Chinese Mechanisms for Resolving Investor-State Disputes

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This article addresses China's responsibility in resolving investor-State disputes as it is the second-largest FDI recipient after the United States. It questions why China thus far has rarely been involved as a respondent in international arbitration or any other dispute resolution mechanisms in relation to foreign investment. It attempts to examine China's national system and practice for resolving disputes between foreign investors and the host State and investigates cultural and political reasons for why China has almost never been called to international arbitration to resolve disputes with foreign investors. Finally, it suggests some future directions of investment dispute settlement and calls for China taking more responsibilities in world affairs.

INTRODUCTION

China is the world’s second-largest recipient of Foreign Direct Investment (after the United States), attracting around US$ 95 billion in 2009, according to the World Investment Report 2010.1 More than 30 years ago, China adopted policies on domestic economic reform and opening to the outside world. One of the features of that policy was the attraction of FDI which would bring not only badly needed capital but also advanced technology and management skills to the country. For that purpose, the Chinese-Foreign Joint Venture Law was adopted in 1979. Almost ten years later, the Chinese-Foreign Cooperative Venture Law was enacted, followed by the Wholly Foreign-Owned Enterprise Law.2 Its huge population, enormous market and vast commercial opportunities have gradually made China one of the most attractive and important destinations for FDI.

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2 In the present context, it should be pointed out that none of these laws includes specific provisions on investor-State dispute settlement.
During the same 30-year period, the legal regime on foreign investment in China, including the mechanisms for resolving investor-State disputes, has also been gradually established and improved to be commensurate with the changing landscape of economic development.

With increased foreign investment activities in China, logically, the number of disputes involving those investments is also likely to rise. However, China has thus far rarely been involved as respondent in international arbitration or any other dispute resolution mechanisms in relation to foreign investment. Why should this be? Focusing on this interesting issue, this article offers an overview of investor-State dispute settlement in China. Part I examines China’s national system and practice for resolving disputes between foreign investors and the host State, followed by discussions in Part II on the implications of this system on practice of international agreements to which China is a party. Part III investigates possible reasons why China has almost never been called to international arbitration to resolve disputes with foreign investors. Finally, Part IV focuses on the future directions of investment dispute settlement involving China and the factors that may affect its course.

**Part 1: The National System for Resolving Disputes Between Foreign Investors and the Chinese Government**

Under the present Chinese domestic legal system, when an investor-State dispute arises, the foreign investor or foreign-invested enterprise concerned may resort to administrative reconsideration or/and administrative litigation. According to the Law of the People’s Republic of China on Administrative Reconsideration adopted in 1999, foreign investors or foreign-invested enterprises may apply for administrative reconsideration if they consider that certain specific administrative acts infringe upon their

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4 Under the Law on Administrative Reconsideration, the qualified applicants for administrative reconsideration are citizens, legal persons or other organisations, and Article 41 provides: “This Law shall be applicable to foreign nationals, stateless persons and foreign organizations that apply for administrative reconsideration within the territory of the People’s Republic of China.”
lawful rights or interests⁵ or that an administrative body has infringed upon their lawful decision-making power, imposed duties on them illegally, failed to deal with their applications or protect their property rights, etc.⁶

When refusing to accept a specific administrative act, the applicant must apply for administrative reconsideration to either the people’s government at the same level,⁷ the competent department at the next higher level,⁸ the local people’s government at the next higher level,⁹ or the department under the State Council,¹⁰ depending on the circumstances. The applicant may also claim for administrative compensation while applying for administrative reconsideration.¹¹ A decision made after administrative reconsideration which changes a specific administrative act shall be enforced by the administrative reconsideration body according to law, or an application shall be made to a People’s Court for compulsory enforcement.¹²

A foreign investor or foreign-invested enterprise, if unsatisfied with a decision of administrative reconsideration, may submit his/its dispute to

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⁵ Such specific administrative acts may include but are not limited to decisions made by administrative organs (1) to impose on them administrative penalties such as fines, confiscation of illegal gains, orders for suspension of production or business operations, and temporary suspension or rescission of licenses; (2) to impose on them compulsory administrative measures including sealing up, seizure or freezing of property; (3) to alterate, suspend or revoke such documents as permits, licenses and qualification certificates; (4) to infringe upon their right of ownership in or the right to the use of natural resources. See, Article 6 of the Law on Administrative Reconsideration.

⁶ Article 6 of the Law on Administrative Reconsideration.

⁷ Article 12.1 of the Law on Administrative Reconsideration provides: “When refusing to accept a specific administrative act taken by the department of a people’s government at or above the county level, the applicant may choose to apply to the people’s government at the same level or to the competent department at the next higher level for administrative reconsideration.”

⁸ Article 12.2 of the Law on Administrative Reconsideration provides: “When refusing to accept a specific administrative act taken by an administrative organ that exercises vertical leadership over the customs, banking, national tax and foreign exchange administration, or by a State security organ, the applicant shall apply to the competent department at the next higher level for administrative reconsideration.”

⁹ Article 13 of the Law on Administrative Reconsideration provides: “When refusing to accept a specific administrative act taken by a local people’s government at any level, the applicant shall apply to the local people’s government at the next higher level for administrative reconsideration.”

¹⁰ Article 14 of the Law on Administrative Reconsideration provides: “When refusing to accept a specific administrative act taken by a department under the State Council or by the people’s government of a province, autonomous region or municipality directly under the Central Government, the applicant shall apply to the said departments or people’s government for administrative reconsideration.”

¹¹ Article 29 of the Law on Administrative Reconsideration.

¹² Article 33 of the Law on Administrative Reconsideration.
a People’s Court.\textsuperscript{13} Foreigners, stateless persons and foreign organisations conducting administrative litigation in China usually enjoy the same rights and are subject to the same obligations as Chinese citizens and organisations. However, where a court of a foreign country restricts the administrative litigation rights of Chinese citizens and organisations, the Chinese court will apply the principle of reciprocity to the administrative litigation rights of citizens and organisations of that country.\textsuperscript{14} In addition, foreign plaintiffs can only appoint Chinese lawyers as their agents \textit{ad\ litem}.\textsuperscript{15} Differently from civil disputes, mediation will not be conducted for administrative lawsuits.\textsuperscript{16}

Where it is found by the court that the specific administrative act was taken in circumstances where the evidence was insufficient, laws and regulations were incorrectly applied, statutory procedures were violated or the related administrative organ acted beyond its authority or abused its powers, the People’s Court will annul the act and order the administrative body to make another specific administrative act.\textsuperscript{17} However, it is worth noting that only specific administrative acts are adjudicable in China. In other words, Chinese courts will not hear cases involving those administrative laws and regulations or decisions or orders of administrative authorities that have general application or any State acts related to national defence or foreign

\textsuperscript{13} Exceptional circumstances are provided in Article 30 of the Law on Administrative Reconsideration, stipulating that: “Where a citizen, legal person or other organization believes that the specific administrative act taken by an administrative organ infringes upon his or its right of ownership in or right to the use of natural resources such as land, mineral resources, waters, forests, mountains or hills, grasslands, wasteland, tidal flats and sea areas, which he or it has acquired according to law, he or it shall first apply for administrative reconsideration; if he or it refuses to accept the decision made after administrative reconsideration, he or it may bring an administrative lawsuit before a People’s Court according to law. The decisions made after administrative reconsideration by the people’s governments of provinces, autonomous regions or municipalities directly under the Central Government confirming the right of ownership in or the right to the use of natural resources such as land, mineral resources, waters, forests, mountains or hills, grasslands, wasteland, tidal flats and sea areas, on the basis of the decisions made by the State Council or the people’s governments of provinces, autonomous regions or municipalities directly under the Central Government confirming the right of ownership in or the right to the use of natural resources such as land, mineral resources, waters, forests, mountains or hills, grasslands, wasteland, tidal flats and sea areas, which he or it has acquired according to law, are final.” Moreover, according to Article 14 of the Law, for any dispute arising out of the act of a department under the State Council or by the people’s government of a province, when refusing to accept a decision made after administrative reconsideration, the applicant may bring an administrative lawsuit before a People’s Court, or apply to the State Council for a ruling, and any such ruling made by the State Council shall be final.


\textsuperscript{15} See, Article 73 of the Administrative Procedure Law.

\textsuperscript{16} See, Article 50 of the Administrative Procedure Law. However, according to Article 67 thereof, mediation may be conducted in the proceedings of an administrative lawsuit regarding claims for damages.

\textsuperscript{17} See, Article 54 of the Administrative Procedure Law.
affairs.\footnote{See, Article 12 of the Administrative Procedure Law.} Therefore, if a foreign-invested enterprise considers its right or interest has been impaired by the regulations of an administrative organ, it may not get a desired remedy through administrative litigation. This is also the case even if it brings a lawsuit on the specific administrative act made according to the abovementioned laws or regulations, as the courts are, under Chinese law, obliged to enforce the laws and regulations adopted by authorised bodies.

Restricting the power of judicial review to specific administrative acts is a distinct feature of Chinese law. This may not, however, have adverse effects on the resolution of disputes involving foreign investors and Chinese government bodies because most such disputes concern specific acts of the government rather than the general application of laws. Even if a given dispute relates to the application of a law or administrative regulation, where what is challenged is its application to specific cases rather than the law or administrative regulation itself, the court will have judicial review power. In China, therefore, what matters in practice is how the laws and regulations are actually implemented.

International treaties also have a significant impact on the Chinese legal system, including judicial review. China’s accession to the WTO in 2001, for instance, had very important impacts. According to the Protocol on the Accession of the People's Republic of China to the WTO, the country needed not only to “abolish and amend” its existing laws that were not in conformity with the relevant GATT/WTO rules.\footnote{For instance, China used to issue a \textit{Catalogue for the Guidance of Foreign Investment Industries}, a very important legal document listing the economic sectors in which foreign investments were encouraged, restricted, or prohibited. After its WTO accession, however, China became very cautious in producing this \textit{Catalogue} in order to avoid possible violations of the relevant WTO provisions. For more discussion on the impacts of WTO accession on China's domestic legal system, see, Guiguo Wang, “Globalising the Rule of Law”, 48 \textit{Indian Journal of International Law} 1, pp. 21-44.} It also needed to stipulate, as required in Article X:3 (b) of the GATT, Article VI:2(a) of the GATS, and Article 41(4) of the TRIPS Agreement, that all government administrative actions are subject to judicial review. One consequence of this is that the Chinese domestic courts have been placed in a more powerful position in exercising judicial review over governmental actions and decisions related to foreign investment. Take intellectual property as an example. In this age of the “knowledge economy”, most cross-border investment activities also concern trademarks, patents or copyrights. Both Chinese domestic IP laws and international intellectual property provisions,
including those of the TRIPS Agreement, regulate the substantive and procedural aspects thereof. These norms empower China’s national courts to review administrative acts relating to intellectual property issues.\textsuperscript{20}

In both traditional and contemporary Chinese culture, litigation is not encouraged. The Government also takes great care about disputes with foreign investors, as it fears that such disputes, if not properly handled, will affect the image of the country’s environment for foreign investment and, in the end, the in-flow of foreign capital and technology. To resolve disputes with foreign investors without resorting to litigation, mechanisms such as Complaint Centres, Mediation Panels and Working Panels have been established at different administrative levels throughout China. Some of these have been established within the local administrative bodies in charge of foreign trade and investment while others are affiliated with the local associations of foreign investors, with staff assigned by the local governments. In fact, as early as the 1980s, the Chinese government had paid special attention to disputes with foreign investors. Where environmental considerations, city planning or public concerns meant that a foreign investment project had to be relocated, instead of paying compensation the Chinese government on many occasions helped the foreign investors find another location for the project and offered more preferential terms.\textsuperscript{21}

The Ministry of Commerce also promulgated, in 2006, The Interim Measures on Complaints from Foreign-invested Enterprises (“Interim Measures”),\textsuperscript{22} according to which foreign-invested enterprises or foreign investors which deem that their legitimate rights or interests have been infringed by an administrative authority may file a complaint with the complaint acceptance authority for coordination or settlement. The Interim Measures establish a National Complaint Centre for Foreign-invested Enterprises responsible for handling complaints directly filed with it, trans-provincial complaints and complaints with great influence. The Interim Measures also stipulate that local complaint acceptance authorities shall be responsible for accepting complaints from foreign-invested enterprises or foreign investors within their locality and any complaints transferred from or supervised by the National Complaint Centre. In addition, a Complaint

\textsuperscript{20} For more discussion, see, Guiguo Wang, \textit{The Law of the WTO: China and the Future of Free Trade}, Sweet & Maxwell Asia, Hong Kong, 2005, Chapters 1 and 6.

\textsuperscript{21} For further discussions, see, Guiguo Wang, \textit{China’s Investment Law: New Directions}, Butterworths, Hong Kong, 1988, Chapter Two.

Coordination Office for Foreign-invested Enterprises was established to coordinate and supervise the work of the National Complaint Centre and the local complaint authorities and to handle complaints involving different sectors or industries which need to be settled through trans-ministerial coordination meetings. In order to avoid conflicts of jurisdiction, a complaint which is being, or has been, handled through the process of administrative reconsideration, litigation or arbitration may not be handled by the complaint centres.

In so far as the complaint centre procedures are concerned, a complaint should, in general, be settled within 30 days. After reviewing a complaint, the National Complaint Centre or local complaint handling authorities may issue an opinion letter, making suggestions for the settlement, or may coordinate with the relevant authorities.

Apart from the Interim Measures, there are also regulations or rules issued by local authorities that govern the work of local complaint authorities. For example, the Guangdong Provincial Government has set up a Guangdong Complaints Centre for Foreign Investment which is authorised, as a governmental institution, to handle the complaints by foreign-invested enterprises in Guangdong Province. It has adopted rules for complaint filing, mediation and coordination with detailed requirements, procedures and time limits for settlement of disputes involving foreign investors. According to these rules, administrative disputes are handled through coordination, while commercial disputes are handled by mediation. The complainants do not need to pay fees for coordination. The Administrative Affairs Division of the Centre is responsible for hearing cases complaining about governmental departments. In 2006, the local complaint authorities in Guangdong Province received 96 complaints, among which 92 were accepted and 79 were settled. 40 complaints (41.7%) were against governmental organs, among which 29 involved administrative authorities of foreign trade, tax, administration of industry and commerce, environmental protection, public security, land management and customs, and 7 concerned judicial organs. The nature of the disputes included improper application of law or policies, low working efficiency, bad

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23 See, Articles 5 and 6 of the Interim Measures.
24 See, Article 9 of the Interim Measures.
25 See, Article 10 of the Interim Measures.
26 See, Article 11 of the Interim Measures.
working manner and unreasonable fee collections, among others. The Guangdong Complaint Centre itself handled 21 cases in 2006.

Other foreign investment complaint centres have also played an important role in resolving disputes between foreign investors and both the Chinese Central Government and local governments. Take the case of Zibo Siemens as an example. In 1998, the foreign party of Zibo Siemens Vacuum Pump & Compressor Co. Ltd (“Zibo Siemens”) acquired the shareholding of its Chinese party, Zibo Vacuum Pump Factory and, as a result, Zibo Siemens was no longer a Chinese-foreign equity joint venture but a wholly foreign-owned enterprise. During its operation, the joint venture had signed employment contracts with 196 employees of Zibo Vacuum Pump Factory with a term of two years. After the expiration of the contract, nine of those employees did not have their contracts renewed and thus submitted their dispute with Zibo Siemens regarding the method of calculating the economic compensation payable to them to the related local governmental authority. Zibo Siemens Co. refused to accept the award issued by the local labour authority and resorted to the local court. The Intermediate Court of Zibo City ruled that Zibo Siemens should pay the economic compensation for the workers according to the terms of the contracts they had entered into. However, the local labour authority still insisted on its own view. If the local labour authority’s decision had been enforced, Zibo Siemens would have had to pay a large amount of economic compensation which would have been a heavy economic burden for it because of serious losses it had suffered in the previous year. The management of Zibo Siemens suggested to its German headquarters that it withdraw its investment. A complaint was then filed by Zibo Siemens with the Zibo City Complaint Centre for Foreign-Invested Enterprises, as a result of which the dispute was reported to the leaders of the Zibo Municipal Government. The Centre considered that the complaint was closely related to the image of the city’s foreign investment environment and therefore should be seriously dealt with. With the efforts of the leaders of the Zibo Municipal Government, the decision of the labour authority was finally revoked. This also illustrates that the Complaint Centre system is quite flexible that foreign investors may resort to it either before or after the formal procedures.


The Fuzhou Xinyuan case did not turn out as well for the foreign investor. In May 1997, with the cooperation of the Fuzhou Municipal Government, Sauming International Investment Co. Ltd (“Sauming”), a wholly-owned subsidiary of China Travel Services (Hong Kong) Holdings Limited, concluded a joint venture agreement with Fuzhou Urban and Rural Construction and Development Company (“Fuzhou Construction”), a State-owned enterprise, to jointly found the Fuzhou Xinyuan Urban Bridge Co. Ltd (“Fuzhou Xinyuan”). Fuzhou Xinyuan would be responsible for the construction of Ming River No. 4 Bridge, as well as operating the Ming River No. 2, No. 3 and No. 4 Bridges and the Baihuting Toll Station. Sauming was to invest RMB 840 in Fuzhou Xinyuan, representing 70% of the shareholding. The duration of the joint venture was to be 28 years.

In order to guarantee the joint venture’s return on investment, in October 1997 the Fuzhou Municipal Government signed an Agreement on Exclusive Right with Fuzhou Xinyuan, promising that in the first nine years it would require all motor vehicles traveling from Fuzhou Second Ring Road, or from any intra-city road inside the Second Ring, onto the Fuzhou-Xiamen Expressway or National Highway 324, or vice versa, to go through the Baihuting Toll Station. The government also assured Fuzhou Xinyuan that if its economic interests were negatively affected by any circumstances, it would be entitled to compensation. Sauming was also assured by the Fuzhou Municipal Government that it would receive the full amount of its investment as well as compensation calculated at a net rate of return of 18% per annum if the exclusive right should be withdrawn.

From October 1997 to April 2004, everything ran smoothly and Fuzhou Xinyuan had a stable income. However, problems arose after the Fuzhou Second Ring Road was completed and opened to traffic on 16 May 2004, 31 months earlier than that provided in the Agreement on the Exclusive Right. Since many motor vehicles were then able to bypass the Baihuting Toll Station, Fuzhou Xinyuan’s income dropped drastically and the company entered into serious financial trouble.

After several rounds of negotiations, it was reported that the investors of Fuzhou Xinyuan and the Fuzhou Municipal Government had reached a consensus on the settlement of their dispute on 12 June 2004. However, this was later denied by the Fuzhou Municipal Government. In July 2004, Fuzhou Xinyuan submitted the dispute to the China International
Economic and Trade Arbitration Commission (CIETAC) for arbitration, claiming for compensation of RMB 900 million.29

From these and other cases, it is quite clear that the teachings of Chinese traditional culture have strongly influenced dispute resolution involving foreign investments in China. At the same time, attraction of foreign investment is an important factor by which Chinese leaders assess the performance of government officials and local governments. In order to avoid having any cases that might have negative effects on them disclosed or reported to the Central Government, local governments and officials are likely to choose amicable settlements with foreign investors. The complaint centres have also played an important part in such efforts.

**PART-2: INTERNATIONAL MECHANISMS FOR SETTLING INVESTOR-STATE DISPUTES INVOLVING THE CHINESE GOVERNMENT OR CHINESE INVESTORS**

The international mechanisms for settling disputes involving foreign investors with China include those provided for in the bilateral and multilateral treaties to which China is a party. Beginning in 1982, when it signed its first Bilateral Investment Treaty (BIT) with Sweden, China has developed an increasingly more positive attitude towards BITs and therefore has concluded one with nearly all of its major trading partners (except the United States). As of 1 June 2011, China had concluded 128 BITs30 and therefore ranked second (after Germany) in terms of the total number of BITs signed. China’s recent FTAs, including its agreements with ASEAN, Chile, Pakistan and New Zealand, also contain provisions on bilateral investment.31

Many of China’s early BITs stipulated that if an investor-State dispute could not be settled through negotiations, it should be submitted to the national courts of the host State. These BITs usually excluded the jurisdiction of the International Centre for Settlement of Investment Disputes (ICSID)

29 “Fuzhou Government Sued for US$110 Million”; available at: <http://www.chinadaily.com.cn/english/doc/2004-07/15/content_348755.htm> (last visited 12 June 2011). As CIETAC arbitration is carried out in camera and its awards are not made public (some awards are published after heavy editing by deleting the names of the parties, etc.), the end result of this case is not available.
30 See, the list of China’s BITs provided on the UNCTAD website at: <http://www.unctad.org/sections/dite_pcbh/docs/bits_china.pdf>
or stated that the parties would consent to ICSID arbitration after they had all become parties to the ICSID Convention. Some BITs included provisions that an *ad hoc* international tribunal was competent to handle disputes involving a foreign investor and the host State. For example, the 1986 China-United Kingdom BIT provides:

“[W]here the dispute is referred to international arbitration, the national or company and the other Contracting Party concerned in the dispute may agree to refer the dispute either to: (a) an international arbitrator appointed by the parties to the dispute; or (b) an *ad hoc* arbitral tribunal to be appointed under a special agreement between the parties to the dispute; or (c) an *ad hoc* arbitral tribunal established under the *Arbitration Rules of the United Nations Commission on International Trade Law*.”

Although this is only an agreement to agree, it marked significant progress for China because it still was not familiar with the international arbitration system. It should also be noted that in most of China’s early-generation BITs, an *ad hoc* arbitral tribunal only has jurisdiction over disputes “involving the amount of compensation resulting from expropriation, nationalisation, or other measures having effect equivalent to nationalisation or expropriation”. In such BITs, it was usually provided that disputes between foreign investors and the host government should first be submitted to local courts for settlement.

China’s reluctance to agree to the referral of investor-State disputes to international arbitration, including that using the ICSID procedures, has changed dramatically in recent years. In 1998, China entered into a BIT with Barbados whereby investor-State disputes may be submitted to ICSID arbitration. Similar provisions are found in other subsequent

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32 See, for example, Article VII(c) of the China-Turkey BIT (1990); available at: <http://www.unctad.org/sections/dite/iia/docs/bits/china_turkey.pdf>.
33 See, Article 7(2) of the China-United Kingdom BIT (1986); available at: <http://www.unctad.org/sections/dite/iia/docs/uk_china.pdf>.
34 See, for example, Article 13(3) of the China-Singapore BIT (1985); available at:<http://www.unctad.org/sections/dite/iia/docs/china_singapor.pdf>.
BITs, such as the ones concluded with the Netherlands (2001),36 Germany (2003)37 and Finland (2004).38 Nevertheless, these new-generation BITs also impose requirements that must be met by foreign investors before they may submit a dispute to international arbitration. For example, the Protocol to the China-Germany BIT provides:

“[W]ith respect to investments in the People’s Republic of China an investor of the Federal Republic of Germany may submit a dispute for arbitration under the following conditions only: (a) the investor has referred the issue to an administrative review procedure according to Chinese law; (b) the dispute still exists three months after he has brought the issue to the review procedure, and (c) in case the issue has been brought to a Chinese court, it can be withdrawn by the investor according to Chinese law.”39

The three-month review procedure is provided to give government authorities an opportunity to settle the dispute amicably. As to whether the dispute may or may not be eventually settled by the review procedure, this is a different issue and should not be a bar to bringing it to international arbitration.

Some of China’s recent FTAs, such as those with Pakistan and New Zealand, also provide for investor-State arbitration. Both of these FTAs, however, also make attempts to reach amicable settlement through negotiation a prerequisite for submission of a dispute to international arbitration. If

36 Article 10(3) of the China-Netherlands BIT provides: “If the dispute [between an investor and the host State] has not been settled amicably within a period of six months, from the date either party to the dispute requested amicable settlement, each Contracting Party gives its unconditional consent to submit the dispute at the request of the investor concerned to: a) the International Centre for Settlement of Investment Disputes, for settlement by arbitration or conciliation under the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature at Washington on 18 March 1965; or b) an ad hoc arbitral tribunal, unless otherwise agreed upon by the parties to the dispute, to be established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).” Text available at: <http://www.unctad.org/sections/dite/iia/docs/bits/china_netherlands.pdf>.


38 Article 9(2) of the China-Finland BIT (2004) provides: “If the dispute has not been settled within three months, from the date at which it was raised in writing, the dispute may, at the choice of the investor, be submitted: ... (b) to arbitration by the International Centre for the Settlement of Investment Disputes (ICSID), established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature at Washington on 18 March 1965.” Text available at: < http://www.unctad.org/sections/dite/iia/docs/bits/china_finland.pdf>.

39 Article 6 of the Protocol to the China-Germany BIT (2003), supra, note 37.
the dispute cannot be settled within a period of six months, the investor concerned may decide to submit its dispute through other means. Under the China-Pakistan FTA, the investor may choose to submit its dispute to either a competent domestic court of the host country or ICSID arbitration; once a local court is chosen, submitting the same dispute to the ICSID for arbitration is precluded, and vice versa.

The China-New Zealand FTA also authorises investors to make use of ICSID conciliation or UNCITRAL arbitration procedures. Before availing themselves of international arbitration, however, they must give three months advance notice to the State party. The purpose of this provision is to allow the host country to require the use of its domestic administrative review procedures. The administrative review process, in any event, may not exceed three months. Host countries always encourage investors to submit their disputes to local courts, but investors in most cases prefer international arbitration. Under the China-New Zealand FTA, an investor that has submitted its dispute to a local court of the host country may later decide to resort to international arbitration, provided that it has withdrawn its case from the local court before a final judgment is reached. This arrangement stands in sharp contrast to that established under the China-Pakistan FTA and reflects the changes in China’s attitude towards international arbitration that occurred in the interim. The China-New Zealand FTA also has detailed rules on arbitration procedures that have the effect of modifying the domestic laws of the Parties as well as ICSID’s normal procedures. One such modification is that the statute of limitations for the submission of disputes must be within three years from “the time at which the disputing investor became aware, or should reasonably have become aware, of a breach of obligation” by the host country which has “caus[ed] loss or damage to the investor or its investments”.

41 China-Pakistan FTA (2006), ibid., Article 54(2).
42 China-New Zealand 2008 FTA, supra, note 31, Article 153(2).
43 Ibid, Article 153(1).
44 Ibid, Article 153(2).
46 Article 153(4) of the China-New Zealand FTA (2008), ibid., clearly states that the provisions of the FTA on dispute settlement prevail over both ICSID and UNCITRAL arbitration and conciliation procedures.
47 Ibid, Article 154(1).
As is reflected in the abovementioned BITs and FTAs, ICSID is the most commonly used multilateral mechanism for settlement of investor-State disputes. ICSID was established under the Convention for the Settlement of Investment Disputes between States and Nationals of Other States, to which China acceded on 6 February 1993. At that time, it made the reservation that “pursuant to Article 25(4) of the Convention, the Chinese Government would only consider submitting to the jurisdiction of ICSID disputes over compensation resulting from expropriation and nationalisation”. China was also one of the earliest Contracting Parties (becoming a signatory in 1991) to the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA). Over the years, MIGA has been actively involved in investment dispute settlement in China, including the mediation of disputes between foreign investors and the Chinese government.

Although China is a party to both the ICSID Convention and the MIGA Convention, so far there has been only one case brought to international arbitration against China. There have been, however, several cases which threatened to take China to international arbitration tribunals. The Changchun Huijin case is one such. In 1999, the Government of Changchun City reached an agreement with Huijin Co. Ltd., a corporation registered in the British Virgin Islands, to jointly build and operate Changchun Beijiao Huijin Sewage Disposal Plant. In March 2000, Changchun Drainage Company and Huijin Co. Ltd. signed a cooperative joint venture contract to establish the Changchun Huijin Sewage Disposal Co. Ltd. (“Changchun Huijin”). Huijin Co. Ltd. invested RMB 302 million in the project. The cooperative company managed a sewage disposal plant that was capable of dealing with 390,000 tons of sewage each day in the City. In order to facilitate the operation of Changchun Huijin, in July 2000, the Changchun Municipal Government issued a decree — the Administrative Rules on the Exclusive Right of Sewage Disposal by Changchun Huijin (“Administrative Rules”) — setting up the parameters of Changchun Huijin’s operation, management methods and working conditions.

The project was completed and entered into operation in late 2000. However, in mid-2002, the Changchun Drainage Company stopped paying sewage disposal fees to Changchun Huijin despite the requirements of the
contract. The total of these unpaid fees reached around RMB 100 million by the end of 2003. At the mediation meeting presided over by the Foreign Trade Department of Jilin Province, Changchun Huijin was informed that the Administrative Rules had been abolished by the Changchun Municipal Government on 28 February 2003. Changchun Huijin considered that this act had totally destroyed the foundation of its establishment and operation. It therefore resorted to the local court for remedy in August 2003. However, it lost its case against the Changchun Municipal Government in both the first instance and the appeal. During the appeal, Changchun Beijiao Huijin Sewage Disposal Plant stopped operations. As a result, 390,000 tons of raw sewage was discharged into the Songhua River every day. Huijin Co. Ltd. even considered withdrawing its investment, and this triggered wide attention. Due to concerns that withdrawal of Huijin’s investment might have an adverse impact on foreign investments, the potentially huge economic losses to be suffered by Changchun Huijin, as well as the severe pollution that was being caused, and thanks to the mediation of the Intermediate People’s Court, the Changchun Municipal Government entered into a repurchase contract with Changchun Huijin in August 2005, according to which it would pay in three instalments a total of RMB 280 million to Changchun Huijin.49

The Quanzhou Mingyuan Hotel was another case that might have been submitted to international arbitration. In that case, Mr. Wang Quancheng, a Singaporean investor, invested around US$ 20 million in the five-Star Anxi Mingyuan Hotel, which was the first top-level hotel in Anxi County of Quanzhou City, in 2000. The operation of the project was smooth going for the first few years. In 2006, officials of the local Tax Bureau visited Mingyuan Hotel many times and enjoyed luxury dinners there without paying. After requests by the Hotel for payment, which were rejected, the Anxi Tax Bureau conducted a tax examination of the Hotel, obviously in revenge. The examination did not follow the procedures provided by law, after which the Mingyuan Hotel was ordered to pay around RMB 1.87 million as taxes and fines (which was later reduced to RMB 1.23 million), including “urban real estate tax” and “prostitution tax”, both of which were deemed unreasonable by the Hotel's management. According to provincial regulations, moreover, the Mingyuan Hotel had been exempted from real estate tax for three years. In addition, since prostitution is not allowed in China, the Mingyuan Hotel refused to pay the “prostitution tax”. Due to

the disagreement, the Anxi Tax Bureau stopped providing the Hotel with certificate books which are printed for and distributed by tax authorities according to Chinese law and without which business entities cannot issue certificates for payment. This seriously affected the business operations of the Mingyuan Hotel and it tried to protect its legitimate interests through administrative reconsideration and administrative litigation. Its applications for administrative reconsideration were not accepted, and its claims against the local tax authorities were rejected in both the first and second instance courts.\(^5\) On November 3, 2008, the attorney for the Mingyuan Hotel, Mr. Wang, sent a lawyer’s letter to the Government of Anxi County to seek its consent for ICSID arbitration.\(^5\) Yet, for unknown reasons, the dispute was not submitted to ICSID for arbitration.

The Shanghai Baileyuan is yet another case that might have reached the ICSID for arbitration. In 1992, the American Enterprise Group, registered in the British Cayman Islands, initiated a cooperative project – World Baileyuan – with the People’s Park of Shanghai. For this purpose, Shanghai Baileyuan Pleasure Ltd. was established. The project was approved by the Shanghai Municipal Government. Nevertheless, in December 1994, the Foreign Investment Commission of the Shanghai Municipal Government announced that the project location must be changed due to urban planning. Nonetheless, in June 1996, the Foreign Investment Commission of the Huangpu District of the Shanghai Municipal Government issued an order that it agreed that the project could be continued in the original location. The project was thus restarted.

Two years later, however, the Shanghai Municipal Government issued another document to change the location of World Baileyuan once again, which led to the project running aground. The changed location failed to gain the approval of the Shanghai Administration Department of Afforestation and the Shanghai Metro Management Co. At that point, millions of renminbi had been invested by American Enterprise Group in the project. In 2003, the investor twice submitted applications to the Shanghai Urban Planning Bureau, requesting it to re-examine the planned location for the project. Those applications were rejected. Shanghai Baileyuan Pleasure Ltd. also lost its case against the Urban Planning Bureau.


in the court of the first instance and its appeal in 2004. It was reported that the investor was going to submit the dispute to ICSID for arbitration but, again for unknown reasons, the case never reached ICSID.\textsuperscript{52}

As far as investor-State disputes under China-related BITs are concerned, \textit{Tza Yap Shum v. Peru}\textsuperscript{53} is the only case. In that case, the Claimant investor, who was born in Fujian Province of China and later became a Hong Kong resident, submitted his dispute with regard to tax liens to ICSID on the basis of the China-Peru BIT. One of the issues in dispute was the Tribunal’s jurisdiction. Article 8 of the China-Peru BIT reads as follows:

“1. Any dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute.

2. If the dispute cannot be settled through negotiations within six months, either party to the dispute shall be entitled to submit this dispute to the competent court of the Contracting Party accepting the investment.

3. If a dispute involving the amount of compensation for expropriation cannot be settled within six months after resort to negotiations as specified in Paragraph 1 of this Article, it may be submitted at the request of either party to the international arbitration of the International Centre for Settlement of Investment Disputes (ICSID), established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, signed in Washington D.C. on March 18, 1965. Any disputes concerning other matters between an investor of either Contracting Party and the other Contracting Party may be submitted to the Centre if the parties to the disputes so agree. The provisions of this Paragraph shall not apply if the investor concerned has resorted to the procedure specified in Paragraph 2 of this Article.”\textsuperscript{54}


\textsuperscript{53} \textit{Tza Yap Shum v. Republic of Peru}, ICSID Case No. ARB/07/6, registered 12 February 2007, award issued 7 July 2011 (not yet published).

The Peruvian government argued that, according to Article 8(3) of the BIT, only disputes “involving the amount of compensation for expropriation” could be submitted to international arbitration and that, therefore, the Tribunal did not have jurisdiction over the present dispute about tax liens. The Tribunal, however, stated that it “shall” interpret the terms of the BIT “in good faith in accordance with the meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. Yet it failed to give due consideration to the clear and plain language of Article 8(3) of the BIT. It instead stated:

“It may be assumed, in accordance with the wording of the Preamble of the BIT, that the purpose of including the entitlement to submit certain disputes to ICSID arbitration is that of conferring certain benefits to promote investments. Had the Contracting Parties really had the intention of excluding such important issues as those listed in Article 4 [of the BIT] from the arbitral proceeding, the Tribunal would determine so, although with certain scepticism with regard to whether such mechanism could possibly help attracting foreign investment.”

In the end, the Tribunal decided that it had jurisdiction over the case despite Article 8(3) of the BIT. Although the Tza Yap Shum case was not concerned with China’s behaviour, the way in which the Tribunal handled the matter will certainly have a direct impact on China’s policy and practice in respect of dispute resolution involving foreign investors.

A point related to investment dispute settlement mechanisms is that, under Chinese law, any international treaty obligations that China has assumed prevail over domestic legal provisions. The General Principles of Civil Law of the People’s Republic of China, for instance, provides in its Article 142 that, “if any international treaty concluded or acceded to by the People’s Republic of China contains provisions differing from those in the civil laws of the People’s Republic of China, the provisions of the international treaty shall apply...” If “neither the law of the People’s Republic of China nor any international treaty concluded or acceded to by the People’s Republic of China has any provisions”, international practice may also be applied with legally binding force. As such, those treaty provisions –

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56 Ibid.
among them, those included in BITs, FTAs and the ICSID Convention – which provide substantive rights and obligations of the contracting parties and investors, or generally accepted international practices and customs related thereto, are part of Chinese law. This legislative arrangement, on the one hand, demonstrates China’s seriousness toward its international obligations and, on the other hand, provides those unfamiliar with the Chinese legal system with some confidence when investing in China.

PART-3: REASONS FOR CHINA’S LACK OF INVOLVEMENT IN INTERNATIONAL INVESTMENT ARBITRATION

As noted above, China has shown reluctance to accept the settlement of investor-State disputes by means of international arbitration. Even though it acceded to the ICSID Convention in 1993 and then began to accept ICSID jurisdiction in an increasing number of BITs, it was only on 12 February 2007 that ICSID registered an arbitration request that involved a BIT to which China is a party.58 On 24 May 2011, a Malaysian company filed the first-ever case against the Chinese government before ICSID, but that case was “suspended” on 12 July 2011 “pursuant to the parties’ agreement”.59 Given that China is one of the major recipients of FDI, it is surprising that investor-State disputes have rarely been submitted to international arbitration. There could be a variety of reasons behind this.

Among all the possible reasons, traditional Chinese culture, which still has tremendous influence in modern China, has most contributed to the amicable settlement of disputes. Non-litigation methods for resolving disputes, such as consultation and mediation, are the culturally preferred means and are better suited to the Chinese environment. Among numerous considerations from the cultural perspective, praise of harmony usually comes first. This has actually been the common theme of all the major traditional Chinese schools of thought that provide the philosophical foundation for contemporary views and ways of approaching disputes. The traditional view is that disputes, whatever their reasons, are serious challenges to harmony and good relationships among people within the society. Confucianism, the dominant cultural influence in Chinese society for over two thousand years, strongly discourages social conflicts because

58 Tza Yap Shum v. Republic of Peru, supra, note 53.

Electronic copy available at: https://ssrn.com/abstract=3705039
of their “possible obstruction with the natural order of life and other intrinsic disharmonious principles”\textsuperscript{60}. Since harmonious relationships are more appreciated than are individuals’ rights and interests, people are encouraged to compromise, which “reflects the concern for the group over the individual in that it demands a disputant to give up something to the other party for the sake of restoring a balance between them”.\textsuperscript{61} In accordance with this line of thinking, those involved in disputes are encouraged to solve their disputes by themselves in the first place.

Against the above cultural background, consultation has been the prevalent method of dispute settlement for thousands of years in China.\textsuperscript{62} Mediation, as a favoured back-up to consultation, is the “first line of defence” against the deterioration of “disputes between friends” into “disputes with enemies”\textsuperscript{63} and is also much appreciated. In contrast, there has been a long tradition of dislike of litigation in Chinese society. When a dispute arises, those influenced by the teachings of Confucianism – and there are many in China even today – are likely to try to resolve their disputes through informal means, as litigation is considered to adversely affect the good neighbourhood. As for government officials, a low litigation rate within their region may be regarded as evidence of good governance, successful education of the people and establishment of a harmonious society.\textsuperscript{64}

In addition to cultural influences, the litigation system itself contributes to the Chinese preference for non-adversarial means of settling investment disputes. The Chinese legal system relating to foreign investment has basically developed over the last 30 years. At the same time, China is a civil law country which has a tradition of adopting laws without detailed provisions.\textsuperscript{65} This has left government officials and judges with much discretion. Foreign investors, unfamiliar with the Chinese judicial system and practice, tend to rely on their Chinese partners whenever they run into difficulties with the Chinese government. The Chinese partners naturally prefer, in most cases, to talk to the officials in charge of administration to


\textsuperscript{61} Michael Moser, Law and Social Change in a Chinese Community, Oceana Publishing, New York, 1982, p. 66


\textsuperscript{64} See, Albert Hung-Yee Chen, An Introduction to the Legal System of the People’s Republic of China, Butterworths Asia, Hong Kong, 1992, p. 21

\textsuperscript{65} For instance, the Chinese-Foreign Equity Joint Venture Law has only 18 articles. For implementation purposes, regulations and detailed rules have been adopted by the State Council and various Ministries.
resolve any differences with the government. Unfavourable reports on the Chinese judiciary and the difficulties of enforcement of judgments also contribute to the preference of non-litigation methods.

Government officials’ attitudes toward disputes with foreign investors are equally important in this assessment. For the last few decades, China’s economic growth has been described as being in a “GDP-centred” mode, which implies that the pursuit of GDP growth is the foremost (if not the only) economic goal of the Chinese government. With such a policy in place, the performance of government officials will be evaluated largely by their ability to increase GDP. Foreign investment is an important aspect of this, as foreign investments over the last two decades and more have contributed substantially to GDP growth in China. Any decrease in foreign investments is therefore expected to inevitably lead to a decrease in local GDP. In these circumstances, attracting foreign investment is considered a benchmark in the evaluation of the performance of local governments and their officials. Where the attraction of foreign investment is essential for both GDP and the positive performance evaluations of local governments, any dispute with foreign investors would be seen to be counterproductive to this effort, as it may be viewed as creating a poor environment for foreign investment. Whenever a serious dispute arise and triggers withdrawal of foreign investments, the local government officials in charge may be held responsible. Such withdrawals might also lead to increases in unemployment and, in some cases, other social problems (such as “instability”) that are considered inconsistent with the political theme of “a harmonious society”. All these influences act as incentives for Chinese government officials to maintain tight control over any disputes that may arise with foreign investors. In the event of the submission of an investor-State dispute to an international tribunal, the local government would be seen as having failed to effectively manage its own affairs. If a case were to be lost, moreover, the career of the officials concerned might be seriously affected or, at the least, should they be considered in the future for promotion, their competitors would have something against them. Needless to say, China’s unfamiliarity with the operation of the international arbitration system also makes its officials reluctant to resort to it.

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Foreign investors also have their own reasons for not choosing to submit their disputes with the Chinese government to international arbitration. China is still developing itself into a full market economy. In this transitional process, the government – both the Central Government and local governments – plays an important, and in some cases vital, role in the success of foreign investments. Having operated within this system, most foreign investors know that maintenance of good relations with the government and its officials is not only in compliance with Chinese culture but also helpful for ensuring their success in investing in China. One of the ways to maintain good relations is not to resort to adversarial means of dispute resolution unless it is absolutely necessary. With such motives and understanding of the Chinese community, foreign investors are likely not to use ICSID and other bodies to resolve their disputes with the Chinese government. In fact, in a number of unreported cases, where foreign investors suffered losses, the concerned government has tried to make up for them in other projects. At the same time, where a foreign investor insists on holding the local government or its officials responsible, it would in the end be very difficult for that investor to continue its investment. This situation is not, in fact, confined to the Chinese community. The treatment received by those investors who have undergone the investor-State dispute resolution process with Argentina and other countries supports that conclusion.

The Chinese system relating to recognition and enforcement of arbitral awards also discourage foreign investors to have their disputes with China settled by arbitration. China has different mechanisms for enforcement of domestic arbitral awards67, arbitral awards involving foreign elements68 and foreign awards69. The Civil Procedural Law70 and

67 “Domestic arbitral awards” are those rendered in disputes with no foreign party and wherein the subject matter is purely domestic.
68 According to Article 304 of The Opinions on Various Issues Arising from the Application of the Civil Procedural Law of the People’s Republic of China, issued by the Supreme People’s Court on 14 July 1992, a case involves a foreign element if: (1) one or both parties are foreign nationals, stateless persons or foreign companies or organizations; (2) the legal actions leading to the formation, amendment or termination of a legal relationship occurred in a foreign country; or (3) the subject matter is located in a foreign country. (Text of The Opinions available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=6690>. Therefore, arbitral awards rendered by Chinese arbitration institutions for disputes involving foreign elements are defined in the same way.
69 Foreign awards include Convention Awards made in the States which are Contracting Parties to the New York Convention, and non-convention awards made in other countries. See, Zhao Xiwen and Lisa A. Kloppenberg, “Reforming Chinese Arbitration Law and Practice in the Global Economy”, 31 U. Dayton L. Rev. 421.
the Arbitration Law71 are the primary Chinese laws containing provisions regulating the recognition and enforcement of arbitral awards. These are supplemented by the judicial interpretations of the Supreme People’s Court of China72 and the administrative regulations of the State Council. As China gives precedence to the provisions of international treaties over Chinese law,73 these may also be applied directly by the Chinese courts. This is, however, restricted to disputes between parties with equal status.

Regarding recognition and enforcement of arbitral awards, Article 258 of the Civil Procedure Law restates the grounds of Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards74 for refusing recognition and enforcement of foreign arbitral awards, although with slightly different wording. The Notice 1995 established an internal reporting system under which local courts may not refuse recognition and enforcement of a foreign award unless this is approved by the Supreme People’s Court. It also authorises the Intermediate People’s Court to be the court in charge.75 For the purpose of ensuring recognition and enforcement, The Provisions 2002 further restricted the competent courts to the Intermediate People’s Court at the locality of the capital city of the provinces and autonomous regions as well as the municipalities directly under the Central Government. The Intermediate People’s Courts of special economic zones and cities directly under the State planning and other Intermediate People’s Courts designated by the

71 The Law of the People’s Republic of China on Arbitration (the Arbitration Law) was adopted at the 9th Session of the Standing Committee of the 8th National People’s Congress, promulgated on 31 August 1994, and became effective as of 1 September 1995; available at: <http://np.china-embassy.org/eng/EconomyTrade/zchfl/t167702.htm>.
73 Article 142 of the General Principles of Civil Law of China, supra, note 57, stipulates that the provisions of the international treaties and agreements to which China is a party and to which no reservations have been made shall prevail over the provisions of the Chinese law in case a conflict exists between them.
75 According to Article 257 of the Civil Procedure Law, supra, note 75, the jurisdiction of the court is determined on the basis of the domicile of the party whose obligation it is to execute the award or the place where the disputed property is located.
Supreme People’s Court may also handle cases involving recognition and enforcement of foreign arbitral awards and awards with foreign elements.\(^{76}\)

The above system does not, however, apply to investor-State arbitral awards like those made by ICSID Tribunals. On acceding to the New York Convention, China made a “commercial reservation” – i.e. only those arbitral awards concerning disputes arising from contractual and non-contractual commercial legal relationships may be recognised and enforced in China. Subsequent to China’s becoming a contracting party to the New York Convention, the Supreme People’s Court of China issued The Notice 1987, expressively excluding arbitral awards in respect of investor-State disputes from the list of awards recognisable and enforceable in China.\(^{77}\)

Assisted by Article 5(2) of the New York Convention,\(^{78}\) The Notice 1987 will preclude all foreign arbitral awards involving investor-State disputes, except those made in accordance with the ICSID Convention, from recognition and enforcement in China.

The fate of ICSID arbitral awards may not be any better. In its recent BITs and FTAs, China has agreed to investor-State arbitration, and in most cases this means ICSID arbitration. Although the ICSID Convention has a self-execution system relating to enforcement of its awards, its Article 54(3) stipulates that the execution of awards “shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought”. Thus, where the relevant domestic law does not permit execution against the property of the state, the arbitration in question cannot be enforced. In so far as China is concerned, it does not have any law permitting enforcement of arbitral awards (including ICSID awards) against State property. At the same time, China still adheres to the principle of absolute sovereign immunity.\(^{79}\) Presumably, this will also

\(^{76}\) Article 1 of The Provisions 2002, supra, note 79.

\(^{77}\) Article 2 of The Notice 1987, supra, note 79, provides: “‘Contractual and non-contractual commercial legal relationship’ means the economic rights and duties arising from contracts or torts or stipulated in the regulations, such as goods sale, property lease, project contract, processing contract, technique transfer, joint venture, joint business operation, exploration and development of natural resources, insurance, financial credit, personal services, agency, consulting services and marine, air, railway and road transportation of cargo and passengers, product liability, environmental pollution, accidents at sea and ownership disputes, except the disputes between foreign investors and the government in the host country.”

\(^{78}\) According to Article 5(2) of the New York Convention, supra, note 81, the Contracting Parties may refuse to recognize or enforce an award if the subject matter may not be dealt with through arbitration under their domestic laws.

\(^{79}\) In FG Hemisphere Associates LLC v. Democratic Republic of Congo, the Court of Final Appeal of the Hong Kong Special Administrative Region, in accordance with Article 158(3) of the Basic Law, requested the Standing Committee of the National People’s Congress of China to interpret the relevant provisions of the Basic Law. In its interpretation of 26 August 2011, the Standing Committee confirmed that, inter alia, China adheres to the principle of absolute sovereign immunity and that the courts of Hong Kong must observe this principle.
prevent local courts from attaching the assets of the State for the purpose of enforcing an ICSID award. In these circumstances, foreign investors are discouraged from engaging in any arbitration against China, since, even if they win arbitration, the arbitral award may not be enforced.

As discussed earlier, there are various means for amicable solution of disputes in China. With the good faith participation of both the government and investors, such amicable means of dispute resolution have proved to be of great assistance. After all, the ultimate goal of foreign investors is to operate their investments successfully. So long as there are other means of dispute resolution which are free of charge or not as expensive as arbitration, and unless they are forced into a corner, they will prefer to concentrate on their business rather than spending time and money on arbitration.

**PART 4: THE WAY FORWARD**

Over the course of the last thirty years, China has gradually accepted the practice of international arbitration as a means to resolve disputes with foreign investors. Treaty provisions on full protection and security, fair and equitable treatment, umbrella clauses, minimum standards of treatment, etc. have now been routinely incorporated into China’s new-generation BITs and FTAs. This demonstrates China’s willingness to adopt internationally accepted practices and standards for protection of foreign investments.

In so far as investor-State dispute resolution is concerned, in the past, China was very cautious and limited the resort to international arbitration to the ascertainment of the amount of compensation for expropriation. It is now ready to accept international arbitration on any matters relating to investment. This change confirms China’s preparedness and determination to engage as an equal partner in international economic exchanges. Such a policy change has profound implications because, once an arbitral award is made, China would be under an obligation to enforce it. This will not only benefit foreign investors at large by enhancing their legal rights under the BITs and FTAs but will significantly improve the overall investment environment in China and help accelerate the process of making China into a mature market economy. It will also have a positive effect on the establishment of the rule of law in China. With international tribunals as watch dogs, Chinese government officials must behave more carefully and in accordance with established international legal procedures and
standards. This is also in line with China’s policy on domestic legal reform for “establishing good governance standards as a reference for legislative, administrative, and judicial conduct”.80

China’s change of policy on investor-State dispute settlement and standards of treatment of foreign investment and investors is also a reflection of China’s economic status. China is now the largest recipient of foreign investment among the developing markets. At the same time, it is also emerging as a major source of outward investment.81 According to the 2009 Statistical Bulletin of China’s Outward Foreign Direct Investment published by the Chinese government, the direct investments made by Chinese entities in other countries and regions amounted to US$ 56.53 billion in 2009. By the end of that year, Chinese entities had invested in about 13,000 enterprises in 177 countries and regions, and the accumulated outward FDI had reached a total of US$ 245.75 billion.82 Against this background, it is natural for China to accept international arbitration as a means for resolving investor-State disputes. In doing so, Chinese investments in other countries may also benefit; host countries of Chinese investments may not have a tradition of amicable resolution of disputes or may not have well-established mechanisms for doing so like those that exist in China. In addition, although the Chinese government and society encourage negotiation and mediation, it is possible that foreign investors may prefer international arbitration to resolve their disputes with the Chinese government, in which case China has little choice but to be prepared for that.

The above having been said, it does not mean that there will not be setbacks in integrating China into the international community. The most probable event that may trigger such setbacks is arbitral decisions like that handed down in the Tza Yap Shum case. In the first place, the Tza Yap Shum Tribunal clearly demonstrated a bias towards a country like China. When commenting on the application of Article 8(3) of the China-Peru BIT, which restricts ICSID arbitration to the determination of the amount

of compensation for expropriation, it stated that the section reflected a “certain degree of distrust or ideological unconformity on the part of communist regimes regarding investment of private capital, and maybe also certain concern about the decisions of international tribunals on matters such regimes are not familiar with and over which they had no control”. This extremely biased and obviously discriminatory statement disclosed the Tribunal’s unwillingness to analyse the meaning and effects of the BIT provisions seriously. This is also evidenced in the subsequent discussion presented by the Tribunal. On the one hand, it admitted that Article 8(3) limited the scope of application of ICSID arbitration under the BIT to “the amount of compensation for expropriation”. At the same time, it stated that such a determination “may include, in addition to the amount of compensation, a determination of other important matters related to the alleged expropriation … [and, for a variety of reasons, the Tribunal has decided that … the broadest interpretation, happens to be the most appropriate]”.84

What is the “variety of reasons”? Why are the unfamiliarity of communist regimes with the international arbitration system and their desire to control the outcome of arbitration relevant in interpreting the BIT? The purpose of such statements seems to serve as the Tribunal’s preparation for deviating from the clear provisions of the BIT by referring, in this case in a very farfetched way, to its object and purpose.

What the Tribunal did was to replace the contracting parties’ agreement with its own assumptions on what is needed for “attracting foreign investment”. This kind of interpretation is not helpful in promoting international investment law and will weaken the confidence and trust of BIT contracting parties in international investment dispute settlement mechanisms. In fact, where the parties deliberately have restricted ICSID jurisdiction to ascertaining the amount of compensation for expropriation, a tribunal is not permitted to enlarge its scope of jurisdiction by assuming or guessing their intent or, even worse, by alleging that “a determination of other important matters related to the alleged expropriation” is needed. The question is what the contracting parties have agreed to authorise ICSID tribunals to decide and not what, in the view of any such tribunal, is relevant or important to decide. Decisions like the one handed down by the Tza

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83 Tza Yap Shum v. Republic of Peru, Decision on Jurisdiction and Competence of the Arbitral Tribunal, supra, note 55, para. 145.
84 Ibid, para. 150.
Yap Shum Tribunal, are likely, to say the best, to invite annulment on the basis of the tribunal having “manifestly exceeded its powers”. In this particular case, it may well be that the contracting parties to the BIT did not intend to make Article 8(3) functional. If that is the case, the tribunal should have given such intent effect by interpreting the relevant provisions faithfully.

Apparently in order to defend its position, the Tza Yap Shum Tribunal turned to the last sentence of Article 8(3), which says that “[t]he provisions of this Paragraph shall not apply if the investor concerned has resorted to the procedure specified in Paragraph 2 of this Article”. In its analysis, the Tribunal stated:

“[T]he last sentence dispels any doubt about whether an investor (of any Contracting Party), when deciding on a course of action to settle a dispute in accordance with Article 8, finds himself with an irrevocable either-or choice, also known as ‘fork in the road’. The investor ‘shall be entitled to submit this dispute to the competent court of the Contracting Party’ pursuant to paragraph 8(2), but if the investor does [so], by virtue of paragraph 8(3) [it] may not, under any circumstance, make use of ICSID arbitration to settle a ‘dispute involving the amount of compensation for expropriation’.”

In fact, immediately preceding the last sentence relied on by the Tribunal, there is another sentence which says that “[a]ny disputes concerning other matters between an investor of either Contracting Party and the other Contracting Party may be submitted to the Centre if the parties to the disputes so agree”. The logical conclusion through reading the two sentences together should be that the disputing parties may agree to submit other disputes to ICSID for arbitration, provided the matters in dispute have not been submitted to the court of the host State for a decision. The Tribunal deliberately ignored the provisions mentioned earlier in order to reach its illogical conclusion. Also in accordance with the rules of treaty interpretation, special provisions should prevail over general provisions.

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86 Tza Yap Shum v. Republic of Peru, Decision on Jurisdiction and Competence of the Arbitral Tribunal, supra, note 55, para. 159.
In this regard, the provision on the “amount of compensation” is clearly specific compared with the last sentence of Article 8(3). The Tribunal’s decision is therefore also inconsistent with the generally accepted principle of giving preference to specific provisions over general ones.

It is true that foreign investors consider international arbitration to be an important dispute settlement mechanism and even a more favourable mechanism than litigation in the courts of the host State. Nonetheless, arbitral tribunals may not ignore the clearly stipulated provisions of a BIT, as was done in the Ṭza Yap Shum case, and restructure, in accordance with their own desires, a dispute settlement procedure. BITs and FTAs should be interpreted according to the Vienna Convention on the Law of Treaties, in particular Articles 31 and 32 thereof, which reflect the customary rules of treaty interpretation. Unless arbitral tribunals and other dispute settlement bodies follow the rules and principles correctly and strictly, many undesirable decisions and awards may be the result. This is likely to have a very important impact on countries such as China which have accepted investor-State arbitration as a means to settle disputes with foreign investors only recently. Of course, the provisions outlining a treaty’s object and purpose are important. Nevertheless, it would diminish the due effect and function of other provisions to overly emphasise the object and purpose of a BIT. The importance of the object and purpose provisions is that, when a provision on substantive issues is unclear, these can throw light on the understanding of the unclear provision.

The expansive interpretation of the most-favoured-nation clause to extend it to dispute resolution is another example that may slow the pace of China in adopting a liberal policy toward investor-State dispute resolution. Contradictory decisions made by different arbitral tribunals on the basis of identical substantive facts may further delay the process, although, in the long run, China will have to accept the mainstream practices of the international community.

In conclusion, over the last thirty years, China has evolved from being solely a recipient of FDI into an important country in terms of both capital inflows and outflows. Commensurate with its economic development, China’s laws and legal system are being modernised with detailed provisions. All the new-generation BITs and FTAs that China has entered into stipulate the standards of treatment currently accepted by other countries. The acceptance of ICSID jurisdiction in its disputes
with foreign investors in recent years is a significant and welcome step taken by China. Yet, there are still hurdles within its domestic system for enforcement of investor-State arbitral awards which are not commensurate with the Chinese government’s desire to integrate into the rest of the world. With the growth of its economic and political powers in the international community, China must take more responsibilities in world affairs, including foreign investment issues. As the French philosopher Voltaire noted: “With great power comes great responsibility.”87