increasing outbound investments, and the less than satisfactory domestic legal regime and arbitration mechanism, China at present needs to be Investor – State arbitration friendly to match up with the economic development strategy. Although relying on the Chinese courts may well satisfy its domestic public policy interests, however, for those Chinese investors of outbound investment will be placed in a situation of suffering from the domestic courts of host states that have even more unsatisfactory legal systems.

(i) Adopt new model of BIT with more prudence on the acceptance of ICSID arbitration jurisdiction

For inward investment of China, so far the “comprehensive consent” to ICSID arbitration jurisdiction makes no real sense to attracting foreign investment. China's huge market potential and the preferential investment commitments that China has made to the foreign capitals, are the real attracting factors to the foreign investors. Therefore, from this point of view, the “comprehensive consent” to ICSID arbitration is not that essential. For China's overseas investment, the investors choosing to invest in a state have not primarily considered whether the state signed a BIT with China and

whether the BIT fully accepted ICSID jurisdiction.[18] Moreover, China's current inward investment is far more than outward investment[19]. Therefore it seems not worth to risk the sovereign and benefits of China to protect a less possible claim of Chinese investors against the host state of outward investment.

Therefore, in terms of the arbitration mechanism to investment disputes between the host government and foreign investors, China should abandon the existing position of the "comprehensive consent", reduce the acceptance range of international arbitration jurisdiction, and adopt a more prudent approach to accept the ICSID arbitration jurisdiction. For instance, China may reiterate the principle of exhaustion of local remedies; make a strict limitation to the range of dispute issues which foreign investors can directly file to international arbitration; adopt a position of partial acceptance as the principle and full acceptance case-by-case where appropriate as an exception. It is improper to have all investment disputes submitted to international arbitration except for some particular disputes in relation to expropriation, compensation, etc.

(ii) Put more effort on transparency requirements

It is worthwhile for China to learn from the 2012 U.S. Model BIT which embodies the **transparency requirements** regarding the publication of laws and decisions respecting investments (Article 10), and arbitration proceedings (Article 29), and proposed and adopted regulations (Article 11). The author personally considers that this new approach is a very effective approach to forestall the investor-state disputes as the investors could consider how the proposed regulations would affect them, and give their comments to the host states. The host states also have an opportunity to re-assess their proposed regulations before final promulgation. Thus, problems may be settled before the disputes occur. In fact, both host states and investors could benefit from this new approach.

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[18] *Id.*

[19] The data as of the end of March 2011 shows that China has actually used nearly $ 1.1 trillion foreign capitals while the total non-financial overseas direct investments are $320 billion.

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