

# China's Outward Foreign Direct Investment and International Investment Law

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## ABSTRACT

As China's outward foreign direct investment (FDI) has grown, its approach to international investment agreements (IIAs) has changed. China is now one of the world's most important outward investors, with Chinese FDI facing widespread criticism. The challenge for China is to adapt to this new configuration of interests stemming from these developments, both in terms of its national policies and the contents of its IIAs. In so doing, it is likely to influence, perhaps significantly, the further evolution of international investment law. This article deals briefly with the salient features of China's outward FDI and the policies that support it (Section A); the perception and reception of China's outward FDI in key host countries (Section B); and the changing nature of the country's approach to international investment treaties (Section C). The article concludes (Section D) with a brief review and outlook.

## I. SALIENT FEATURES OF CHINA'S OUTWARD FDI AND POLICY ISSUES RELATED TO THEM

### A. The rise of China's outward FDI

China has become a major player in the world FDI market. The country's outward FDI flows grew from US\$7 billion in 2001<sup>1</sup> to US\$101 billion in

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1 Unless otherwise indicated, all data are from UNCTAD *Stat*, available at <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (last visited 6 March 2015).

2013<sup>2</sup> and US\$116 billion in 2014,<sup>3</sup> for an accumulated stock of US\$730 billion.<sup>4</sup> In terms of outflows, this made China the single most important *home* country among *all emerging markets*<sup>5</sup> in 2014, and the third (behind the USA and Hong Kong (China)) largest among *all* home countries,<sup>6</sup> complementing its role as the single largest *host* country among developing countries. Indications are that China's outward FDI will continue to rise, with one source projecting US\$1-2 trillion in global Chinese outward FDI from 2010–20.<sup>7</sup> In fact, China's outward FDI flows have already almost caught up with China's inward FDI flows: in 2001, outward FDI flows as a percentage of inward FDI flows were 15%;<sup>8</sup> in 2014, they were 90%.<sup>9</sup> China may soon be a net outward FDI flows country.

China's 16,000 multinational enterprises (MNEs) had established some 22,000 foreign affiliates in 179 countries and territories by end-2012.<sup>10</sup> Mergers and acquisitions (M&As) have become an important entry mode into foreign markets. It is, however, difficult to ascertain how the country's FDI is distributed across sectors and geographic regions, as more than two-thirds of China's non-financial sector outflows are channelled via financial centers and tax havens (Hong Kong, the Cayman Islands, the British Virgin Islands, Luxembourg, Panama);<sup>11</sup> consequently it is not known in which countries and sectors they are ultimately invested. But it seems to be likely that services and natural resources are the most important sectors, and that Chinese firms have invested substantially in both developed and developing countries.

These figures should not disguise, however, that, globally, China's average share in world FDI outflows averaged only 5% during 2010–12, while its share in the world's outward FDI stock was 3% in 2014.<sup>12</sup>

A mix of motives drives the growth of China's outward FDI, motives also known from the growth of MNEs headquartered in other countries, although their relative importance may vary.<sup>13</sup> A good part is resource-seeking, explained by the fact that China is short of mineral and petroleum resources, while its rapid economic growth needs these in high quantities. Trade-supporting FDI is important, reflecting the country's leading role in international exports. Also relevant is the desire to access

2 See UNCTAD, *World Investment Report 2014: Investing in the SDGs. An Action Plan* 206 (Geneva: UNCTAD, 2014), available at [http://unctad.org/en/PublicationsLibrary/wir2014\\_en](http://unctad.org/en/PublicationsLibrary/wir2014_en).

3 See, UNCTAD, *World Investment Report 2015: Reforming International Investment Governance* (Geneva: UNCTAD, 2015) A4.

4 See *ibid.* at A8.

5 See *ibid.* Annex table 2.

6 See UNCTAD, above n 3, at 8.

7 See Thilo Hanemann and Daniel H. Rosen, *Chinese Invests in Europe: Patterns, Impacts and Policy Implications* 5 (New York: Rhodium Group, 2012). This compares to a global FDI outward stock of US\$ 26 trillion in 2013; see UNCTAD, n 2, at 30.

8 See UNCTAD *Stat*, available at <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>.

9 See UNCTAD, n 3, at A4.

10 Ministry of Commerce People's Republic of China (MOFCOM), *Summary 2012 Statistical Bulletin of China's Outward Foreign Direct Investment* (10 August 2013), available at <http://www.mofcom.gov.cn/article/tongjiziliao/dgz/201309/20130900295526.shtml>.

11 MOFCOM, *2011 Statistical Bulletin of China's Outward Foreign Direct Investment*, available at <http://images.mofcom.gov.cn/hzs/201309/20130923082710756.pdf>.

12 UNCTAD, above n 3.

13 See, e.g., Peter J. Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 38 *Journal of International Business Studies* 499 (2007).

markets through direct investment (as opposed to trade), including to protect the China's exporters against possible trade barriers. A number of projects are further characterized by the need to acquire technology and other asset-augmenting resources (such as brand names and distribution networks). Given rising costs particularly in the country's coastal provinces (especially of labor), efficiency-seeking investment is becoming important, directed mainly to some Asian and African countries. Finally, a number of specific factors play a role, including round-tripping funds back into the country (e.g., to benefit from the protection of bilateral investment treaties (BITs)), to benefit from lower taxes (or avoid taxes), to park funds abroad for future uses, or simply to take funds out of the country under the guise of outward FDI.<sup>14</sup>

### B. Principal characteristics

Apart from its rapid and speedy rise and the salient features already mentioned, there are two other features that characterize China's outward FDI.

The first one is that, in distinction to virtually all other major outward investors, state-owned enterprises (SOEs) account for a substantial share of the country's outward FDI flows and stock. In addition, many non-SOEs (especially the bigger ones) are linked to China's government in one way or another, including because top executives and board member are members of the Chinese Communist Party, sometimes in high positions.<sup>15</sup> Although, as of the end of 2011, some 13,500 Chinese financial and non-financial enterprises had established about 18,000 foreign affiliates in 177 host economies,<sup>16</sup> the 113 central SOEs controlled by the State-owned Assets Supervision and Administration Commission (SASAC)<sup>17</sup> alone accounted for 66% of China's non-financial FDI outflows and 76% of the country's non-financial outward FDI stock in 2011.. This raises the question of whether China's outward FDI (or at least a good part of it) might be made for purposes other than commercial ones and, more specifically, may be detrimental to the national security of host countries.<sup>18</sup> The extent to which this might be the case in a systematic manner is difficult to ascertain, as it is for the outward FDI of SOEs headquartered in other countries.<sup>19</sup>

14 This can also involve individuals who may buy real estate or otherwise take their funds abroad under the guise of outward FDI.

15 See Curtis J. Milhaupt and Wentong Zheng, 'Beyond Ownership: State Capitalism and the Chinese Firm', *Georgetown Law Journal* (forthcoming 2015). It is of course difficult to determine how much influence this has on the day-to-day operations of a firm, as many of the founders and chief executives of that generation were members of the Party and/or government.

16 MOFCOM, above n 11, at 3.

17 See State-owned Assets Supervision and Administration Commission of the State Council, available at <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html> (last visited 17 July 2014).

18 For a discussion of these concerns, Karl P. Sauvant et al. (eds), *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press, New York 2012).

19 In this context, it should be noted that outward FDI by SOEs headquartered in developed countries is significantly more important than that by SOEs headquartered in emerging markets. More specifically, in 2010, of the top 100 largest non-financial MNEs worldwide and the 100 largest headquartered in emerging markets (determined on the basis of the size of their foreign assets), 49 were SOEs. Of these 49, 20 were headquartered in developed countries, controlling US\$1.4 trillion in foreign assets, while 29 were headquartered in emerging markets, controlling US\$0.4 trillion. See Karl P. Sauvant and Jonathan Strauss, 'State-controlled Entities Control Nearly US\$2 Trillion in Foreign Assets', 64 *Column FDI*

Still, as will be discussed below, these concerns have led to the creation or strengthening of regulatory review processes of incoming M&As in a number of countries, especially for certain sensitive industries. The September 2012 veto by the President of the USA of a Chinese windmill project near a military base in Oregon—the first such veto in 22 years, and only the second one in the history of the Committee on Foreign Investment in the USA—is emblematic of these concerns.<sup>20</sup> On the other hand, China's government has encouraged private enterprises' overseas investment in the past several years. For example, the National Development and Reform Commission issued 'The Implementation Opinions on Encouraging and Guiding Private Enterprises to Actively Conduct Overseas Investment' in 2012,<sup>21</sup> which created preferential policies for the outward FDI of private enterprises, including tax incentives, financial support, and custom reform.

The second feature that distinguishes China's outward FDI concerns the fact that China has a relatively sophisticated regulatory framework dealing with outward FDI. It is a framework that has moved, within two decades, from restricting to encouraging.<sup>22</sup> Embedded in an overall development strategy, China's 'going out' strategy<sup>23</sup> has two principal purposes. One, the regulatory framework facilitates and supports outward FDI to create globally competitive Chinese firms: a portfolio of locational assets in form of an international network of foreign affiliates provides access to resources of all kinds (including know-how, brand names) and facilitates access to markets; both enhance corporate competitiveness, including by allowing firms to upgrade their own capabilities and thus compete more successfully in the domestic market (with other domestic firms and foreign affiliates in China). Two, China's outward FDI framework encourages the type of outward FDI that contributes directly to China's development, especially by obtaining natural resources, promoting exports or strengthening the country's technological base.<sup>24</sup> The government has put in place an institutional structure and various instruments ('home country measures') for this purpose.

Although a number of government institutions have, in one way or another, a say on outward FDI, the principal ones are the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM). Together with a number of other institutions, they established (in 2006) a 'Sector direction policy' that provides guidance for specific promotional measures on the basis of investment that is encouraged, allowed and prohibited.<sup>25</sup> The specific instruments used to

Perspectives(2012) 1. 'SOEs' are defined as enterprises in which the government has a controlling interest, with 'control' defined as a stake of 10% or more of voting power. *ibid* at 2.

20 *In rare move*, 'Obama Unwinds Chinese Acquisition of U.S. Wind Farms', 12(39) *Inside U.S. Trade I*, (2012) at 16–17.

21 See National Development and Reform Commission, available at [http://www.sdpc.gov.cn/fzgggz/wzly/zcfg/wzzcjwz/201404/t20140410\\_606603.html](http://www.sdpc.gov.cn/fzgggz/wzly/zcfg/wzzcjwz/201404/t20140410_606603.html) (last visited 26 August 2014).

22 For a detailed discussion, see Karl P. Sauvant and Victor Z. Chen, 'China's Regulatory Framework for Outward Foreign Direct Investment', 7 *China Economy Journal* 141 (2013), at 141–163.

23 The 'going out' strategy, which guided the creation of the current FDI policy and regulatory framework, was announced by the Third Plenum of the Ninth National People's Congress in March 2000. See Xiao Yu and Lei Jiao, 'A Brief Introduction of the "go out" Strategy', 2 *Qiaowu Gongzuo Yanjiu* 1 (2011), available at <http://qwgzzy.gqb.gov.cn/yjyt/159/1743.shtml>.

24 See Sauvant and Chen, above n 22.

25 See *ibid*.

encourage outward FDI include various subsidies (including financial and fiscal support); priority access to loans; expedited approval; priority access to foreign exchange; tax rebates on (or waivers for) the export of goods (e.g., equipment); priority regarding overseas financing, investment consulting, risk assessment, risk control, and investment insurance; and priority treatment regarding information questions, consular protection, customs exit and the entry of personnel, expatriate personnel approval, registration and the domestic coordination of import–export operation rights, and international communication.<sup>26</sup> These home country measures seem to be equally available to both SOEs and private enterprises, at least as far as the formal regulatory framework is concerned.<sup>27</sup> At the same time, China has a number of regulations in place that prescribe standards of behavior for its foreign investors.<sup>28</sup>

Finally, a network of 130 bilateral investment treaties (BITs),<sup>29</sup> as well as a number of other international investment agreements, provides protection to China's outward investors. While these treaties were originally concluded with inward FDI in mind, they have evolved considerably over time to reflect the rise of China as an outward investor, an evolution discussed below in this paper.

### C. Implications

Against this background, three observations are in order.

One, while China's regulatory framework for outward FDI appears to be very sophisticated, the approval process is complex, cumbersome, and can be slow.<sup>30</sup> With the further growth of outward FDI, the approval process will have to be simplified considerably, if not replaced by mere notifications, unless it might collapse under

26 See *ibid.*

27 In practice, though, SOEs may benefit more from the home country measures that are available. For example, the approval process may be faster for (especially large) SOEs; and SOEs (especially the central ones) may have easier access to credit (typically an obstacle to SMEs everywhere—and most of China's outward investors are SMEs), especially if this finance comes from state-owned banks. Some of these benefits may simply be related to size, and regardless of whether outward investors are SOEs or privately owned enterprises. See *ibid.*

28 See MOFCOM: Outward Investment and Economic Cooperation, *Chinese foreign investment joint venture construction compilation*, available at [http://fec.mofcom.gov.cn/article/zcfg/zcfb/dwtz/201303/1741680\\_1.html](http://fec.mofcom.gov.cn/article/zcfg/zcfb/dwtz/201303/1741680_1.html) (last visited 1 October 2014); MOFCOM: Outward Investment and Economic Cooperation, *Chinese foreign investment joint venture construction compilation—Preparation instructions*, available at [http://www.gov.cn/gzdt/2009-06/01/content\\_1329230.htm](http://www.gov.cn/gzdt/2009-06/01/content_1329230.htm); <http://www.caep.org.cn/book/中国对外投资中的环境保护政.pdf>; The Export–Import Bank of China, *Environmental Impact Assessment Framework*, 2 January 2011, available at [http://www.eximbank.gov.cn/tm/medialist/index\\_23\\_14365.html](http://www.eximbank.gov.cn/tm/medialist/index_23_14365.html); The Export–Import Bank of China, *Resettlement Policy Framework*, 2 January 2011, available at [http://www.eximbank.gov.cn/tm/medialist/index\\_23\\_14367.html](http://www.eximbank.gov.cn/tm/medialist/index_23_14367.html); China Banking Regulatory Commission, Notice on Issuing the *Green Credit Guidelines*, 24 February, 2012, available at <http://www.cbrc.gov.cn/EngdocView.do?docID=3CE646AB629B46B9B533B1D8D9FF8C4A>; China Chamber of Commerce of Metals, *中国对外矿业投资社会责任指引》草*, available at [http://www.syntao.com/Uploads/file/Public-Consultation\\_Draft\\_Guideline\\_Chinese.pdf](http://www.syntao.com/Uploads/file/Public-Consultation_Draft_Guideline_Chinese.pdf).

29 See, available at <http://investmentpolicyhub.unctad.org/IIA/liasByCountry#iialnnerMenu> (last visited 17 December 2014). UNCTAD reported that the three countries with the most BITs were Germany, China, and France.

30 The last of these characteristics can create problems in the case of M&As when, at times, speedy decisions are required.

its own weight (given the growing number of Chinese MNEs and their foreign affiliates). Reform may, indeed, be in the offing as part of XI Jiping's broader reform efforts; indicative of this change is that, beginning in May 2014, requiring only deals valued at more than US\$ 1 billion to be approved by the National Development and Reform Commission, as compared to deals valued at more than US\$ 100 million previously.<sup>31</sup> It would also be more efficient to create a one-stop shop for the various measures available to qualifying outward investors. The combination of both approaches, if pursued, would imply that control measures regarding outward FDI would increasingly be replaced by incentives in order to support the government's broader economic development goals, making home country measures even more important to encourage outward FDI that contributes as much as possible to the country's development.

Two, as already noted, China is in the process of becoming a net outward investor. One likely implication of this trend is that the government's interest in protecting its outward investments and facilitating access to markets for its firms would be further enhanced, perhaps eventually trumping its interest to protect its own firms from inward FDI in certain sectors.<sup>32</sup> This, in turn, most likely would have implications for the country's policy stance on international investment agreements. The watershed accord reached in July 2013 between the governments of China and the USA (in the context of the USA–China Strategic and Economic Dialogue) to continue their negotiations of a BIT on the basis of pre-establishment national treatment (i.e., granting foreign investors market access) and the negative list approach to exceptions from such treatment (i.e., listing sectors that are restricted to foreign investors, as opposed to sectors that are open to them)<sup>33</sup> pinpoints the shift in emphasis in the country's perspective from a host country to a home country. At the same time, it is of course entirely possible that this shift in approach was also motivated—and perhaps greatly so—by the expectation that it could help in internal economic reform processes (including capital-market and SOE reforms). For this reason, the BIT negotiations ('century negotiations') between China and the USA

31 See National Development and Reform Commission, People's Republic of China, Order No. 9, 8 April 2014, available at [http://www.sdpc.gov.cn/fzgggz/wzly/zcfg/wzczjwzt/201404/t20140410\\_606603.html](http://www.sdpc.gov.cn/fzgggz/wzly/zcfg/wzczjwzt/201404/t20140410_606603.html). (The reference is to NDRC No. 9 Order of 2014.) MOFCOM still uses the same review documents as before, but is proposing a new document in which only sensitive areas/industries will require full reviews. See MOFCOM Department of Treaty and Law, Commerce Department on 'Overseas Investment Management (Amendment) (draft)' for public comment, available at <http://tfs.mofcom.gov.cn/article/as/201404/20140400551680.shtml> (last visited 17 July 2014).

32 In fact, it may well be that certain industries might already have reached such a degree of competitiveness that protection is no longer needed and hence opening up might not have any discernible impact on the market dynamics in those industries. For example, if one takes the Internet sector (where foreign firms have mostly either been excluded completely or restricted in their operations), China's firms in that industry have gained such a degree of market dominance that it is difficult to see foreign firms competing successfully in that industry. Rather, these Chinese firms are now beginning the early stages of their 'going out' process, potentially posing a threat to the established dominant Western firms in overseas markets. We are grateful to Louis Brennan for this insight.

33 'Important Outcomes in Economic Track in the Context of the Fifth-round of the U.S.–China Strategic and Economic Dialogue', *Xinhua* (12 July 2013). The devil is, of course, in the detail: much will depend on what kind of exceptions will be negotiated with future treaty partners and, as far as the negative list is concerned, what industries will be placed on them.

have at times been compared to the negotiations that led to China's entry into the World Trade Organization, in terms of the internal reform consequences this entry brought with them.<sup>34</sup> In any event, soon after this watershed accord, China's State Council approved (on 17 August 2013)—in a move reminiscent of the establishment of the first special economic zone in Shenzhen in 1980—a pilot free trade zone in Shanghai<sup>35</sup> that, among other things, will operate on the basis of a negative list of exceptions for foreign investment.<sup>36</sup> Other experimental free trade zones of this type may well be established in due course.

Three, China is not the only country that pursues its own national objectives in regard to the outward FDI of its firms and that has put home country measures into place to promote these objectives. Virtually all developed countries (but only a few developing ones) pursue—to a larger or lesser extent—similar policies and support them through appropriate instruments.<sup>37</sup> Hence, if home country measures become an object of international negotiations, a number of countries would be directly affected.

Nevertheless, in the view of a number of developed countries, helping firms to invest abroad has become undesirable, at least when it involves SOEs. The principal reason<sup>38</sup> might well be that MNEs from emerging markets, and especially SOEs

- 34 According to a representative of the MOFCOM's delegation negotiating the BIT, 'the significance of the China-US BIT negotiation is comparable to that of the WTO accession. While the WTO access negotiation is related to opening up of trade, the BIT negotiation is related to the reform of the administrative system of foreign investment and the opening up of foreign investment. Hence the BIT negotiation will have more challenges but more profound implications'. See Jiang Wei, *中美双边投资协定进入文本谈判阶段* ('China-US BIT Negotiations advance to negotiations on text'), 21st Century Business Herald (16 January 2014), available at <http://jingji.21cbh.com/2014/1-16/yMMDA2NTFMTAONTIyMA.html>. Wang Xinkui of the Shanghai WTO Center put it even stronger: 'The China-US bilateral investment pact carries more significance than China's accession into the World Trade Organization.' Li Jiabao, 'China, US "pragmatic about pact"', *China Daily Asia* (16 January 2014), available at [http://www.chinadailyasia.com/business/2014-01/16/content\\_15112679.html](http://www.chinadailyasia.com/business/2014-01/16/content_15112679.html) (quoting Wang Xinkui).
- 35 See China (Shanghai) Pilot Free Trade Zone, *Promote reform with opening-up and promote development with innovations*, available at [http://en.shftz.gov.cn/homepage\\_note.html](http://en.shftz.gov.cn/homepage_note.html) (last visited 2 August 2014). See China (Shanghai) Pilot Free Trade Zone, *Regulations of China (Shanghai) Pilot Free Zone (Adopted at the 14th Session of the Standing Committee of the 14th Shanghai Municipal People's Congress of Shanghai on July 25, 2014)*, available at <http://en.shftz.gov.cn/Government-affairs/Laws/General/319.shtml> (last visited 25 July 2014). For a discussion, see Timothy P. Stratford and Scott Livingston, 'The Third Wave?', *Insight*, November 2013, at 22, available at <https://www.amcham-shanghai.org/NR/rdonlyres/89B7633D-3682-4EBF-AC3F-F64D40151D1A/20363/1Cover1.pdf>. The authors suggest that the Shanghai FTZ 'could signal the launch of a third wave of economic reform'. *Ibid* at 23.
- 36 For an unofficial translation of the negative list, see, American Chamber of Commerce in Shanghai, *Negative List for Shanghai Free Trade Zone*, available at <http://amcham-shanghai.org/NR/rdonlyres/88D66CDB-B8C8-42C8-BBA0-69E18E02EC72/20131/UnofficialTranslationNegativeListOctober2013.pdf> (last visited 2 August 2014). The Shanghai free trade zone is a pilot project; at the time of writing this chapter, not all regulations had as yet been put in place, and the negative list was reportedly being revised. See 'The Compilation of the Negative List (2014 Version) Has Started', *China Business News*, 20 December 2013, available at <http://www.yicai.com/news/2013/12/3253248.html>.
- 37 For an extensive analysis, see Karl P. Sauvant et al., 'Trends in FDI, Home Country Measures and Competitive Neutrality', in Andrea Bjorklund (ed.) *Yearbook on International Investment Law and Policy* (Oxford University Press, New York 2014) 2012–2013.
- 38 In the case of China's rapidly rising outward FDI, furthermore, broader geo-political considerations related to strategic competition may come into play, especially in the case of the USA.

from China, have become significant outward investors.<sup>39</sup> Such help, in the form of home country measures, is seen as giving special advantages to SOEs,<sup>40</sup> distorting in this manner the competitive OFDI landscape in favor of these enterprises in the markets in which they invest. The relevant concept is 'competitive neutrality'.<sup>41</sup> In the international context, this concept means that no entity in an international market should have undue competitive advantages vis-à-vis its competitors. Thus, measures to help firms in their outward FDI, even when available equally to both public and private entities, may in the future be evaluated in terms of their impact on competitive neutrality.

The international discussions so far, however, have focused only on advantages that are enjoyed by SOEs. This is the case in spite of the fact that, in the case of countries that make such incentives available, home country measures are available to both public and private firms and that there is no systematic evidence that home country measures regularly provide SOEs with competitive advantages over their private (or mixed) counterparts when engaging in FDI, and regardless of whether SOEs are based in developed economies or emerging markets.<sup>42</sup> A recent OECD study came to the same conclusion when it noted regarding the types of advantages granted to SOEs by governments with respect to cross-border activities: '[e]xisting information on such advantages is often either anecdotal or limited to individual cases.'<sup>43</sup>

The competitive neutrality discussions are being carried out in the OECD, but this issue has also entered the negotiations of the Trans-Pacific Partnership Agreement<sup>44</sup> and is expected to do so in other future negotiations,<sup>45</sup> with a view toward imposing disciplines on the availability of measures supporting outward FDI by SOEs. Depending on the outcome of these negotiations and, in particular, future negotiations in which China might participate, the support that China's SOEs obtain when investing abroad may eventually become a difficult policy issue.

39 Outward FDI from all countries *not* classified by UNCTAD as 'developed' reached US\$550 billion in 2013 (*see* UNCTAD, above n 2)—some eleven times of what world FDI flows were during the first half of the 1980s.

40 SOEs—and, for that matter—also other enterprises may be able to draw on other advantages, e.g., when they have a monopoly position in their domestic market. The discussion here focuses narrowly on specific measures meant to help firms invest abroad.

41 The 2005 OECD 'Guidelines on corporate governance of state-owned enterprises' stipulate that '[t]he legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.' *See* Organisation for Economic Co-operation and Development (OECD), *Guidelines on Corporate Governance of State-Owned Enterprises* at 18 (2005), available at <http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf>.

42 *See* Sauvart et al., above n 37.

43 Przemysław Kowalski et al., 'State-owned Enterprises: Trade Effects and Policy Implications', 147 *OECD Trade Policy Papers* (2013) at 10.

44 For a discussion of the SOE issue in the Trans-Pacific Partnership negotiations, *see* David A. Glantz, 'The United States and the Trans-Pacific Partnership', in Bjorklund, above n 37.

45 For example, in the context of the negotiations a Transatlantic Trade and Investment Partnership. *See* Office of the United States Trade Representative, available at <http://www.ustr.gov/about-us/press-of-fice/fact-sheets/2013/february/US-EU-TTIP> (last visited 2 August 2014).

## II. THE PERCEPTION AND RECEPTION OF CHINA'S OUTWARD FDI IN HOST COUNTRIES

### A. Rising scepticism

China's outward FDI is facing rising scepticism. This is partly the result of the speed with which this investment has grown; the leading role of SOEs in the country's outward FDI (and the associated concern that it could serve non-commercial purposes); the negative effects that can be associated with FDI (such as the transfer of research-and-development facilities from newly acquired firms to parent firms); the fear, especially regarding natural resource projects, that host countries do not get a fair deal in the distribution of benefits from such projects (including when these projects employ primarily Chinese workers); perceived unfair competition, especially in the case of SOEs (based on, e.g., the suspicion of subsidized financing); the negative image of the home country in some host countries (related also to the fact that members of the Chinese Communist Party are often in leading positions in Chinese MNEs); and the fear that China's outward FDI might compromise national security (especially regarding such investment in critical industries and infrastructure) while supporting the country's emergence as a global strategic competitor.<sup>46</sup> A look of the most important host countries among developed countries emerging markets for China's outward FDI helps to throw more light on these matters.<sup>47</sup>

46 See, e.g., Hanemann, above n 7, at 54–61; Peter Drysdale and Christopher Findlay, 'Chinese Foreign Direct Investment in the Australian Resource Sector', in Ross Garnaut, Ligang Song and Wing Thyee Woo (eds), *China's New Place in a World in Crisis* (Canberra: ANU Press, 2009) 349–388, available at <http://press.anu.edu.au/wp-content/uploads/2011/06/ch162.pdf>; Cosima Cassel, Giuseppe de Candia and Antonella Liberatore, 'Building African Infrastructure with Chinese Money', Paper (2010), available at <http://www.barcelonage.eu/tmp/pdf/ITFD10Africa.pdf>; Xiaofang Shen, *Private Chinese Investment in Africa: Myths and Realities* (Washington: World Bank, 2013), mimeo; and Transparency matters: disclosure of payments to governments by Chinese extractive companies, *Global Witness* (January 2013), available at [http://www.globalwitness.org/sites/default/files/library/transparency\\_matters\\_lr.pdf](http://www.globalwitness.org/sites/default/files/library/transparency_matters_lr.pdf). Some of these fears accompanied also the rise of Japan as an outward investor in the 1980s. For a study of the reactions in the USA to this rise, see Curtis J. Milhaupt, 'Is the US ready for FDI from China? Lessons from Japan's experience in the 1980s', in Karl P. Sauvant (ed.), *Investing in the United States: Is the US Ready for FDI from China?* (Cheltenham: Edward Elgar, 2009) 185–208. And a number of these concerns (as well as others) were traditionally also voiced by developing and other countries, see UNCTAD, *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development* (Geneva: UNCTAD, 1999).

47 Extensive research was conducted between early September 2013 and the end of March 2014 on the following countries, primarily using Google to locate local newspapers, institutions, and government websites, as well as the Factiva database, and focusing on the years 2012 and 2013; some 700 items were consulted (in a number of cases, the Chrome translation service was utilized): Australia, Belgium, Brazil, Cambodia, Canada, Chile, China, France, India, Indonesia, Iran, Ireland, Italy, Kazakhstan, Laos, Mexico, Mongolia, the Netherlands, Russia, Saudi Arabia, Singapore, Spain, Sudan, the UK, the USA, and Zambia; in addition research was undertaken for the European Union as a whole, reflecting the fact that, after the entry into force of the Lisbon Treaty on 1 December 2009, the Union has exclusive authority in the FDI area. These countries, plus other members of the European Union, accounted for some two-thirds of China's outward FDI stock in 2011 and a somewhat higher share of China's average FDI outflows during 2009–2011 (as reported by MOFCOM), not counting Chinese FDI in the tax havens and financial centers mentioned earlier in the text. See MOFCOM, above n 10. (Note, however, the observation made earlier that the MOFCOM data do not provide an accurate picture about the ultimate destination of China's outward FDI, precisely because most of it is channeled via financial centers and tax havens.) The research was done for English language publications and in each country's official language (except for Indonesia

Overall, FDI from China receives considerable attention in most of the countries researched, even though it is relatively small in the great majority of them, both in absolute amounts and relative to the sums invested by firms from other countries. Moreover, such investment is regarded with some trepidation in most (if not all) countries researched. This is true especially for M&As, for which (apart from national security reasons and competition issues) economic reasons can include that M&As may lead to lay-offs, the closing down of production lines and the transfer of research-and-development capacities to the parent firms (all concerns also known from M&As undertaken by MNEs headquartered in other countries). At the same time, it is recognized that M&As can save firms that otherwise may be failing. Chinese greenfield investment, on the other hand, is generally welcome, although there are issues in the case of FDI in natural resources and telecommunications.

Perceptions of incoming Chinese FDI are not uniform across constituencies within countries, however, nor are reactions to it across countries.

### B. The media

In most of the host countries to Chinese FDI that were researched, *newspapers* tend to represent a more critical constituency—but, again, unevenly so. Everywhere, the rise of incoming Chinese FDI (and especially important Chinese acquisitions) receive attention, far out of proportion of the relative importance of Chinese inward FDI compared with that from other countries.<sup>48</sup> Headlines in newspapers read, for example: ‘Latin America playing a risky game by welcoming in the Chinese dragon’,<sup>49</sup> ‘Kazakh opposition calls for halt to Chinese expansion’,<sup>50</sup> ‘Chinese investment and aid in Cambodia a controversial affair’,<sup>51</sup> ‘Chinese investment in Mongolia: An

and Saudi Arabia) to obtain the relevant information. To the extent possible, official statements from each country's administration as well as parliamentary debates related to new legislations affecting Chinese outward FDI were consulted. In addition, a good part of the information found was contained in both domestic and international newspapers and, in some cases, research papers. Research for Germany was conducted by Schahram Ghalebegi, *The Perception and Reception of China's FDI in Germany* (Berlin School of Economics and Law, Berlin April 2014) (on file with the authors); research for Kazakhstan and Russia was conducted by Andrei Panibratov, *Perceptions of Chinese FDI in Neighboring Emerging Economies: Different Groups' Opinions in Russia and Kazakhstan* (St. Petersburg State University, St. Petersburg May 2014) (on file with the authors); and research for all other countries was conducted by Camilla Gambarini, Nancy Lee and Adrian Torres, *The Perception and Reception of China's Outward FDI in Key Host Countries* (New York: Columbia Center on Sustainable Investment, April 2014) (on file with the authors).

- 48 In 2012, for example, the USA received US\$ 4 billion in FDI from China, accounting for 5% of the total; Kazakhstan received US\$ 3 billion, accounting for 3% of the total; the UK received US\$ 3 billion, accounting for 3% of the total; Australia received US\$ 2 billion, accounting for 3% of the total; and Indonesia received US\$ 1 billion, accounting for 2% of the total. See MOFCOM, *2012 Statistical Bulletin of China's Outward Foreign Direct Investment* 36 (Beijing: China Statistics Press, 2012). In a few countries however, like Cambodia, China accounts for a substantial share of inward FDI flows.
- 49 Kevin Gallagher, Latin America Playing a risky game by welcoming in the Chinese dragon, *The Guardian* (30 May 2013, 2:00 PM), available at <http://www.theguardian.com/global-development/poverty-matters/2013/may/30/latin-america-risky-chinese-dragon>.
- 50 Robin Paxton, Kazakh opposition calls for halt to China expansion, *Reuters* (28 May 2011, 10:57 AM), available at <http://uk.reuters.com/article/2011/05/28/kazakhstan-china-protest-idUKLDE74R02M20110528>.
- 51 Heng Pheakdey, Chinese investment and aid in Cambodia a controversial affair, *East Asia Forum* (16 July 2013), available at <http://www.eastasiaforum.org/2013/07/16/chinese-investment-and-aid-in-cambodia-a-controversial-affair/>.

uneasy courtship between David and Goliath,<sup>52</sup> and 'Fears over growing Chinese industry in Laos'.<sup>53</sup> National security concerns are particularly salient in the USA, France,<sup>54</sup> and the UK.<sup>55</sup> Chinese FDI in natural resources sectors receives attention in natural resource-rich countries, such as Australia, Canada, Kazakhstan, and Zambia. The fear is that, when critical resources are controlled from abroad,<sup>56</sup> the benefits associated with such projects may not be equitably distributed between foreign investors and host countries, including because labor is often imported from China and working conditions may be poor.<sup>57</sup> Media concerns in Australia also relate to the worry that strong Chinese investment in Australian real estate is leading to a real estate bubble.<sup>58</sup> Other media criticism involves broader negative effects such investment can bring. For example, in France it was claimed (in relation to Chinese acquisitions of enterprises in key sectors of the European and French economies) that 'China's cooperation dialogue usually hides the will of power and fast profits'.<sup>59</sup> In

- 52 Justin Li, Chinese investment in Mongolia: an uneasy courtship between David and Goliath, *East Asia Forum* (2 February 2011), available at <http://www.eastasiaforum.org/2011/02/02/chinese-investment-in-mongolia-an-uneasy-courtship-between-goliath-and-david/>.
- 53 Conor Woodman, Fears over growing Chinese industry in Laos, *BBC News* (28 May 2011), available at [http://news.bbc.co.uk/2/hi/programmes/from\\_our\\_own\\_correspondent/9498760.stm](http://news.bbc.co.uk/2/hi/programmes/from_our_own_correspondent/9498760.stm).
- 54 M. Jean-Marie Bockelf, *Rapport d'Information fait au nom de la commission des affaires étrangères de la défense et des forces armées sur la cyberdéfense* (Paris: French Senate, 18 July 2012), available at <http://www.senat.fr/rap/r11-681/r11-6811.pdf> (noting that, while the USA and Australia have banned the use of Chinese routers for reasons of national security (i.e., Chinese enterprises may be connected to the government and there are suppositions of cyber espionage), such a ban does not exist in the European Union. According to the author of the report, it is indispensable that the Commission introduces a ban on the use of routers from China because it affects national security).
- 55 Brian Wheeler, *Is it a good idea to allow China a stake in UK nuclear?*, BCC (Oct. 17, 2013), available at <http://www.bbc.com/news/uk-politics-24563535> (reporting several concerns on the potential participation of Chinese companies in United Kingdom nuclear power plants).
- 56 In Latin America and the Caribbean, Chinese FDI in natural resources accounted for an average of almost 90% of the country's FDI in the region during 2007–2011 (compared to a share of 25% for all foreign investors in that region). See Taotao Chen and Miguel Perez Ludena, *Chinese Foreign Direct Investment in Latin America and the Caribbean* (Santiago: ECLAC, 2014) 13. Together with the high share of natural resources in China's imports from Latin America (70%, see *ibid.*), this has given rise to the fear that a new center-periphery relationship is in the making. See also Miguel Perez Ludena, 'Is Chinese FDI Pushing Latin America into Natural Resources?', 63 *Column FDI Perspective* (19 March 2012).
- 57 In response to the low wages offered by Chinese firms, the Zambian government raised the minimum wage (which came into effect on 4 July 2012). See Zambia: dreaming of a minimum wage, *IRIN News* (10 July 2012), available at <http://www.irinnews.org/fr/report/96073/zambia-dreaming-of-a-minimum-wage>.
- 58 Vesna Nazor, China's appetite for Aussie real estate sparks boom, *SBS News* (6 November 2013), available at <http://www.sbs.com.au/news/article/2013/11/06/chinas-appetite-aussie-real-estate-sparks-boom>.
- 59 Philippe Delalande, Les investissements chinois en France: les craindre ou les souhaiter, *Le Monde* (15 October 2012), available at [http://www.lemonde.fr/idees/article/2012/10/15/les-investissements-chinois-en-france-les-craindre-ou-les-souhaiter\\_1775602\\_3232.html](http://www.lemonde.fr/idees/article/2012/10/15/les-investissements-chinois-en-france-les-craindre-ou-les-souhaiter_1775602_3232.html). ('les Français devront se départir d'une certaine naïveté face aux Chinois. Ils se laissent séduire pas les discours chinois sur la coopération qui masquent souvent une volonté de puissance et de profits rapides. Et ils sont déçus par la collusion constante en Chine des autorités politiques et des entreprises, contraire à leur conception de l'économie de marché. L'Europe doit réformer son droit pour se préserver des risques que comportent les investissements chinois et ne retenir que ceux qui lui seront bénéfiques. Elle pourrait s'inspirer de la législation chinoise dont la priorité est toujours la préservation des intérêts de la Chine. A défaut, on peut craindre que le capital productif et patrimonial de l'Europe ne passe, sans profit pour elle, sous la coupe chinoise plus vite qu'on le pense.'). See also De grands patrons chinois en escale à Paris pour chercher inspiration et investissements, *AFP* (24 June 2013), available at [http://lentreprise.lexpress.fr/de-grands-patrons-chinois-a-paris-pour-chercher-inspiration-et-investissements\\_1527422.html](http://lentreprise.lexpress.fr/de-grands-patrons-chinois-a-paris-pour-chercher-inspiration-et-investissements_1527422.html) ('les investisseurs

Cambodia, the activities of Chinese firms have been criticized for severely damaging the environment.<sup>60</sup> In Mongolia, the influx of foreign laborers, particularly Chinese, has been noted negatively, especially since many Mongolians remain unemployed.<sup>61</sup> In Indonesia, the lack of integration of Chinese enterprises into the country's society, which includes a very complex traditional social system, were criticized.<sup>62</sup>

On the other hand, other newspapers—often the business press in some countries<sup>63</sup>—are neutral in tone, and headlines focus on, e.g., 'New study shows no evidence of German "industrial crown jewels" sell off to China',<sup>64</sup> 'Chinese firms to invest 700 m in Holland',<sup>65</sup> 'China keen on investing in Brazil infrastructure, manufacturing',<sup>66</sup> 'Chinese investment funds target Singapore properties',<sup>67</sup> and 'Kenny sells the Irish as "a great bunch of lads"'.<sup>68</sup>

Again other media focus on positive aspects, reflected in such articles as 'Made in Italy: Investimenti cinesi, Stanca: spesso un bene per l'Italia',<sup>69</sup> 'Le développement de la Chine n'est pas une menace mais une opportunité',<sup>70</sup> 'India invites foreign

chinois ont mené ces dernières années une offensive sur les vignobles français, engrangeant une trentaine de châteaux du Bordelais et Gevrey-Chambertin en Bourgogne.' Interestingly, the author of the article uses the word 'une offensive'.

- 60 Heng Pheakdey, Chinese investment and aid in Cambodia a controversial affair, *East Asia Forum* (16 July 2013), available at <http://www.eastasiaforum.org/2013/07/16/chinese-investment-and-aid-in-cambodia-a-controversial-affair/> (noting that, while Chinese investment and aid is much needed for economic development, China's unquestioning approach to how its aid and investment money is distributed and used has exacerbated corruption, deteriorated good governance and human rights, and ruined Cambodia's resources and natural environment. Moreover, human rights activists have often accused Chinese textile factories of abusing worker's rights, while China's hydropower investments have destroyed protected areas, forest biodiversity and wildlife habitat.). See also Concern over Chinese investment, *Radio Free Asia* (7 February 2013), available at <http://www.rfa.org/english/news/cambodia/china-02072013175545.html>.
- 61 M. Zoljarga, Contractors bring illegal workers while Mongolians remain unemployed, *The UB Post* (17 December 2013), available at <http://ubpost.mongolnews.mn/?p=7031>.
- 62 Great Han Samarinda, Investment from China's enterprises, *The Jakarta Post* (21 September 2012), available at <http://www.thejakartapost.com/news/2012/09/21/your-letters-investment-china-s-enterprises.html>.
- 63 For example, the *Frankfurter Allgemeine Zeitung* and the *Manager Magazine* in Germany and *Il Sole 24 Ore* in Italy.
- 64 See Press Release, BGM Associates, *Dragons and Tigers Hunting in Germany: Chinese and Indian Acquisitions of German Firms 2002-2012*, available at <http://www.bgmassociates.com/news.html>. The study found that Chinese acquisitions were mainly motivated by the desire to acquire technologies, knowledge and brands.
- 65 Chinese firms to invest €700m in Holland, *Dutch News* (30 October 2009), available at [http://www.dutchnews.nl/news/archives/2009/10/chinese\\_firms\\_to\\_invest\\_700m\\_i.php](http://www.dutchnews.nl/news/archives/2009/10/chinese_firms_to_invest_700m_i.php).
- 66 Gerald Jeffris, China Keen on Investing In Brazil Infrastructure, Manufacturing, *The Wall Street Journal* (10 May 2013, 6:07 PM), available at <http://online.wsj.com/article/BT-CO-20130510-715152.html>.
- 67 Jacquelyn Cheock, Chinese investment funds target Singapore properties, *The Business Times* (3 September 2013), available at <http://www.stproperty.sg/articles-property/singapore-property-news/chinese-investment-funds-target-singapore-properties-cbre/a/135247>.
- 68 Fiach Kelly, Kenny sells the Irish as 'a great bunch of lads', *Irish Independent* (21 February 2012), available at <http://www.independent.ie/opinion/analysis/fiach-kelly-kenny-sells-the-irish-as-a-great-bunch-of-lads-26823861.html>.
- 69 Sonia Montrella, Made in Italy: Investimenti cinesi, Stanca: spesso un bene per l'Italia [Made in Italy: Chinese Investment, Stanca: usually a good opportunity for Italy], *AgiChina* 24 (18 January 2013), available at <http://www.agichina24.it/in-primo-piano/made-in-italy/notizie/investimenti-cinesi-stancabr-spesso-un-bene-per-lrsquoitaliabr->
- 70 Le développement de la Chine n'est pas une menace mais une opportunité, *French.people.com.cn* (25 September 2013), available at <http://french.peopledaily.com.cn/International/8410014.html>.

direct investment from China';<sup>71</sup> 'Fear of Chinese investment misses the economic point';<sup>72</sup> 'Chinese firms act for profit, not state';<sup>73</sup> and 'Messieurs les Chinois, investissez svp'.<sup>74</sup> In the USA, e.g., Chinese investments in depressed areas, such as Detroit, were positively commented upon.<sup>75</sup> In the Netherlands and Luxembourg, there was little negative public opinion, perhaps because Chinese investments there typically require relatively higher-skilled labor.

### C. The business community

The *business community* itself does not appear to be strongly engaged in the public debate on this subject. Big business—out of self-interest—typically supports an open international investment regime that provides strong protections for investors and investments and access to markets. Moreover, China is an important export market and host country for many firms, making the enterprises involved reluctant to advocate restrictive policies, for fear of retaliation. However, it may well be that firms and business associations lobby the government to take action, especially because of perceived competitive threats, and the arrival of new competitors is not always welcome. In the case of FDI by SOEs, moreover, concerns about possible competitive advantages of these enterprises come into play. In fact, the Business Coalition for Transatlantic Trade (BCTT—the most important US business coalition for the Transatlantic Trade and Investment Partnership negotiations) is a driving force to impose disciplines on SOEs, in the context of outward FDI and competitive neutrality.<sup>76</sup> BCTT's

71 India invites foreign direct investment from China, *The Economic Times* (28 February 2013), available at [http://articles.economictimes.indiatimes.com/2013-02-27/news/37331014\\_1\\_chinese-companies-china-s-jaishankar-mutual-investment](http://articles.economictimes.indiatimes.com/2013-02-27/news/37331014_1_chinese-companies-china-s-jaishankar-mutual-investment).

72 Wenran Jiang, Fear of Chinese investment misses the economic point, *Edmonton Journal* (15 February 2012), available at <http://www2.canada.com/edmontonjournal/news/ideas/story.html?id=763d030e-f0d3-4f45-8fe9-7e64d2221a1f>.

73 Peter O'Neil, Chinese firms act for profit, not state, *Vancouver Sun* (22 February 2012), available at <http://www2.canada.com/vancouversun/news/archives/story.html?id=ce11da98-bbf1-4040-a95b-29eafbfb887a>.

74 Messieurs les Chinois, investissez svp, *La Libre.be* (2 June 2006), available at <http://www.lalibre.be/economie/actualite/messieurs-les-chinois-investissez-svp-51b88ec9e4b0de6db9ae0ead>.

75 Kathy Chen, U.S. cities seek to woo Chinese investment, *The Wall Street Journal* (6 April 2010), available at <http://online.wsj.com/news/articles/SB10001424052702303410404575151593460208482>.

76 Most major USA associations and major companies are members of BCTT. Under the heading 'Disciplines for State Favored Commercial Actors', a short basic paper on competition policy lists the following among BCTT's objectives regarding state-owned/state-favored commercial actors:

Discipline government financial advantages provided on a preferential access and non-commercial basis to these entities.

Discipline government non-financial/regulatory treatment, including prohibiting selective enforcement of laws and regulations that is often done in a manner that is partial to these entities.

Ensure that a government is accountable for these entities' decisions in the market that are proven to be discriminatory or made as a result of government influence and not conducted in accordance with commercial consideration.

The obligations to address all of these distortions are subject to dispute settlement.

position is very similar to that of the US Business Coalition for TPP (the Trans-Pacific Partnership).<sup>77</sup>

#### D. Trade unions

*Trade unions*, too, do not seem to be that engaged. This is somewhat surprising since many of Chinese firms' M&As involve firms that are in difficulty or even insolvent,<sup>78</sup> and the consequences of such situations typically involve lay-offs. On the other hand, if such firms are taken over and continue as going concerns, this is a positive development. In the end, trade union welcome any investment, whether domestic or foreign, that creates or maintains jobs, as long a working conditions are fully in line with domestic legislation, or even better.<sup>79</sup> At the same time, at least the AFL-CIO is concerned about FDI by SOEs in the USA, fearing that it is asset-stripping or consists only of toehold investment.<sup>80</sup>

77 This Coalition has, among its Principles the following:

11. An agreement that promotes fair competition and a level playing field

A successful TPP agreement should ensure a level playing field by protecting and promoting the competitive process through strong rules on transparency and due process in competition-policy proceedings. In addition, this agreement should ensure that state-owned, state-invested and state-favored industries compete on a level playing field with private and foreign companies.

See *Principles*, U.S. Business Coalition for TPP, available at <http://tpcoalition.org/about/> (last visited 26 August 2014).

- 78 In Germany, a leading European host country for Chinese firms, a 2013 study found that, of the 46 foreign affiliates covered in the study and taken over by BRIC investors, 33% were insolvent or insolvency proceedings had been initiated. Among these 46 firms, 15 were Chinese affiliates; the overall insolvency rate appears to apply to them as well (there were about 615 Chinese foreign affiliates in Germany in 2013). See Kai Bollhorn and Sophie Golinski, *BRIC-Investitionen in Deutschland: Mythen & Realitaet* (Marburg/Leipzig: Phillips-Universitaet/Leibniz-Institut fuer Laenderkunde, 2013). The study was undertaken for the Hans Boeckler Stiftung, a foundation close to Germany's trade unions.
- 79 To quote Celeste Drake of The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO): 'We support increased investment of all kinds, including foreign and domestic, so long as the investments help grow our economy and create good job opportunities.' See Celeste Drake, 'Testimony for the Hearing: "Discussion draft of H.R. \_\_\_\_, The Global Investment in American Jobs Act of 2013" before the House Subcommittee on Commerce, Manufacturing, and Trade' at 1 (Washington D.C.: AFL-CIO, 18 April 2013).
- 80 'A looming threat—that of increased outward investment by Chinese SOEs—is also on the horizon. US firms will increasingly face unfair direct competition in the US by Chinese SOEs operating here as they scour the globe for investment opportunities resulting from the huge cache of funds they have amassed from their protectionist and predatory policies. To date, such investment has taken the form of either asset stripping of distressed companies or "toehold" investments to ensure market access and has operated to maximize employment within China at the cost of employment in the target countries.' Letter from R. Thomas Buffenbarger, Chair, Labor Advisory Committee for Trade Negotiations and Trade Policy (President, International Association of Machinists and Aerospace Workers), to Terry McCartin, Deputy Assistant US Trade Representative for China Affairs regarding the *Labor Advisory Committee Input for the Tenth WTO Transitional Review Mechanism for China*, 12 August 2011, available at <http://www.afm.org/uploads/file/LACChina.pdf> (last visited 13 October 2014). Consequently, 'We believe that the USTR should ensure that SOEs and any other entities acting with state-delegated authority do not undermine the competitiveness of private enterprise or the rights, pay, and benefits available to their workers. Nor should these entities be allowed to skew supply chains or engage in predatory practices in the U.S. or third country markets, thereby destroying jobs for American workers.' Testimony of Thea Mei Lee, Deputy Chief of Staff, American Federation of Labor and Congress of Industrial Organizations Before the Congressional Executive Commission on China, China's Compliance with the WTO and

## E. Governments

Finally, *governments*, i.e., the Executive and legislative bodies, reflect the conflicted attitude of other stakeholders. On balance, however, the *Executives* of the countries that were researched maintain a welcoming attitude, not only regarding incoming FDI in general, but also regarding such investment from China. For instance, in May 2007, the President of the USA, George W. Bush, issued a statement on 'Open Economies',<sup>81</sup> reaffirming the country's openness to FDI. (The statement was released just before the Foreign Investment and National Security Act was enacted, which strengthened the country's M&A review process.) Moreover, governments from all parts of the world have supported missions to China to attract investment, and often competition for such investment takes also place at the sub-national level (e.g., in the USA).<sup>82</sup> Chinese FDI was especially welcome in the European countries most affected by the Euro crisis, at times as a means to forestall the bankruptcy of domestic firms and to re-launch economic growth.<sup>83</sup> Some countries even introduced regulations to facilitate such investment, e.g., by simplifying the visa process.<sup>84</sup>

International Trade Rules (15 January 2014) at 7, available at <http://www.cecc.gov/sites/chinacommision.house.gov/files/CECC%20Hearing%20-%20WTO%20-%20Thea%20Lee%20Written%20Statement.pdf>.

81 Press Release, President Bush's Statement on Open Economies, *The White House Archives* (10 May 2007), available at <http://georgewbush-whitehouse.archives.gov/news/releases/2007/05/20070510-3.html>.

82 Business ties between China and The Netherlands intensified, *Dutch Daily News* (21 September 2012), available at <http://www.dutchdailynews.com/business-ties-between-china-and-the-netherlands-intensified/>; Hollande encourage les relations commerciales avec la Chine, *Les Echos* (25 June 2013), available at <http://afase.org/fr/>; in Latin America, Chile was particularly active in seeking to attract Chinese FDI (see Acuerdo que dinamizará el comercio de servicios entre Chile y China sería aprobado antes de la visita del Presidente Hu Jintao, Senado de la Republica, 13 April 2010, available at <http://www.senado.cl/> (last visited 4 August 2014)); Comisión de Relaciones Exteriores apoyó el acuerdo suplementario con China, Senado la Republica, 16 August 2013, available at <http://www.senado.cl/> (last visited 4 August 2014); Visan ocho acuerdos internacionales que profundizan materias de seguridad, comercio, cultura y reciprocidad diplomática, 4 September 2013, available at <http://www.senado.cl/> (last visited 4 August 2014); Sesión 53a, Ordinaria, en miércoles 4 de septiembre de 2013, 6 September 2013, available at <http://www.senado.cl/>, last accessed on 4 August 2014 Kathy Chen, U.S. cities seek to woo Chinese investment, *The Wall Street Journal* (6 April 2010), available at <http://online.wsj.com/news/articles/SB10001424052702303410404575151593460208482>.

83 See, e.g., Montrella, above n 68. See Sergey Filippov, *European Investment Promotion Agencies vis-à-vis Multinational Companies from Emerging Economies: Com-parative Analysis of BRIC Investor Targeting* (Maastricht: UNU-MERIT, 2012), for a discussion relevant here.

84 Reportedly, Ireland and Spain introduced new visa regulations specifically with Chinese investors in mind. Ireland introduced the Immigration Scheme for Investors and Entrepreneurs in 2012. In adopting this Scheme, the Ministry of Justice and Equality underlined that the implementing measures are not unique internationally and Ireland should compete with other countries (e.g., Australia, New Zealand, the UK) to attract migrant investors and entrepreneurs from Hong Kong and mainland China. See *Immigrant Investor Programme and Start-up Entrepreneur Scheme: Statements*, House of the Oireachts (9 February 2012), available at <http://debates.oireachtas.ie/seanad/2012/02/09/00006.asp>.

As to Spain, the country's Parliament passed the new law for entrepreneurs in September 2013, Ley 14/2013, available at <http://www.boe.es/boe/dias/2013/09/28/pdfs/BOE-A-2013-10074.pdf>. Its Article 63 provides for a special visa for investors making considerable investments in Spain. The new rules facilitate the obtainment of visa for foreign investors from China (and Russia). See Statement by the Secretary of the Ministry of Commerce and Competition, Mr. Jaime-García Legaz, reported in Mónica Cebario Belaza, *El Gobierno planea otorgar a quienes compren pisos de 160.000 euros*, EL PAÍS (19 November 2012), available at [http://politica.elpais.com/politica/2012/11/19/actualidad/1353320638\\_988833.html](http://politica.elpais.com/politica/2012/11/19/actualidad/1353320638_988833.html); Ferran

In Belgium,<sup>85</sup> Brazil,<sup>86</sup> Germany,<sup>87</sup> and the UK,<sup>88</sup> government officials encouraged incoming Chinese FDI. In Russia, the highest authorities welcome Chinese FDI (although there are also fears that China's role might become too strong).<sup>89</sup> The same approach appears to prevail in Kazakhstan<sup>90</sup> (including to balance the country's relationship with Russia) and Saudi Arabia (to mitigate its petrodollar dependency).<sup>91</sup> South-East Asian countries, for their part, are tightly linked with China through global value chains,<sup>92</sup> and governments therefore regard Chinese FDI as a positive factor for their development and have actively sought it.<sup>93</sup>

But the Executives of a number of countries also have concerns and, in any event, are subject to pressure from their *Legislatures*, or individual members (or group of members) of such bodies. Concerns relate to the various issues mentioned at the beginning of this section, especially in the areas of national security and the role of SOEs in China's outward FDI. Security concerns are particularly pronounced in the USA, where the issue of cyber-security (particularly in the area of telecommunications) adds an additional dimension.<sup>94</sup> In Australia and Canada, governmental concerns focus more on the control of natural resources and the net benefits associated

Ferrer, Residencia en España, a cambio de inversión inmobiliaria, *El País* (17 September 2013), available at [http://economia.elpais.com/economia/2013/09/17/vivienda/1379441954\\_406528.html](http://economia.elpais.com/economia/2013/09/17/vivienda/1379441954_406528.html).

85 Chen Jia, Wealth fund to help Chinese companies invest, *China Daily* (3 May 2013), available at [http://europe.chinadaily.com.cn/europe/2012-05/03/content\\_15195452.htm](http://europe.chinadaily.com.cn/europe/2012-05/03/content_15195452.htm).

86 A. Moreira, Para atrair investimentos chineses, Brasil promete segurança jurídica, *Portos E Navios* (6 November 2013), available at <http://www.portosenavios.com.br/geral/21586-para-atrair-investimentos-chineses-brasil-promete-seguranca-juridica>.

87 See, e.g., Bruederle lehnt Schutzwall gegen auslaendische Investitionen ab, *DAPD Nachrichtenagentur*, (27 December 2010), available at <http://www.themenportal.de/nachrichten/bruederle-lehnt-schutzwall-gegen-auslaendische-investitionen-ab-46024> (mentioning that Germany's Minister of Economics, Bruederle, explicitly invited Chinese FDI to Europe and especially Germany).

88 Matt Warman, London will offer China more than Singapore can, *The Telegraph* (12 October 2013), available at <http://www.telegraph.co.uk/finance/china-business/10373854/London-will-offer-China-more-than-Singapore-can-says-Boris-Johnson.html>.

89 Panibratov, above n 47.

90 Ibid. See also Daniel O' Neill, *China's Support for Investment in Kazakhstan: Good Neighbor, Good Economics or Good Geopolitics?* (Saint Luis: Washington University, 2009), available at <http://www.irex.org/resource/chinas-support-investment-kazakhstan-good-neighbor-good-economics-or-good-geopolitics-resea>.

91 Saudi Arabia and China team up to build a gigantic new oil refinery – is this the beginning of the end for the petrodollar?, *Alt-Market* (22 March 2012), available at <http://www.alt-market.com/articles/1446-saudi-arabia-and-china-team-up-is-this-the-beginning-of-the-end-for-the-petrodollar>.

92 See UNCTAD, *World Investment Report 2013: Global Value Chains. Investment and Trade for Development* (Geneva: UNCTAD, 2013).

93 See, e.g., Eka Utami Aprilia, China asked to invest in shipping, *Tempo* (24 November 2010); China to increase investment in Indonesian fisheries industry, *Kompas Cyber Media* (22 September 2010); Indonesia insists China to support joint ventures, *Indonesian Government News* (28 March 2010).

94 See Chairman Mike Rogers and Ranking Member C.A. Dutch Ruppersberger, *Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE*, H. R. Rep. (8 October 2012), available at <http://intelligence.house.gov/sites/intelligence.house.gov/files/documents/Huawei-ZTE%20Investigative%20Report%20%28FINAL%29.pdf>. Cyber-security is also a concern in the United Kingdom. See *Foreign Involvement in the Critical National Infrastructure: The implications for National Security*, Intelligence and Security Committee, Chairman: The Rt. Hon. Sir Malcolm Rifkind, MP, June 2013, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/205680/ISC-Report-Foreign-Investment-in-the-Critical-National-Infrastructure.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205680/ISC-Report-Foreign-Investment-in-the-Critical-National-Infrastructure.pdf), last accessed on 25 July 2014 (The report addresses the Huawei's threat to the Telecommunication sector of

with their exploitation (mirroring the discussions in media), although other tests (including national security) are employed as well. The discussions surrounding the take-over of Australia's Lynas<sup>95</sup> and the acquisition of Canada's Nexen<sup>96</sup> exemplify this. In the Latin American countries researched, it does not appear that Chinese FDI issues have figured noticeably in parliamentary discussions. But in India, 19 questions relating to FDI from China were asked in the Lower House of Parliament and 19 in the Upper House during the period 7 July 2009 and 22 February 2014, with 10 of these questions involving national security.<sup>97</sup> The perhaps best-known parliamentary reaction was a 2005 resolution adopted by the US House of Representatives condemning, in a vote of 138 to 15, the attempted take-over of the US firm Unocal by CNOOC of China.<sup>98</sup>

These various cross-cutting pressures are reflected in the fact that a number of countries have strengthened or established review mechanisms for incoming FDI, focused on M&As by SOEs (and also, before the Western financial crisis, by sovereign wealth funds). This involves walking a fine line balancing the mitigation of concerns with maintaining an investment climate that remains attractive to (in this case) Chinese MNEs. The focus of these mechanisms is on national security and net benefits for the host country (especially concerning technology-intensive industries and critical infrastructure, as well as natural resource industries), including concerns about SOEs benefitting from various subsidies that put them in a competitive advantage vis-à-vis domestic firms.

While the competitive advantage concern has been taken up (as mentioned earlier) in international negotiations (that are likely to be of particular interest to China), a number of countries have strengthened their mechanisms to review incoming M&As, to make sure that such transactions are in their national interest. The actions taken by the USA, Canada, and Australia exemplify this approach.

the United Kingdom and the potential issues of cyber attacks. Most of the concerns surrounding Huawei relate to its perceived links to the Chinese government.)

- 95 Cole Latimer et al., China's rare earth monopoly threatens global suppliers, rival producers claim, *The Financial Times* (29 May 2009), available at <http://www.ft.com/intl/cms/s/2/75fe65ce-4c4e-11de-a6c5-00144feabdc0.html#axzz349iZ5X6C>; China's CNMC to acquire Australia's Lynas for A\$505 million, *Domain-b.com* (2 May 2009), available at [http://www.domain-b.com/industry/Mining/20090502\\_china\\_nonferrous.html](http://www.domain-b.com/industry/Mining/20090502_china_nonferrous.html); see also Bruno A., Growing bilateral ties between Australia and China may benefit Lynas, *Investor Intel* (29 May 2014), available at <http://investorintel.com/rare-earth-intel/growing-bilateral-ties-australia-china-may-benefit-lynas-corp/>.
- 96 Ian Austen, Canada clears \$15 billion Chinese takeover of an energy company, *New York Times* (7 December 2012), available at [http://dealbook.nytimes.com/2012/12/07/canada-clears-15-billion-chinese-takeover-of-an-energy-company/?\\_php=true&\\_type=blogs&\\_r=0](http://dealbook.nytimes.com/2012/12/07/canada-clears-15-billion-chinese-takeover-of-an-energy-company/?_php=true&_type=blogs&_r=0); Nathan Vaderklippe, Investment deal with China coming in 'short order', *The Globe and Mail* (16 October 2013), available at <http://www.theglobeandmail.com/report-on-business/international-business/asian-pacific-business/investment-deal-with-china-coming-in-short-order-baird/article14884704/> (noting that, although the deal was eventually approved, the CNOOC takeover of Nexen was accompanied by 'new handcuffs on SOEs, whose ability to do big deals, particularly in the oil sands, now appears to be limited').
- 97 This is, however, a small percentage of all 1185 questions asked during this period. Still, they show the saliency of Chinese FDI in India; on the other hand, no other country received more questions related to FDI and national security. See Premila Nazareth Satyanand, Policy Brief, *What do India's MPs want to know about FDI? (2 July 2009–21 February 2014)*, New Delhi National Council of Applied Economic Research" (forthcoming).
- 98 H.R. Res. 344, 109th Cong. (2005), available at <https://www.govtrack.us/congress/bills/109/hres344/text>.

In the USA, the Foreign Investment and National Security Act,<sup>99</sup> adopted by the US Congress in 2007, strengthens the role of the Committee on Foreign Investment in the USA (itself established in 1988, as a reaction to the rapid growth of Japanese FDI in the USA) to review incoming M&As. Among other things, it requires that incoming M&As by state-controlled entities need not only to be notified but also are (in principle) subject to investigations.<sup>100</sup>

The Government of Canada had issued 'Guidelines: Investment by state-owned enterprises. Net benefit assessment'<sup>101</sup> in December 2007, to clarify the investment process as applicable to acquisitions of a certain size by SOEs. The continued growth of M&As by such firms led the Government to issue further clarifications in December 2012, in a 'Statement Regarding Investment by Foreign State-Owned Enterprises'.<sup>102</sup> The Statement provided that, 'For the purposes of evaluating proposed investments by foreign SOEs, Section 20 of the ICA [Investment Canada Act] and supporting Guidelines require that the investor satisfies the Minister of the investment's commercial orientation; freedom from political influence; adherence to Canadian laws, standards and practices that promote sound corporate governance and transparency; and positive contributions to the productivity and industrial efficiency of the Canadian business.' It continues to say: 'Each case will be examined on its own merits; however, given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be net benefit to Canada on an exceptional basis only.'<sup>103</sup> In June 2013, then, the Canadian Parliament amended the Canada Investment Act, specifying the threshold for reviewable private foreign investment and for reviewable foreign SOE investment and spelling out a definition of SOEs.<sup>104</sup>

The Government of Australia announced in February 2008 a new policy (consisting of a set of principles) that require the Treasurer to examine a number of specific issues when considering applications for investments by foreign governments and their agencies, including whether an investor's operations are independent from the relevant foreign government, whether the investor observes common standards of business behavior, whether the investment may have an impact on the country's

99 *Foreign Investment and National Security Act*, Public Law 110-149 (2007), available at <http://www.gpo.gov/fdsys/pkg/BILLS-110hr556enr/pdf/BILLS-110hr556enr.pdf>.

100 For a discussion of the Act, see David N. Fagan, *The US regulatory and institutional framework for FDI, in* *Sauvant*, above n 46, at 4-84.

101 See Government of Canada News Release, *Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises* (7 December 2012), available at <http://news.gc.ca/web/article-en.do?nid=711489>. In releasing these guidelines, the Government outlined some of its key considerations to be taken into account when reviewing incoming FDI projects by SOEs, reflecting the concern that foreign SOEs could present certain risks: 'First, foreign SOEs are, although to varying degrees, inherently susceptible to foreign government influence that may be inconsistent with Canadian national industrial and economic objectives. Second, SOE acquisitions of Canadian businesses may also have adverse effects on the efficiency, productivity and competitiveness of those companies, which may have negative effects on the Canadian economy in the longer term.'

102 See *ibid.*

103 See *ibid.*

104 See *Investment Canada Act*, available at <http://laws-lois.justice.gc.ca/eng/acts/I-21.8/page-3.html#h-9> and <http://laws-lois.justice.gc.ca/PDF/I-21.8.pdf>.

national security, and what the contribution of an investment is to the country's economy and broader community.<sup>105</sup> Reportedly, the influx of Chinese investment triggered this action.<sup>106</sup>

The principal purpose of these measures taken by these three countries was to create the tools to block, if need be, undesirable M&As—not only from China, but also from firms headquartered in other countries.<sup>107</sup> However, it is noteworthy that these actions took place—in fact, were triggered—when China's outward FDI began to rise rapidly, and that the screening mechanisms are particularly strong for M&As undertaken by SOEs.

From China's perspective, government activities that impact Chinese (SOE-dominated) outward FDI through host country review mechanisms are, not surprisingly, of concern, creating an interest to address this subject in international investment agreements. In fact, all countries that have some kind of review mechanism would want to protect it in their international investment agreements.

In sum, the perception and reception of China's growing outward FDI in the country's principal host countries has been decidedly mixed, both regarding the entry strategies of Chinese MNEs into host countries (M&As vs. greenfield investments) and the perception of, and reactions to, such investment by (and within) various host country constituencies.<sup>108</sup> This was recently recognized publicly in China. To quote the Governor of China's Central Bank, Zhou Xiaochuan, 'Different entities have behaved differently. There may have been some phenomena of Chinese

105 Australia's Foreign Investment Policy, available at <http://www.firb.gov.au/content/policy.asp> (last visited); see Australian Government, Foreign Investment Review Board, *2008/2009 Annual Report* at 7, available at [http://www.firb.gov.au/content/Publications/AnnualReports/2008-2009/\\_downloads/2008-09\\_FIRB\\_AR.pdf](http://www.firb.gov.au/content/Publications/AnnualReports/2008-2009/_downloads/2008-09_FIRB_AR.pdf). The Treasurer is already obliged, under the 'Foreign Acquisitions and Takeovers Act 1975,' to determine whether proposed foreign investments. The Treasurer is already obliged, under the 'Foreign Acquisitions and Takeovers Act 1975,' to determine whether proposed foreign investments above a certain amount are consistent with Australia's national interest (which is not defined). See Foreign Acquisitions and Takeovers Act 1975, available at <http://www.comlaw.gov.au/Details/C2013C00089>.

106 Peter Cai, Delicate balancing act for the foreign investment board, *The Sydney Morning Herald* (26 October 2013), available at [http://newsstore.smh.com.au/apps/viewDocument.ac.jsessionid=BD5FEACDC3FE58239A711B03BC59962A?sy=afr&pb=all\\_ffx&dt=selectRange&dr=1month&so=relevance&sf=text&sf=headline&rc=10&rm=200&sp=brs&cls=1435&clsPage=1&docID=SMH13102629BJS7M4T2E](http://newsstore.smh.com.au/apps/viewDocument.ac.jsessionid=BD5FEACDC3FE58239A711B03BC59962A?sy=afr&pb=all_ffx&dt=selectRange&dr=1month&so=relevance&sf=text&sf=headline&rc=10&rm=200&sp=brs&cls=1435&clsPage=1&docID=SMH13102629BJS7M4T2E).

107 This may well be part of a broader reassessment of the role of FDI in national economies, at least as far as M&As are concerned. This is exemplified by the decree issued by the government of France in 15 May 2014, at the time when both GE (USA) and Siemens (Germany) were interested in acquiring a part of the French firm Alstom. See Michael Stothard, France widens its powers to stop foreign acquisitions, *Financial Times* (17–18 May 2014) at 9. This decree toughens an existing measure by giving the government an effective veto over M&As in an expanded list of industries.

108 There is, however, one area in which the discussion has subsided, at least for the time being. In the wake of the economic crisis (during which many countries were desperate for employment-creating FDI, regardless of its origin and the form it took), the discussions about sovereign wealth funds (including China's) entering the world FDI market (although not in a substantial manner)—which reached its climax just before the onset of the crisis and had led to the adoption (under the aegis of the IMF) of the 2008 'Santiago Principles' (International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds Generally Accepted Principles and Practices 'Santiago Principles'*, available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf> (last visited 25 July 2014))—have died down. It remains to be seen, however, whether, with the economic performance of countries recovering, FDI by sovereign wealth funds will receive renewed critical public attention.

investors [that were] not so good, not so satisfactory'.<sup>109</sup> As China's outward FDI grows, it may well be that scepticism toward such investment will grow as well in some circles.

### F. Implications for China's national outward FDI policy

So the obvious question is: what could be done to deal with the reaction to China's outward FDI to avoid a backlash and build trust? (There is of course also the challenge for host countries, and especially developed ones, to accommodate the rise of China's outward FDI and respect that country's interests.)

At the national level, SOEs—as the main outward investors—have a special responsibility to make sure that their investments abroad are well planned, prepared, and received. This is particularly important when investments take the form of M&As and are in industries that are sensitive (e.g., for national security of cultural reasons) or involve iconic targets. (Even M&As in other areas may elicit concerns, as they are frequently associated with restructuring and the shedding of jobs.) Hence, governments at all levels need to be carefully prepared, and the benefits of a particular acquisition need to be spelled out. Moreover, once established, SOEs need to make an extra effort to become 'insiders', i.e., good corporate citizens that are recognized as such. This can be achieved, for example, through sourcing from local suppliers, by employing nationals in high corporate positions, becoming members of local associations, and engaging in various corporate social responsibility (CSR) activities. In fact, SOE affiliates in host countries could commit themselves to dedicate a small percentage of their earnings to CSR activities in their host countries<sup>110</sup> and to support the initiative of the Group of 7<sup>111</sup> to establish a global facility that helps developing countries (and especially the least developed among them) negotiate large scale contracts with MNEs to ensure that both host countries and investors benefit equitably from the investments made, especially in natural resources.

But China's government also has a role to play. For example, it could pay more attention to enforcing the various instruments that it has already in place to guide the behavior of its foreign investors abroad. More ambitiously, China could complement its 'going-out' strategy with a 'going-in' strategy.<sup>112</sup> Such a strategy would seek to maximize not only the benefits of the country's outward FDI for China (and its

109 Javier Blas, China's central bank chief admits difficulties with Africa, *Financial Times* (22 May 2014, 6:13 PM), available at <http://www.ft.com/intl/cms/s/0/5b212302-e1c9-11e3-b7c4-00144feabd0.html#axz3EolVbxrE> (quoting the governor).

110 A variation of what India's Companies Act 2013 mandates for corporate responsibility spending by its own firms in India. See The Companies Act, No. 18 of 2013, India Code, available at <http://indiacode.nic.in/acts-in-pdf/182013.pdf>.

111 The Group of 7, in its June 2014 Summit, announced 'a new initiative on Strengthening Assistance for Complex Contract Negotiations (CONNEX) to provide developing country partners with extended and concrete expertise for negotiating complex commercial contracts, focusing initially on the extractives sector . . .'. See Memorandum, *The Brussels G7 Summit Declaration*, European Commission - MEMO/14/402 05/06/2014, available at [http://europa.eu/rapid/press-release\\_MEMO-14-402\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-402_en.htm). Part of this initiative is a Knowledge Portal, developed by the Columbia Center on Sustainable Investment, available at [www.negotiationsupport.org](http://www.negotiationsupport.org), last accessed on 25 July 2014, and launched 17 June 2014.

112 For a brief elaboration of such a strategy, see Karl P. Sauvant and Victor Z. Chen, 'China Needs to Complement its "going-out" Policy with a "going-in" Strategy', 121 *Column FDI Perspectives*, (12 May 2014), available at <http://ccsi.columbia.edu/publications/columbia-fdi-perspectives/>.

firms), but also for the economic, social, and environmental development of the host countries in which Chinese firms invest, and takes place in fair governance mechanisms—in short, a strategy for sustainable FDI. Key elements of such a ‘going-in’ strategy could be to reinforce China’s current regulatory framework dealing with the behavior of Chinese MNEs abroad, to expand it (e.g., in line with the OECD Guidelines for Multinational Enterprises, to which China could adhere) and better to monitor and enforce the country’s regulatory framework guiding the behavior of its firms abroad (including by linking access to various home country measures regarding outward FDI to the observance of certain requirements). Such a strategy could be underpinned by requiring, by law, that Chinese SOEs (and, for that matter, other outward investors) dedicate a small percentage of their earnings to CSR activities in host countries. The government itself could furthermore support the earlier mentioned initiative of the Group of 7 to establish a negotiations support facility.

A ‘going-in’ strategy by China along these lines could become a model for other home countries, whether they are developed or developing. Conceivably, it could also influence the content of international investment agreements and give home country governments a role in ensuring that the outward investment by firms headquartered in their territories has as much as possible the characteristics of sustainable FDI.

Beyond that, and most importantly in the context of this article, the mixed perception and reception of China’s OFDI in important host countries for its MNEs strengthens China’s interest in international investment agreements that protect the country’s outward FDI (especially against discriminatory treatment of its investors, including SOEs) and that help to secure access to markets. (Considerations of this type may well be one of the principal driving forces behind China’s interest to conclude BITs with the USA and the European Union, the world’s biggest markets, as well as other important host countries.) At the same time, China would want to protect its ‘going out’ strategy and the various instruments it has put in place in the context of this strategy.

Thus, China’s interests have changed profoundly since it entered to world FDI market in a substantial manner more than a decade ago. Accordingly, the country’s approach to international investment agreements has changed, and can be expected to evolve further—a topic that is being considered next.

### III. CHINA’S CHANGING APPROACH TO INTERNATIONAL INVESTMENT AGREEMENTS

As mentioned earlier, China has signed more BITs than any other country except Germany.<sup>113</sup> China also has in place other IIAs, including free trade agreements (FTAs) containing investment chapters (ASEAN, Chile, Costa Rica, Iceland, New Zealand, Pakistan, Peru, Singapore, and Switzerland) and a trilateral agreement with Japan and the Republic of Korea.<sup>114</sup> China’s IIA program, which was initiated in

113 As of December 2014, Germany had concluded 134 BITs and China 130. See <http://investmentpolicyhub.unctad.org/IIA/IiasByCountry#iiaInnerMenu> (last visited 17 December 2014).

114 See China FTA Network, MOFCOM, available as <http://fta.mofcom.gov.cn/english/index.shtml> (last visited 30 September 2014). China is also currently negotiating FTAs with the Gulf Cooperation Council, Australia, Norway, and Japan/Republic of Korea.

1982, has undergone a major shift in focus during the past approximately 15 years. This shift corresponds to the evolution of China's policy respecting foreign investment. Indeed, as China has gradually become a capital-exporting nation, it became necessary for it to ensure protection of Chinese interests abroad.

### A. China's evolving investment treaty program reflects an increasing engagement in ISDS

After decades of isolation, China opened up to foreign investment in around 1980.<sup>115</sup> The first BIT that China entered into was with Sweden in 1982, and China's focus for the major part of the 1980s was clearly on inward investment. During this period, most of China's BITs were concluded with European countries. It was only in the 1990s that China's investment treaty endeavors gained significance.<sup>116</sup> Between 1988 and 1998, more than 60 BITs were signed, the majority of which were with developing countries.

This first generation of China's BITs, concluded between 1982 and 1998, is marked by the restrictive approach taken with respect to both substantive protections, such as national treatment, and investor-state dispute resolution. Indeed, arbitrability of disputes arising under these investment treaties is arguably limited.<sup>117</sup> China was then a predominantly capital-importing country, and it had little incentive to place its trust in a dispute resolution mechanism in which its sovereignty could be impinged. The dispute resolution clauses in these first BITs exhibited language to the effect that only 'disputes concerning the amount of compensation for expropriation'<sup>118</sup> or 'disputes involving the amount of compensation for expropriation' could be arbitrated.<sup>119</sup> As a result, disputes arising out of a first-generation treaty should arguably be limited to the very narrow question of quantum where a foreign investor was dispossessed of its investment.<sup>120</sup> In most BITs entered during this period, China's so-limited consent was to arbitration by ad hoc tribunals under the UNCITRAL Rules.

In keeping with the limited nature of its consent to arbitrate disputes with foreign investors, China qualified its ratification of the ICSID Convention in 1993 by stating that 'the Chinese Government would only consider submitting to the jurisdiction of the International Centre for Settlement of Investment Disputes for disputes over compensation resulting from expropriation and nationalization'.<sup>121</sup>

115 See Stephan W. Schill, 'Tearing Down the Great Wall', 15 *Cardozo Journal of International and Competitive Law* 73 (2007), at 77–80.

116 See Congyan Cai, 'Outward Foreign Direct Investment Protection and the Effectiveness of Chinese BIT Practice', 7 *Journal of World Investment and Trade* 621ff. (2006).

117 See e.g., Peter J. Turner and Mark Mangan, 'China's Investment Treaties: Substantive and Procedural Rights', 5 *Asian Counsel* 43(2007) ('Typically the right to arbitration was restricted under these BITs to the amount of compensation payable on expropriation (but not the initial question of whether an expropriation had taken place'); see also Schill, above 115, at 89–91.

118 See, e.g., China–U.K. BIT.

119 See, e.g., China–Mongolia BIT, Art. 8(3).

120 It should be noted here that some tribunals have taken the view that a dispute over the amount of compensation should be construed as encompassing the very existence of an expropriation. See below Section IIIB.

121 See China's Notification, dated 7 January 1993, available at [icsid.worldbank.org](http://icsid.worldbank.org). This notification was never repealed, despite China's broad adherence to the concept of investment dispute settlement through arbitration in later iterations of IIAs. This notification, however, does not prevent arbitrating

In its second generation of BITs, starting with its agreement with Barbados in 1998, China considerably broadened its consent to arbitration for disputes with foreign investors. The majority of treaties concluded between 1998 and 2008 vested arbitral tribunals—either under the auspices of ICSID or ad hoc/UNCITRAL—with the competence to hear ‘any disputes concerning an investment’.<sup>122</sup> The broadening of China’s consent to arbitration in the second generation of its BITs at the turn of the century coincided with an impending announcement of the country’s ‘going out’ strategy in 2001 and the subsequent rise in outward investment, from around US\$2 billion in 1999 to US\$116 billion in 2014.<sup>123</sup>

As China’s outbound FDI has increased over the past decade, so too has its resolve to protect Chinese interests abroad. The third generation of China IIAs embodies distinctive features showing a seemingly more careful approach to treaty protection with, on the one hand, a tightening of the admissibility of investors’ claims and, on the other hand, an increased level of substantive protections afforded to investors, including SOEs. China’s new tailored approach seems to reflect a balancing act. It ensures that its SOE-focused investment program is protected while the protections afforded to foreign investors are on par with current international standards but nonetheless allow sufficient flexibility for China to exercise its sovereign police powers.

### 1. Restrictions in China IIAs to admissibility of investor claims

(i) ‘Investors’. The IIAs that China recently has entered into use language requiring not only that the incorporation or seat of a foreign investor to be in the contracting state, as was the case in previous iterations, but also that a foreign investor have ‘real economic activities’<sup>124</sup> or be ‘engaged in substantive business operations’<sup>125</sup> in the territory of the contracting state. Some other treaties refer to the requirement that the foreign investor, if a corporate entity, must be controlled by nationals of the contracting state to be entitled to treaty protection.<sup>126</sup> These requirements are sometimes coupled with an affirmative ‘denial of benefits’ clause which, as the name suggests, denies to foreign investors the benefit of investment treaty protection when

disputes that would be subjected to IIAs of second or third generation. Indeed, ‘a notification under Art. 25(4) does not stand in the way of consent’. See Christoph H. Schreuer, *The ICSID Convention: A Commentary* (2nd ed., Cambridge University Press, Cambridge 2009) 930. That is because, as the World Bank’s Executive Directors’ Committee expressed in the ICSID Report No. 29 dealing with Art. 25(4) of the ICSID Convention, ‘a statement by a Contracting State that it would consider submitting a certain class of dispute to the Centre would serve for purposes of information only and would not constitute the consent required to give the Centre jurisdiction. Of course, a statement excluding certain classes of disputes from consideration would not constitute a reservation to the Convention.’ *ibid.* at 923–935.

122 See, e.g., 1999 China–Barbados BIT. This BIT, however, subjected arbitration of the dispute to exhaustion of ‘local administrative review procedure’ at the state’s election. See Art. 9(3). In the subsequent 2003 China–Germany BIT, no such exhaustion of remedies provision was inserted in the arbitration clause (Art. 9), although the BIT’s Protocol provided that an administrative review procedure must be initiated by the investor and that ‘the dispute still exists three months after [the investor] has brought the issue to the review procedure’.

123 See above n 3.

124 China–Romania BIT, Art. 2(b).

125 China–Mexico BIT, Art. 1(b).

126 See, e.g., China–Peru FTA, Art. 126.

certain requirements such as control by a national of the contracting state or substantive business activities in the contracting state are not satisfied.<sup>127</sup>

Importantly, Chinese SOEs are now included as falling within the ambit of bilateral treaty protections. Indeed, in recent Chinese IIAs, 'public institutions'<sup>128</sup> or 'governmentally owned or controlled'<sup>129</sup> investors are protected. This language presumably follows the example of NAFTA or the 2004 US Model BIT.<sup>130</sup> Other countries have expressly referred to their government in the definition of 'investor', including Saudi Arabia,<sup>131</sup> Qatar,<sup>132</sup> and the United Arab Emirates.<sup>133</sup>

As seen above, SOEs are crucial to China's outward FDI as they account for between 2/3 and 3/4 of total FDI.<sup>134</sup> As is the case in the vast majority of IIAs,<sup>135</sup> China had not expressly included state entities in the scope of protected investors in previous iterations of IIAs. Although older IIAs did not expressly include SOEs within their purview, one may wonder whether investment treaty's protections should be extended or denied to an SOE thereunder. This question is all the more important as China has historically operated exceedingly heavily through SOEs.<sup>136</sup>

127 *ibid.*, Art. 137.

128 *See, e.g.*, China–Korea BIT, Art 1(2)(b).

129 China–New Zealand FTA, Art. 11; China–Mexico BIT, Art. 1; China–ASEAN FTA, Art. 1(f); China–Japan–Republic of Korea TIT, Art. 1(4).

130 The 2004 US Model BIT defines 'investor of a Party' as 'a Party or state enterprise thereof, . . . that attempts to make, is making, or has made an investment in the territory of the other Party'. This language is almost identical to that of NAFTA Art. 1139 ('investor of a non-Party means an investor other than an investor of a Party, that seeks to make, is making or has made an investment'). Other IIAs take a similar approach, namely the Canada Model BIT Art. 1, U.S.–Australia FTA Art. 1.2, U.S.–Singapore FTA Art. 1.2, Canada–Chile FTA Art. 1(2) and Japan–Mexico FTA Art. 2.

131 *E.g.*, Saudi Arabia–Belgium–Luxembourg BIT, Art. 1(3): 'the term "investor" means: (a) in respect of the Kingdom of Saudi Arabia: . . . III – the Government of the Kingdom of Saudi Arabia and its financial institutions and authorities such as the Saudi Arabian Monetary Agency, public funds and other similar governmental institutions existing in Saudi Arabia'; Saudi Arabia–Italy BIT, Art. 1(3)(a)(iii): 'Con il termine "investitore" si intende . . . il governo del Regno dell'Arabia Saudita e le sue istituzioni ed autorità finanziarie quali la Saudi Arabian Monetary Agency, i fondi pubblici ed altre istituzioni governative analoghe esistenti in Arabia Saudita'; Saudi Arabia–France BIT, Art. 1(2): "Le terme d'investisseur " désigne . . . l'une ou l'autre des Parties contractantes et ses institutions et autorités financières, fonds publics et autres institutions gouvernementales analogues'.

132 Qatar–Germany BIT, Art. 1(3)(b)(3): 'The term "investors" means: . . . in respect of the State of Qatar: . . . (c) the Government of the State of Qatar.' The same language was used in other Qatar BITs, such as the Qatar–Republic of Korea BIT, Art. 1(3)(b); Qatar–Switzerland BIT, Art. 1(1)(c) and Qatar–China BIT, Art. 1(2).

133 UAE–China BIT, Art. 1(2)(b): 'The term "investor" shall mean for the United Arab Emirates (1) the Federal Government of the U.A.E.' and Art. 1(2)(b)(2): 'the Local Governments and their local and financial institutions.'; UAE–Austria BIT, Art. 1(1)(c); UAE–Finland BIT, Art. 1(4)(a); UAE–France BIT, Art. 1(2); UAE–Switzerland BIT, Art. 1(1)(b)(iii); UAE–United Kingdom BIT, Art. 1(e).

134 *See* above Section I.

135 *See* Jo En Low, 'The Status of State-Controlled Entities under International Investment Agreements', in Andrea Bjorklund (ed.), *Yearbook on International Investment Law and Policy* (Oxford University Press, New York 2014) 2012–2013, 543.

136 It was reported that, by 2010, there were 26,319 'centrally controlled non-financial SOEs' in China, accounting for 10% of China's GDP. Sixty six of these SOEs made the 2012 Fortune Global 500 list. *See* Duanjie Chen, *China's State-owned enterprises: how much do we know? From CNOOC to its siblings*, University of Calgary SPP Research Paper No. 6-19 (June 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2277938](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2277938).

One author emphasized that 'if an [SOE] is established as required under the law of a contracting party, it [therefore] qualifies as an "investor" ' such that it is not excluded from the scope of investment protections.<sup>137</sup> Another commentator suggested that 'exclusion of State entities from coverage would leave the investment treaty with no meaningful application' for BITs concluded with communist states.<sup>138</sup> On the other hand, SOEs, as state owned, presumably have greater access to state support when investments are distressed than 'private' BIT claimants may have. Therefore, their access to investor-state arbitration seems less justifiable per se, absent express language to that effect, especially if one considers the concept of competitive neutrality that mandates maintaining a level-playing field between SOEs and private businesses.<sup>139</sup>

In a landmark arbitration award, the arbitral tribunal took the position that protections should be extended where the SOE is not 'performing State functions'.<sup>140</sup> This view corresponds to the traditional dichotomy '*acta jure gestionis*'—i.e., where the country acts in a commercial capacity—versus '*acta jure imperii*'—i.e., where the state acts as a sovereign (and is thus protected by the doctrine of sovereign immunity).<sup>141</sup>

The drafting history of the ICSID Convention is enlightening in that respect. Indeed, the *travaux préparatoires* reflect that the drafters debated, and ultimately rejected, the possibility that investor-states could appear in ICSID proceedings.<sup>142</sup> On the other hand, they considered that an SOE 'should not be disqualified as a "national of another Contracting State" unless it is acting as an agent for the government or is discharging an essentially governmental function" '.<sup>143</sup> Indeed, the purpose of the ICSID Convention was to 'stimulat[e] a larger flow of private international

137 Jo En Low, above n 135, at 547.

138 Claudia Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties', 10(3) *Chinese Journal of International Law* 531(2011), available at <http://chinesejil.oxfordjournals.org/content/10/3/531.short>.

139 See above Sections I and II. Although investor-state arbitration is meant to establish equality of arms where the relationship between parties is by nature imbalanced, it might be argued that providing the benefit of investor protection to an entity that already benefits from state protections would unduly tip the balance.

140 *CSOB v Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, 24 May 1999, paras 23–27.

141 This is also known as the 'Broches test', a reference to ICSID's founding father Aron Broches. See below n 143. An example is *Rumeli v Kazakhstan* in which the tribunal stated that 'a state-owned entity qualifies as a national of another Contracting State unless it acts as an agent for the government or discharges an essentially governmental function'. See also *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008, para 211. See also Walid Ben Hamida, 'Sovereign FDI and International Investment Agreements: Questions Relating to the Qualification of Sovereign Entities and the Admission of their Investments under Investment Agreements', 9 *Law and Practice of International Courts and Tribunals* 22 (2010). See also Annacker, above n 138.

142 See *History of the ICSID Convention*, Washington: World Bank, 2006 vol. II-1, 401, 976–979, 1018 (2006).

143 Aron Broches, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States', 136 *RdC* 331, (1972) 355.

investment<sup>144</sup> which arguably bars access to arbitration to 'nationals' whose investment reflects only governmental concerns.<sup>145</sup>

An UNCTAD report stated on that topic that '[t]he question whether State-owned or controlled enterprises are covered by an investment agreement has to be treated differently from the question whether States parties to the agreement themselves can act as investors. Usually, State enterprises are covered even if not explicitly stated while States themselves tend not to be unless this is expressly provided for.'<sup>146</sup> Yet, it bears noting that China's SOEs, in contrast with some other SOEs and privately owned companies, have been said often not to have financial performance at heart—as evidenced by their profitability ratios<sup>147</sup>—but rather may be animated by strategic state-related considerations. Indeed, to further China's industrial policy 'aimed at leapfrogging global economic powers', China is said to be 'going out' through some of its SOEs in an effort to have access to foreign resources.<sup>148</sup> In the context of access investor-state arbitration, it is legitimate to wonder whether SOEs, to the extent that their impetus is the same as that of the state, should qualify under IIA regimes absent an express agreement to that effect in the applicable IIA. To address this question with respect to China, further clarification is required on a case-by-case basis as to whether Chinese SOEs constitute instrumentalities of the Chinese central government.

(ii) '*Investments*'. For most of its BIT history, China has considered that 'every kind of asset' qualified as investments.<sup>149</sup> It appears that in its most recent treaties, China is departing from this approach. China, following the example of countries such as the USA, now specifically excludes certain business transactions from the definition of qualified investments. So far, China has excluded certain types of loans and debts.<sup>150</sup> China has also excluded claims to money arising out of commercial contracts for sale of goods and services, or out of extensions of credit in connection with contracts for sale of goods and services.<sup>151</sup> By so doing, China effectively denies the benefit of investor-state arbitration to these categories of investments.

Furthermore, to qualify as an 'investment' under China's BITs, an economic investment must be made 'in accordance with the laws' of the host state.<sup>152</sup> Depending upon the specific formulation used in a particular treaty, failure to abide by the

144 Barton Legum and William Kirtley, 'The Status of the Report of the Executive Directors on the ICSID Convention', 27(1) *ICSID Review* (2012) paras 12–13.

145 Caution should be exercised, however, as the distinction between private and public capital is often artificial, considering the frequently hybrid nature of the pooling of funds in a transnational investment. Determining jurisdiction on the basis of the source of capital alone seems outmoded and impractical. See Jo En Low, above n 135, at 558–559.

146 UNCTAD, *International Investment Agreements: Key Issues*, 142 n 12 (2004). For a recent discussion, see Jo En Low, above n 135.

147 Chen, above n 136, at Table 6. The author observes that if we take account of the advantages that SOEs enjoy such as free use of land and natural resources, the numbers plummet even more. *Ibid.*, at 6.

148 *ibid.*, at 12.

149 See, e.g., 1985 China–France BIT, Art. 1(1): 'Le terme « investissement » désigne des avoirs de toute nature'. These clauses would generally include a non-exhaustive list of categories of such investments.

150 China–Mexico BIT, Art. 1(c) and (d); China–New Zealand FTA, Art. 135 and China–Peru, Art. 126.

151 China–Mexico BIT, Art. 1(h).

152 See, e.g., 1982 China–Sweden BIT, Art. 1.

domestic law of the host country may be interpreted as excluding protection under a treaty.<sup>153</sup>

(iii) *Umbrella clause*. The so-called ‘umbrella clauses’, also known as ‘observance of undertakings’ clauses, may allow investors to claim that a breach of a contractual undertaking arising out of an associated contract between the foreign investor and the state constitutes a treaty violation.<sup>154</sup> Umbrella clauses were a hallmark of the second generation of China’s BITs, with some of these treaties imposing on a contracting state the observance of ‘any commitments it may have entered into with the investors’<sup>155</sup> or ‘any contractual obligation it may have entered into towards an investor’.<sup>156</sup>

As many a claimant has attempted to elevate contract breaches to international treaty violations through ‘umbrella clauses’, recent IIAs have generally abandoned this type of provision. China, following the example of the USA and others, has revised its second-generation model dispute settlement clause to narrow its consent to arbitration in the current generation of Chinese IIAs. Arbitration is now restricted to only ‘disputes between a Contracting Party and an investor of the other Contracting Party arising from an alleged breach of [a treaty] obligation’.<sup>157</sup>

153 ‘In accordance with the law’ provisions are generally contained as part of the definition of investments or within the provisions dedicated to admission and protection of an investment. Should the investment contravene the domestic laws of the host state, tribunals can deny jurisdiction. See, e.g., *Fakes v Republic of Turkey*, ICSID Case No. ARB/07/20, Award, July 14, 2010, para 115; *Inceysa Vallisoletana v Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, para 195; *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award, para 204. Not all violations qualify as an exclusion, however, such as minor breaches of bureaucratic formalities. See *Tokios Tokelés v Ukraine*, ICSID Case No. ARB/02/18, Award, 26 July 2007, para 97. It should also be noted that even when no ‘in accordance with the law’ provision was included in the IIA, some tribunals found that such an obligation is implicit. See *Plama Consortium Ltd v Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008. For general developments on ‘in accordance with the law’, see Rudolph Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2012) 92, 13492, 134-139 139. See also Rahim Moloo and Alex Khachaturian, ‘The Compliance with the Law Requirement in International Investment Law’, 34(6) *Fordham International Law Journal* (2011). See also Stephan W. Schill, *Illegal investments in international arbitration*, SSRN (4 January 2012), available at <http://ssrn.com/abstract=1979734>.

154 See, e.g., *SGS Société Générale de Surveillance S.A. v Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004; *Salini Construttori S.p.A. and Italstrade S.p.A. v Morocco*, Jurisdiction, ICSID Case No. ARB/00/4, Award, 23 July 2001. See also Gaillard, *Investment treaty arbitration and jurisdiction over contract claims—the SGS cases considered, in International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* 325 (Cameron & May eds., 2005). Some tribunals, however, denied such an effect to umbrella clauses. See, e.g., *SGS Société Générale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Award on Jurisdiction, 6 August 2003; and *Joy Mining Machinery Limited v Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction dated 30 July 2004. For a comprehensive analysis of the scope of umbrella clauses. See Laura Hanonen, ‘Containing the Scope of the Umbrella Clause’, 1 *Investment Treaty Arbitration and International Law* 27 (T.J. Grierson Weiler, ed. 2008).

155 E.g., 2001 China–Netherlands BIT, Art. 3(4).

156 E.g., 2001 China–Jordan BIT, Art. 9(2).

157 See, e.g., 2008 China–Mexico BIT, Art. 11ff.

(iv) *Non-precluded measures.* Recent IIAs concluded by China invariably contain the so-called 'non-precluded measures' (NPM) clauses. Such clauses allow states to derogate from the duties they would otherwise be compelled to abide, provided certain circumstances occur. The most common such derogation pertains to measures taken by the state in the interest of security under specific circumstances.<sup>158</sup> Other possible NPMs are prudential measures 'to ensure the integrity and stability of the financial system'<sup>159</sup> or taxation measures.<sup>160</sup> Often, IIAs that include a NPM clause state that the clause is self-judging, meaning that whether the measure comports with the scope of the clause is a matter for the judgment of the state taking the measure.<sup>161</sup>

The NPM mechanism calls for some observations in relation with the concept of indirect expropriation. International arbitral tribunals have uniformly recognized the principle that expropriation could be indirect, or creeping<sup>162</sup>, through adoption by the host state of 'measures tantamount to expropriation',<sup>163</sup> such as regulatory or legislative orders effectively depriving the investor from the enjoyment of its investment.<sup>164</sup> Through NPMs—the most notable of which arguably being taxation measures—a state can effectively carve out measures that could otherwise be deemed expropriatory such that it be shielded from liability for the use of its regalian powers. In that respect, recent treaties executed by China contain annexes making clear that 'deprivation of property [through] measures taken in the exercise of a state's regulatory powers as may be reasonably justified in the protection of the public welfare . . . shall not constitute an indirect expropriation'.<sup>165</sup> Because such measures having the effect of depriving an investor of its property should be 'reasonably justified', however, they are not self-judging, contrary to standard non-precluded measures.

(v) *Administrative review.* As it moved toward its second generation of IIAs, seemingly in anticipation of its 'going out' strategy, China adopted the Administrative

158 *E.g.*, China New–Zealand FTA, Art. 201; China–Peru FTA, Art. 194.

159 *E.g.*, China New–Zealand FTA, Art. 203; China–Peru FTA, Art. 197.

160 *E.g.*, China New–Zealand FTA, Art. 204.

161 Language typically used refers to measures 'deemed necessary' or 'that [the host state] considers necessary'. A claim deemed precluded by the state should nevertheless be subject to a balancing test, upon review by an arbitral tribunal as to its admissibility *rationae materiae*. See Michael D. Nolan and Frédéric G. Sourgens, 'The Limits of Discretion? Self-judging Emergency Clauses in International Investment Agreements', in Sauvant (ed.), *Yearbook on International Investment Law & Policy* (2012) 2010–2011, 362ff.

162 See *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award of the Tribunal (17 February 2000). See also *Generation Ukraine Inc. v Ukraine*, ICSID Case No. ARB/00/9, Award, para 20.22 (16 September 2003).

163 See, e.g., *SD Myers v Canada* UNCITRAL/NAFTA, First Partial Award, (13 November 2000), para 285.

164 See, e.g., *Pope & Talbot, Inc. v Gov't of Canada*, NAFTA/UNCITRAL, Interim Award (26 June 2000), para 306. See also L. Yves Fortier and Stephen L. Drymer, 'Indirect Expropriation in the Law of International Investment: I Know it When I See it, or Caveat Investor', 13 *Asia Pacific Law Review* 79 (2005), 81.

165 China–New Zealand FTA, Annex 13; China–Peru FTA, Annex 9. See also 2006 China–India BIT, Protocol, III Ad Art. 5(3): 'non-discriminatory regulatory measures adopted by a Contracting Party in pursuit of public interest, including measures pursuant to awards of general application rendered by judicial bodies do not constitute indirect expropriation or nationalization'.

Reconsideration Law in 1999.<sup>166</sup> Concomitantly, China inserted provisions into its BITs establishing a two-step mechanism for investment disputes, presumably because second-generation IIAs provided that any such disputes could be arbitrated. These disputes ought to be submitted to administrative review under Chinese substantive law within 60 days from the date the investor was notified of the aggrieving act.<sup>167</sup> The administration then disposes of the same time limit of 60 days to render its decision. It is only after expiry of these successive time limits that resorting to arbitration becomes permissible.<sup>168</sup> Pursuant to Article 6 of that Administrative Reconsideration Law, the Chinese administration is vested with the exclusive powers to review, *inter alia*:

administrative penalties such as . . . confiscation of illegal gains, confiscation of unlawful property or things of value, order for suspension of production or business operation, temporary suspension or rescission of permit, temporary suspension or rescission of license . . . freezing of property . . . suspension or revocation of such documents as permits, licenses and qualification certificates . . . right of ownership in or the right to the use of natural resources . . . .”

A commentator has observed that prior recourse to administrative reconsideration should not be warranted if the state act complained of is a court order or piece of legislation, as opposed to an action of an administrative nature.<sup>169</sup>

## 2. Enhanced substantive protections in recent Chinese BITs

(i) *Fair and equitable treatment.* The obligation that foreign investments be afforded fair and equitable treatment (FET) was accounted for as early as the 1982 China–Sweden BIT.<sup>170</sup> With a few exceptions,<sup>171</sup> all Chinese BITs contain a FET clause. A notable distinction exists, however, in that third generation of Chinese BITs subject the FET standard to customary international law.<sup>172</sup> Just like many BITs from other nations,<sup>173</sup> the language of China’s second-generation BITs generally referred to FET ‘in accordance with International Law’<sup>174</sup> or ‘*conformément aux principes du Droit international*’<sup>175</sup> This language coupled with a broad arbitration clause (‘any investment dispute’) arguably exposed China to broad liability. This is because the

166 Law of the People’s Republic of China on Administrative Reconsideration (29 April 1999), available at <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan048297.pdf>.

167 *ibid.*, at Art. 9.

168 *See, e.g.*, China–Germany BIT, Protocol 6 (Ad Art. 9).

169 *See* Wang Guiguo, ‘Investor-State Dispute Settlement in China’, *Transnational Dispute Management* 5 (2011), at 4, available at <http://www.transnational-dispute-management.com/article.asp?key=1764>.

170 China–Sweden BIT, Art. 1(1).

171 1988 China–Japan BIT; 1990 China–Turkey BIT.

172 For an analysis of FET standard encompassing customary international law principles, *see* Dolzer, above n 153, at 134–139.

173 *E.g.*, France IIAs’ FET clauses (‘Chacune des Parties contractantes s’engage à assurer, sur son territoire et dans sa zone maritime, un traitement juste et équitable, conformément aux principes du droit international’).

174 2007 China–Costa Rica BIT.

175 2005 China–Madagascar BIT.

vague reference to international law presumably gives extensive latitude to an arbitral tribunal to interpret the applicable FET standard without necessarily resorting to *opinio juris sive necessitates* (general practice accepted as law).<sup>176</sup> This, among other reasons, may have prompted change in China's recent investment treaties, in which the language historically used is replaced by clauses providing for fair and equitable treatment 'in accordance with commonly accepted rules of international law'<sup>177</sup> or 'in accordance with customary international law',<sup>178</sup> which presumably leaves less room for interpretation as the concept of 'customary international law' commonly refers to 'established state practice'.<sup>179</sup> This change was reported as an example of NAFTA's influence on China's drafting of its third-generation IIAs.<sup>180</sup>

(ii) *Most-favored-nation treatment*. It was the regular practice of drafters of China's BITs, even in the early days, to include a most-favored-nation (MFN) clause granting investments subject to a BIT containing an MFN the same prerogatives and advantages (or some subset of them) offered to investors under other BITs concluded by China.<sup>181</sup> MFN clauses foster equality in the competitive environment among foreign investors.<sup>182</sup> Although the content of the MFN clause itself has not substantially varied through the BIT generations, its import does: it has 'considerable weight since her [*sic*] new generation investment grant broader protection to foreign investors'.<sup>183</sup> Thus, an investor with an investment subject to the protections of a first-generation BIT may attempt to invoke enhanced protections of a second or third-generation BIT.<sup>184</sup>

(iii) *National treatment*. In the first generation of its BITs, China refused to grant national Treatment (NT) to foreign investors that is equal treatment to that afforded to its own citizens, or did so only on a best effort basis.<sup>185</sup> China's original reluctance was said to be caused by the lack of strength of its nascent economy vis-à-vis international actors,<sup>186</sup> or to uphold 'structures of a socialist planning

176 See generally James Crawford, *Browlie's Principles of Public International Law* (Oxford University Press, 2013) 25.

177 2008 China–New Zealand FTA, Art. 143(1).

178 2009 China–Peru FTA, Art. 132.

179 See, Definition of Customary International Law, Legal Information Institute, available at [http://www.law.cornell.edu/wex/customary\\_international\\_law](http://www.law.cornell.edu/wex/customary_international_law). See also, International Court of Justice, *Case concerning the Continental Shelf (Libyan Arab Jamahiriya v Malta)*, Judgment, 3 June 1985, para 27 ('It is of course axiomatic that the material of customary international law is to be looked for primarily in the actual practice and *opinio juris* of States').

180 See Axel Berger, 'Investment Rules in Chinese PTIAs – Partial "NAFTA-ization"', in R. Hofmann, S. Schill and C. Tams (eds.), *Preferential Trade and Investment Agreements: From Recalibration to Reintegration* (2013).

181 See, Rainer Hofmann; Stephan Schill; Christian J. Tams e.g., China–Sweden BIT, Art. 2(2) (subject to conditions of Art. 2(3) regarding customs union or FTA).

182 Schill, above n 115, at 100.

183 *ibid.*

184 See below Section IIIB for a summary analysis of applicability of MFN treatment to IIA arbitration clauses.

185 See, e.g., China–UK BIT, Art. 3(3) which uses the language 'to the extent possible'.

186 Armand De Mestral and Céline Lévesque, *Improving International Investment Agreements* (Routledge, 2013) 65.

economy'.<sup>187</sup> Yet, national treatment is a 'core guarantee' of investment treaty practice for instilling a sense of fairness in competition between foreign and local actors.<sup>188</sup> China shifted gears in its recent treaties. With China's accession to market economy prominence, and notable accession to the WTO regime, which imposes non discrimination and national treatment as core principles,<sup>189</sup> NT clauses are now routinely inserted, albeit with a (significant) caveat: the NT clause contains either the qualification 'without prejudice to its laws and regulations'<sup>190</sup>, or a so-called 'grandfather clause', exempts the state from foreign investors' claims of discrimination on the basis of pre-existing law.<sup>191</sup>

An important development occurred during the on-going negotiations between China and the USA for the conclusion of a BIT. As reported above, China conceded in July of 2013 to granting national treatment at the pre-establishment stage of an investment.<sup>192</sup> Not only that, but China has also agreed to switch from a positive list system—where allowed investments are exhaustively enumerated—to a negative list system—where only the sectors where foreign investment is prohibited are listed, the rest being *libera terra*. This change may well signal China's willingness to further adapt to the standards adopted by other countries and engage in a fourth generation of IIAs.<sup>193</sup>

China had used a positive list for decades, notably pursuant to its Catalogue of Industries for Guiding Foreign Investment ('Catalogue'), delineating the sectors where foreign investment was encouraged, allowed, and prohibited.<sup>194</sup> This positive list system was coupled with a post-establishment—meaning only after approval by the Chinese administration—national treatment protection.

The major change from positive to negative list was meant to 'help establish a level playing ground for market players . . . as two way trade and investment have continued to expand'.<sup>195</sup> China's remarks underline a potential greater adherence to international standards of protection for investors, presumably prompted by a desire to safeguard its interest abroad. But even if China decides to adopt pre-establishment national treatment in a more systematic way,<sup>196</sup> the contours of such protections are unclear and, depending on the content of the negative list, they could very well be

187 Wenhua Shan, *The Legal Framework of EU-China Investment Relations – A Critical Appraisal*, (2005) 163ff.

188 Schill, above n 115, at 94.

189 *ibid.*, at 99.

190 See China Model BIT, Art. 3.2. This type of clause would not frustrate challenges to administrative acts.

191 See, e.g., China–New Zealand FTA, Art. 138: '[NT] does not apply to (a) any existing non-conforming measures maintained within its territory; (b) the continuation [thereof]'.

192 See Paxton, above n 49; Pheakdey, above n 50.

193 One could envision that such a fourth generation of IIAs may well encompass environmental considerations, modern transparency standards, and workforce protection, see below Section IV.

194 See Nie Pingxiang, Negative list in need of some positive tweaks, *China Daily Asia* (19 May 2014), available at [http://www.chinadailyasia.com/business/2014-05/19/content\\_15135843.html](http://www.chinadailyasia.com/business/2014-05/19/content_15135843.html).

195 MOC: China using global approach in investment talks with U.S., *Xinhua* (12 July 2013), available at <http://english.peopledaily.com.cn/90778/8323785.html>.

196 China is currently experimenting the pre-establishment negative list system in its Shanghai Free Trade Zone since 30 September 2013 and in Pingtan Island since 3 June 2014. See Luo Liexin, China's second negative list a move forward, *China Daily* (4 June 2014), available at [http://www.chinadaily.com.cn/china/2014-06/04/content\\_17563011.htm](http://www.chinadaily.com.cn/china/2014-06/04/content_17563011.htm).

hampered in practice. Indeed, one could imagine a list as extensive as to defeat its purpose.<sup>197</sup> In that respect, it is worth noting that the Shanghai Free Trade Zone's pilot program which implements a negative list system reportedly has had a mere 27% reduction in its foreign investment restrictions.<sup>198</sup>

(iv) *Full protection and security.* Initially, Chinese BITs flatly affirmed that foreign investment 'shall enjoy protection'.<sup>199</sup> It is unclear whether this language was intended to cover less than the largely internationally recognized standard of full protection and security (FPS), but China has used more expansive language in recent treaties such as 'constant protection and security',<sup>200</sup> 'full protection',<sup>201</sup> or 'full protection and security'.<sup>202</sup> The standard implies an 'obligation of vigilance'<sup>203</sup> from the part of the host state, with 'the mere lack or want of [its] diligence' sufficing to constitute a breach.<sup>204</sup> There is no consensus as to whether FPS clauses should be understood as limited to physical protection of the investment by the host state<sup>205</sup> or as also extending to circumstances not involving physical violence or damage.<sup>206</sup>

In an interpretive exercise, the NAFTA Free Trade Commission tied FPS clauses with protections not to exceed customary international law standards.<sup>207</sup> This approach found some supporters in investment arbitration<sup>208</sup> and seemed to have been endorsed recently by China. Indeed, in its recent treaties, China circumscribes the FPS clause with 'commonly accepted rules of international law',<sup>209</sup> 'international law minimum standard of treatment of aliens',<sup>210</sup> or 'customary international law'.<sup>211</sup>

In sum, it seems clear, upon review of the Chinese IIAs entered into since the early 1980s, that China's perspective on investment protection has dramatically changed as it has increasingly engaged into outbound investment activities, mainly

197 It seems that the approach taken thus far is to make a mirror-image of the former positive lists of the Catalogue in the first iteration of its negative list. See Pingxiang, above n 191.

198 See Matthew Zito, Camille Chen and Rainy Yao, Shanghai FTZ revised negative list introduces targeted FDI reforms, *China Briefing* (3 July 2014), available at <http://www.china-briefing.com/news/2014/07/03/shanghai-ftz-revised-negative-list-introduces-targeted-fdi-reforms.html>.

199 See, e.g., China–Croatia BIT, Art. 3(1); China–Ethiopia BIT, Art. 3(1).

200 See, e.g., 2005 China–Belgium Luxembourg Economic Union BIT, Art. 2(3)

201 See, e.g., 2006 China–Russian Federation BIT, Art. 2(2).

202 See, e.g., 2005 China–Czech Republic BIT, Art. 2(2).

203 *American Manufacturing & Trading Inc. v Zaïre*, ICSID Case No. ARB/93/1, Award (1997), para 6.05.

204 *Asian Agricultural Products Ltd. v Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award (1990), para 77.

205 See, e.g., *Rumeli v Kazhakstan*, above n 80, at para 668; *Saluka Investments v Czech Republic*, above n 153, at paras 483–484; *BG Group PLC v Republic of Argentina*, UNCITRAL Final Award, 24 December 2007, para 324; *Wena Hotels v Egypt*, ICSID Case No. ARB/98/4, Annulment Proceeding Decision, 5 February 2002, para 84.

206 *CME v Czech Republic*, UNCITRAL Partial Award, 13 September 2001, para 613; *Azurix v Argentina*, ICSID Case No. ARB/01/12, 14 July 2006, para ¶ 406; *Vivendi v Argentina*, ICSID Case No. ARB/97/3, Award (2007), para 7.4.12; *Biwater Gauff v Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, para 729.

207 See Mahnaz Malik, The full protection and security standard comes of age: yet another challenge for states in investment treaty arbitration?, IISD Paper (November 2011), at 9.

208 See, e.g., *Noble v Romania*, ICSID Case No. ARB/01/11, Award (2005), para 164.

209 China–New Zealand FTA, Art. 143.

210 China–Mexico BIT, Art. 5.

211 China–Peru FTA, Art. 132.

through its SOEs, over the past 15 years or so. As it has evolved toward becoming a net outward investor, China has apparently understood—and hence sought—the benefits of investment treaty protections in its BIT program. China balanced its BIT program, however, by adopting the modern cannons of investment treaty protections along the way (e.g., reference to customary international law in its FET and FPS clauses), presumably to delimitate protection of its inbound FDI and perhaps to align with Western nations' model BITs (which in turn should foster confidence in China's protection of inbound FDI). Yet, despite the fact that protections under China BITs have existed for more than three decades, the mechanism through which such protections are ensured and enforced—i.e., investor-state arbitration—has only recently started being triggered in disputes commenced by Chinese investors, as will be seen below. Given the number of first generation BITs, which, as we have seen, allow for limited access to investor-state arbitration, most such disputes involve questions of jurisdiction that respondent-states have raised and arbitral tribunals have examined.

### B. China's consent to arbitral determination as scrutinized by arbitral tribunals

Thus far, only seven cases were reported to have been brought pursuant to a Chinese BIT: five by Chinese investors against foreign states,<sup>212</sup> and two by a foreign investor against China.<sup>213</sup> As mentioned above, investment arbitration under a Chinese BIT very much depends upon the generation of which the BIT is a part. For example, although second and third-generation treaties do provide for investment arbitration for 'any dispute concerning an investment' or disputes arising out of a violation of the treaty, respectively, first-generation BITs only allow those 'involving the amount of compensation for expropriation'. According to the dominant view, therefore, the only disputes that China agreed to arbitrate in its early BITs are solely disputes over quantum due for expropriation. Other grounds for violation of a treaty such as breach of FET, FPS, or the threshold issue of the existence of an expropriation would thus need to be entertained by national courts of the host country. Proponents of an expansionist stance on the scope of China's consent to arbitration have, however, gained some traction recently.

One example of this trend is the *Tza Yap* case. Mr. Tza Yap filed a claim against Peru, registered by ICSID on 12 February 2007, on the basis of the China–Peru BIT dated 9 June 1994. This case involved an alleged expropriation by Peru of Mr. Tza Yap's fish flour company, TSG Peru S.A.C. Mr. Tza Yap claimed \$25 million in

212 *Señor Tza Yap Shum v Republic of Peru* (ICSID Case No. ARB/07/6); *Sanum Investments Limited and The Government of the Lao Democratic People's Republic* (PCA Case No. 2013-13); *China Heilongjiang International Economic & Technical Cooperative Corp., Beijing Shougang Mining Investment Company Ltd., Qinhuangdaoshi Qinlong International Industrial Co. Ltd. v Mongolia* (PCA Case No. 2010-20); *Ping An Life Insurance Company of China, Ltd and Ping An Insurance (Group) Company of China, Ltd v Kingdom of Belgium* (ICSID Case No. ARB/12/29); *Beijing Urban Construction Group Co Ltd v Republic of Yemen* (ICSID Case No. ARB/14/30).

213 *Ekras Berhad (Malaysia) v People's Republic of China*, ICSID Case No. ARB/11/15 (filed on 24 May 2011, the case was suspended on July 22 of the same year to finally be discontinued, upon joint request, on 16 May 2013); *Ansung Housing Co, Ltd v People's Republic of China*, ICSID Case No. ARB/14/25.

compensation. As the then prevailing China–Peru BIT was a first-generation treaty, its dispute resolution clause provided for arbitration of only disputes involving the amount of compensation due for expropriation.<sup>214</sup>

Mr. Tza Yap argued that the language of the BIT did not limit arbitration to the question of the determination of the quantum for expropriation, but the necessary pre-determination of the existence of an expropriation. In its decision on jurisdiction, the Tribunal agreed with him:

Al otro lado del espectro interpretativo, la frase podría incluir, además del monto de la compensación, una determinación de otras cuestiones importantes relativas a la alegada expropiación. Ésta es la interpretación solicitada por el Demandante. Por diversas razones, el Tribunal decide que la última interpretación, la más amplia, resulta ser la más apropiada.<sup>215</sup>

The Tribunal based its decision on the fact that the word ‘involving’ is not restrictive as would the words ‘limited to’ or ‘exclusively’<sup>216</sup> and that the context of Article 8(3) supports such an interpretation.<sup>217</sup> Peru filed a request for annulment of the award and a hearing was held in March 2014 by an ICSID ad hoc committee, the decision of which is pending.

Another example of the recent expansionist trend regarding the scope of China’s consent to investor-state arbitration is the *Sanum v. Laos* arbitration. In this case, a Macao investment firm alleged that it was expropriated from its investment in a hotel and casino project under gambling licenses in Laos, requesting over US\$235 million in damages.<sup>218</sup> Just as in *Tza Yap*, the arbitration provisions of the 1993 China–Laos BIT provides that only ‘disputes involving the amount of compensation for expropriation’ can be submitted to arbitration for resolution. The case has been discontinued further to a settlement agreement dated 15 June 15 2014. Before the case was discontinued, however, the *Sanum* tribunal had an opportunity to rule on Laos’s jurisdictional objections based on the restrictive language of the China–Laos BIT.<sup>219</sup>

The tribunal adopted the *Tza Yap* approach and held that the language of Article 8(3) does allow arbitration of disputes ‘involving the amount of compensation’. The tribunal based its decision on the fact that the word ‘involving’ is not limitative in and of itself. Also importantly, and in the same vein as *Tza Yap*’s reasoning, the tribunal rejected Laos’s argument that Article 8(3) was intended to only submit questions

214 Turner and Mangan, above n 117, at 44–45 ‘the recent claim under this very BIT filed by a Chinese investor [Tza Yap Shum] against Peru could, on the express terms of the BIT as set out above, only be in relation to the compensation that is due as a result of an expropriation that has been determined by a national court to have taken place’.

215 *Señor Tza Yap Shum v Republic of Peru* (ICSID Case No. ARB/07/6) Decision on Jurisdiction and Competence (2009), para 150.

216 *ibid.*, at para 151.

217 *ibid.*, at paras 152ff.

218 See *Sanum Investments Limited and The Government of the Lao Democratic People’s Republic*, Notice of Arbitration, available at <http://rlge.org/DOC/Sanum%20Investments%20-%202002%20-%20NoA.pdf> (last visited 11 September 2014).

219 The Award on Jurisdiction can be downloaded through Investment Arbitration Reporter’s website, available at <http://www.iareporter.com/downloads/20140721>.

of quantum for expropriation to arbitration, the prior question of liability for expropriation being left for the host state's courts to decide. This is because Article 8 contains a so-called 'fork-in-the-road' clause according to which arbitration is not available in the event the claiming party has resorted to local courts. In particular, the tribunal stated that a party would be precluded from ever bringing a claim for determination of the amount of compensation to arbitration because such party would be compelled to resort to local courts for claims over the existence of an expropriation, which would also settle the question of the amount thereof, thereby rendering the arbitration mechanism inoperative.<sup>220</sup>

Because of the possible import of the tribunal's decision on jurisdiction for future disputes, Laos has sought a set aside decision from the courts of Singapore (where the arbitration was held), notwithstanding the settlement agreement.<sup>221</sup> The Singapore High Court went on to annul the *Sanum* award on jurisdiction by judgment dated 20 January 2015, and notably stated *in dictum* that 'the Tribunal did not possess subject-matter jurisdiction over the defendant's expropriation claims because only disputes over the amount of compensation for expropriation can be submitted to arbitration under Art 8(3)'.<sup>222</sup>

The expansionist analysis of China's consent to arbitration in its early IIAs has been criticized,<sup>223</sup> and indeed, certain elements seem to militate against the adequacy of the *Tza Yap* and *Sanum* tribunals' rulings.

First, a treaty must be interpreted 'in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose'.<sup>224</sup> China BITs of the first generation specifically referred to 'disputes involving the amount of compensation for expropriation' as the only disputes between investors and states that could be arbitrated, the other disputes being subject to litigation before national courts. Such language appears, on its face, to be restrictive: if China had agreed to arbitrate all matters of expropriation, it was arguably sophisticated enough as a sovereign to have stated so expressly.

Second, China's intent not to submit to international tribunals' jurisdiction in the early years of its BIT program was expressly recognized, but disregarded, by the *Tza*

220 It is worth noting that the rationale in the *Tza Yap* and *Sanum* cases hinges on a fork-in-the-road provision. In both cases, the mechanism for resorting to international arbitration as provided in the relevant treaty consists of prior negotiations in the context of a pronouncement of expropriation pursuant to the expropriation section of the BIT. It thus seems that the contemplated mechanism for international arbitration is distinct from the national court action that the respective tribunal envisioned. When an expropriation is proclaimed, Art. 8(3) allows arbitration over the amount of compensation if prior negotiations proved unfruitful as to the 'equivalen[ce of the compensation] to the value of the expropriated investment' per Art. 4(2). When expropriation is not proclaimed—and its very existence is thus disputed—the mechanism that China consented to is contained in Art. 8(2), that is resorting to national courts after failed negotiations.

221 See Luke Eric Peterson, China offers support to Laos, in latter's bid to set aside arbitrators' expansive reading of China-Laos BIT, *Investment Arbitration Reporter* (21 July 2014).

222 *Government of the Lao People's Democratic Republic v Sanum Investments Ltd*, Judgment (2015) SGHC 15, para 128.

223 Wei Shen, 'The Good, the Bad or the Ugly? A Critique of the Decision on Jurisdiction and Competence in *Tza Yap Shum v. The Republic of Peru*', 10 *Chinese Journal of International Law*, paras 31ff., available at <http://chinesejil.oxfordjournals.org/content/10/1/55.short>.

224 Vienna Convention on the Law of Treaties (VCLT), Art. 31 (1).

*Yap* and *Sanum* tribunals. In that respect, in its decision to annul the *Sanum* award, the Singapore High Court noted the *Tza Yap* tribunal's observation that 'communist regimes possessed a certain degree of distrust regarding investment of private capital and were concerned about the decisions of international tribunals on matters over which they have no control'.<sup>225</sup> China indeed reiterated that it did not intend to consent to arbitration other than to 'disputes over compensation resulting from expropriation' when it acceded to the ICSID system in 1993 and issued its notification under Article 25(4) of the Washington Convention.<sup>226</sup> As regards *Tza Yap*, which was an ICSID case, it should be noted that the context for the interpretation of a treaty can be extracted from 'any instrument which was made by one or more parties in connection with the conclusion of the treaty'.<sup>227</sup> Given that Article 8(3) of the China–Peru BIT submitted expropriation amount disputes to ICSID, China's above notification appears relevant to establish competence *ratione voluntatis*—or lack thereof—with respect to cases arising under first-generation BITs such as *Tza Yap*'s. As of the date of this article, China has not made any comment disavowing this official position.

Third, the argument that the fork-in-the-road provision would preclude access to investor-state arbitration seems erroneous. Indeed, the BITs under which the *Tza Yap* and *Sanum* cases arose had an express provision contemplating that compensation was due for 'proclaimed' expropriations, which provision is context for, and should be read in conjunction with, the dispute resolution clause. In the light of China's stance on submission to the jurisdiction of international tribunals, it seems clear that the intent of China was to reserve for arbitration only the question of determination of quantum where the state had sovereignly declared an expropriation/nationalization by way of an executive order or regulation. Following that logic, a party could resort to arbitration in case of disagreement over the civil—as opposed to sovereign—question as to whether the 'amount of compensation for expropriation' offered is adequate, given that international standards may be more favorable than those of the host state.

Fourth, there is a line of precedents under BITs from other countries containing similar language than that of Chinese BITs (albeit perhaps more explicitly restrictive) that is at odds with the tribunal's ruling in *Tza Yap*. For example, the tribunal in the *Berschader* case held that, under the Belgium–Russia BIT, 'the ordinary meaning of the provision [which read "any dispute . . . relating to the amount or mode of compensation" for expropriation] excludes from the scope of the arbitration clause . . . disputes concerning whether or not an act of expropriation actually occurred'.<sup>228</sup> In the *RosInvest* case, 'the Tribunal [could not] see how the reference in the first jurisdictional clause expressly to the amount or payment of compensation under Articles 4 or 5 [of the UK-Russia BIT] only can nevertheless be interpreted as a reference also to the earlier sections of Article 5 which deal with expropriation in

225 *Government of the Lao People's Democratic Republic v. Sanum Investments Ltd*, Judgment (2015) SGHC 15, para 123.

226 See above Section IIIA.

227 VCLT, Art. 31(2)(b).

228 *Vladimir Berschader and Moïse Berschader v The Russian Federation*, SCC Case No. 080/2004, Award dated 21 April 2006, para 153.

general'.<sup>229</sup> More recently, the *ST-AD* tribunal decided that, under the Germany–Bulgaria BIT, 'the Tribunal's jurisdiction is limited to one narrow issue only, that is, the amount of compensation for an investment found to be expropriated by a finding made by a Bulgarian court'.<sup>230</sup> We should note, however, that at least one other precedent lends support to the findings of the *Tza Yap* and *Sanum* tribunals. In the *Renta4* case, the tribunal indeed held that it had 'jurisdiction to decide whether compensation is "due" to them under international law by reason of the conduct of which they complain (and if so in which amount)'.<sup>231</sup>

Another interesting and ancillary jurisdictional question raised in the *Sanum* case is whether the 'narrow door'<sup>232</sup> left open by first-generation China BITs could be circumvented through the MFN clause that most of China's early BITs contain. Indeed, it is reported that *Sanum* had attempted to bypass the narrow arbitration clause of the China–Laos BIT through its MFN mechanism. That way, *Sanum* was hoping to benefit from other Lao BITs granting access to international arbitration for disputes beyond issues of quantum, as an alternative argument. *Sanum's* rationale was that the 'activities associated with investments', referred to in the China–Laos BIT's MFN clause, would 'include access to arbitration over both claims of both expropriation and violation of fair and equitable treatment'.<sup>233</sup> Indeed, some tribunals have held that all the provisions, including dispute resolution clauses, were subject to the MFN clause's reach.<sup>234</sup> Yet, the MFN clause is almost invariably textually linked to other provisions regarding the substantive treatment to be given to foreign investment, such as the FET. Consequently, some commentators have posited that the drafters of the BITs intended to reserve MFN benefits to substantive protections only.<sup>235</sup> This understanding was reached by some arbitral tribunals, such as in the

229 *RosInvestCo UK Ltd. v The Russian Federation*, SCC Case No. Arb. V079/2005, Award on Jurisdiction dated October 2007, paras 112–114.

230 *ST-AD GmbH (Germany) v The Republic of Bulgaria*, PCA Case No. 2011-06 (ST-BG), Award on Jurisdiction dated 18 July 2013, paras 368–374.

231 See, e.g., *Renta 4 S.V.S.A et al. v Russian Federation*, SCC No. 24/2007, Award on Preliminary Objections dated 20 March 2009, paras 19ff. In another case, the tribunal also held that it had jurisdiction to decide whether an expropriation had actually occurred. This case is, however, clearly distinguishable from *Tza Yap* and *Sanum* in that the language of the dispute resolution clause provided that disputes 'concerning compensation' were arbitrable, and not disputes 'involving the amount of compensation'. See *European Media Ventures SA v Czech Republic*, High Court, Queen's Bench, Judgment dated 5 December 2007, 2007 EWHC 2851 (Comm).

232 *ST-AD v Bulgaria*, above n 224, at para 372.

233 See Jarrod Hepburn and Luke Eric Peterson, Laos has yet to pay \$56 million arbitral debt but new investors line up to sue; Chinese claimant says MFN clause circumvents narrow arbitration clause, *Investment Arbitration Reporter* (19 August 2012), available at [http://www.iareporter.com/articles/20120819\\_2](http://www.iareporter.com/articles/20120819_2).

234 See, e.g., *Emilio Augustin Maffezini v The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction dated 25 January 2000, para 64; *Austrian Airlines v Slovak Republic*, UNCITRAL, Final Award dated 20 October, 2009, para 124.

235 See Campbell McLachlan QC, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles*, para 7.168 (Oxford University Press, 2007) ('it is particularly important to construe the ambit of the State's consent strictly . . . the balance struck in investment treaties between the various dispute settlement options is often the subject of careful negotiation between the State Parties, selecting from a range of different techniques. It is not to be presumed that this can be disrupted by an investor selecting at will from an assorted menu of other options provided in other treaties, negotiated with other State Parties and in other circumstances . . . . The result, will be that the Most

*Plama v. Bulgaria* case where the arbitration clause at hand contained similar language to that of first-generation Chinese BITs.<sup>236</sup> Confirming the understanding of the *Plama* tribunal, China's recent treaties expressly state that the MFN clause does not apply to dispute resolution.<sup>237</sup> The tribunal in the *Sanum* case eventually denied Sanum's argument because 'to read into [the MFN] clause a dispute settlement provision to cover all protections under the Treaty when the Treaty itself provides for very limited access to international arbitration would result in a substantial re-write of the Treaty and an extension of the States Parties' consent to arbitration beyond what may be assumed to have been their intention'.<sup>238</sup>

Finally, with respect to arbitrations involving China IIAs, it should be observed that there are two other known cases involving a China BIT of first generation currently underway. In the *China Heilongjiang et al. v. Mongolia* arbitration,<sup>239</sup> Chinese SOE investors have alleged that the ad hoc tribunal was competent to decide whether an expropriation by Mongolia occurred further to the revocation of their license to exploit the Tumurtei iron ore deposit, despite the narrow consent provided in Article 8(3) of the China–Mongolia BIT. In the recently filed *Beijing Urban Construction Group Co Ltd v. Republic of Yemen* ICSID case, it is to be expected that,

Favoured Nation clause will not apply to investment treaties' dispute settlement provisions, save where the States expressly so provide'. See also Zachary Douglas, 'The MFN Clause in Investment Arbitration: Treaty Interpretation Off the Rails', 2(1) *Journal of International Dispute Settlement* 97(2011) (arguing that MFN clauses do not apply to dispute settlement mechanism as '[t]here is a fundamental distinction in general international law between the substantive obligations in a treaty, which are addressed to the state parties, and the provisions that create a jurisdictional mandate for an international tribunal, which are addressed to the tribunal and to the disputing parties, who enter into a relationship of procedural equality once arbitration proceedings have been commenced. This distinction must be respected by investment treaty tribunals in confronting the question of the scope of MFN clauses'). But see Stephan W. Schill, 'Allocating Adjudicatory Authority: Most-Favoured-Nation Clauses as a Basis of Jurisdiction-A Reply to Zachary Douglas', 2(2) *Journal of International Dispute Settlement* 353 (2011) (arguing that the application of MFN standard to dispute settlement mechanism 'accords with the structure of international law and the most fundamental duty it imposes on States, namely to comply with its international obligations').

236 *Plama Consortium Ltd v Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction dated 8 February 2005, para 223: 'an MFN provision in a basic treaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them'. See also *Berschader v Russia*, above n 222, at para 206 ('The starting point in determining whether or not an MFN clause encompasses the dispute resolution provisions of other treaties must always be an assessment of the intention of the contracting parties upon the conclusion of the original treaty. The Tribunal has applied the principle that an MFN provision in a BIT will only incorporate by reference an arbitration clause from another BIT where the terms of the original BIT clearly and unambiguously so provide or where it can otherwise be clearly inferred that this was the intention of the Contracting Parties'); *Wintershall Aktiengesellschaft v Argentine Republic*, ICSID Case No. ARB/04/14, Award dated 8 December 2008, paras 173ff.

237 See, e.g., China–New Zealand FTA, Art. 139 (2) ('For greater certainty, the [MFN] obligation in this Article does not encompass a requirement to extend to investors of the other Party dispute resolution procedures other than those set out in this Chapter.')

238 *Sanum v Laos*, Jurisdictional Award, above n 214, at para 358. As seen above, the Sanum tribunal decided that the dispute resolution clause itself encompassed issues of determination of expropriation, making the question of expansion through MFN clause unnecessary.

239 *China Heilongjiang International Economic & Technical Cooperative Corp., Beijing Shougang Mining Investment Company Ltd., Qinhuangdaoshi Qinlong International Industrial Co. Ltd. v Mongolia*, PCA Case No. 2010-20. Mr. Nolan represents Mongolia in this arbitration.

because of the restrictive language in the China–Yemen BIT providing for arbitration of only disputes over the amount of compensation for expropriation,<sup>240</sup> the Chinese investor also will argue that the tribunal has jurisdiction over its claims related to its building of an international airport in Sana'a for an amount of US\$114 million.<sup>241</sup>

### C. The apparent reluctance to resort to investor-state arbitration under Chinese IIAs

Despite the gradual broadening of China's consent to arbitration that its IIAs have reflected as China outward flow of investment has increased, few disputes arising under China's IIAs have been reported.<sup>242</sup> The relative scarcity of cases involving China BITs is somewhat surprising, considering the number of treaties it concluded since the early 1980s and its volumes of inward as well as outward investment registered over the past 15 years.

Some authors advance that the reasons are cultural: 'praise of harmony usually comes first' which makes it preferable for Chinese people not to resort to litigious means of resolution of disputes.<sup>243</sup> Another commentator put it that, in a society dominated by the Confucianist ideology, conflicts are frowned upon for they 'obstruct[] the natural order of life and other intrinsic disharmonious principles'.<sup>244</sup> As a result, mediation or other informal means of resolution of disputes (e.g., direct negotiation with government officials through Chinese partners) is said to have contributed to the paucity of investment arbitration cases.<sup>245</sup>

The reasons may, in fact, be more pragmatic. With respect to inbound investment, foreign investors may be discouraged from risking time, money and efforts in a case where they expect that, irrespective of the outcome, the chances of enforcing the award in China may be slim. Indeed, China's legal landscape has been said currently to disallow enforcement of foreign investor-state arbitral awards. First, China has, upon acceding to the 1958 New York Convention on Recognition and Enforcement of Arbitral Awards, expressly excluded enforceability of investor-state awards.<sup>246</sup> Second, the principle that ICSID awards are self-executing in a state's legal order may be undermined by the requirement that execution be 'governed by the

240 See Chester Brown (ed.), *Commentaries on Selected Model Investment Treaties* (Oxford University Press, 2013), 173.

241 See 'Chinese investor takes on Yemen at ICSID', *Global Arbitration Review*, 9 December 2014, available at <http://globalarbitrationreview.com/news/article/33242/chinese-investor-takes-yemen-icsid/>

242 See Wang, above n 170, at 7ff. We note, however, that six out of the seven investor-state cases reported have been commenced in the last 5 years, which may signal a decreasing frilosity as regards investor-state arbitration under China IIAs.

243 *Ibid.*, at 19.

244 George O. White, 'Navigating the Cultural Malaise: Foreign Direct Investment Dispute Resolution in the People's Republic of China', 55 *Tennessee Journal of Business Law* 64 (2003).

245 Wang, above n 170, at 20–21. Wang emphasizes on the importance for government officials at every level to not deter foreign investment: '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 arises which triggers withdrawal of foreign investments, the local government officials in charge may be held responsible.'

246 Notice on the Implementation of China's Accession to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1987, issued under Art. 5(2) of the New York Convention.

laws concerning the execution of judgments in force in the State in whose territories such execution is sought'.<sup>247</sup> Importantly, China does not have any law allowing enforcement of arbitral awards against state-owned property.<sup>248</sup>

What is more, China adopts a rigid position on sovereignty. China emphatically stated that it strictly adheres to the principle of absolute sovereign immunity. Indeed, in the *FG Hemisphere* case,<sup>249</sup> China propounded that '[t]he consistent and principled position of China is that a state and its property shall, in foreign courts, enjoy absolute immunity, including absolute immunity from jurisdiction and from execution, and has never applied the so-called principle or theory of "restrictive immunity"'.<sup>250</sup> This arguably contributes to investor sentiment that resorting to arbitration against China would prove inefficacious due to the enforcement challenges associated with arbitral award against the state.

The reasons seem similarly rooted with respect to outbound investment. On the one hand, the influence of China in Asia, where much of its outward FDI goes,<sup>251</sup> possibly contributes to prompt settlement between host countries and potential claimants Chinese SOEs outside of litigious avenues. On the other hand, the massive underwriting by the China Export & Credit Insurance Corporation ('Sinosure') of export credit insurance to extend credit enhancement to Chinese investors,<sup>252</sup> mostly SOEs as explained above, makes resorting to legal protections little appealing. It is worthy of note that Sinosure was established and became operational in 2001, that is when China announced its 'going abroad' strategy to the world and concomitant insertion of broad arbitration clause in its IIAs.<sup>253</sup> Coincidentally, the second generation of BITs started including subrogation clauses whereby if a state agency—such as Sinosure—makes a payment to a Chinese investor in relation to investments in

Therefore, awards rendered under the auspices of other arbitral institutions than ICSID, such as ICC or SCC, or by ad hoc tribunals cannot either be enforced in China.

247 Washington (ICSID) Convention, Art. 54(3).

248 Wang, above n 170, at 24–25.

249 *FG Hemisphere Associates LLC v Democratic Republic of the Congo and Ors*, Judgment, [FACV Nos. 5, 6 & 7 of 2010].

250 China's Letter of 25 August 2010, reproduced at para 211 of the Judgment. China goes on to say

The courts in China have no jurisdiction over, nor in practice have they ever entertained, any case in which a foreign state or government is sued as a defendant or any claim involving the property of any foreign state or government, irrespective of the nature or purpose of the relevant act of the foreign state or government and also irrespective of the nature, purpose or use of the relevant property of the foreign state or government. At the same time, China has never accepted any foreign courts having jurisdiction over cases in which the State or Government of China is sued as a defendant, or over cases involving the property of the State or Government of China. This principled position held by the Government of China is unequivocal and consistent.

251 Sophie Song, Southeast Asia receives more foreign direct investment (FDI) than China, which is now the world's third-largest foreign investor, *International Business Times* (5 March 2014), available at <http://www.ibtimes.com/southeast-asia-receives-more-foreign-direct-investment-fdi-china-which-now-worlds-third-largest>.

252 As of late 2013, Sinosure had 'supported export, domestic trade and investment with a total value of USD 1484.65 billion' and had 'facilitated the lending of CNY 1.8 trillion by 190 banks' (about USD 290 billion). See *Sinosure's Company Profile*, available at <http://www.sinosure.com.cn/sinosure/english/Company%20Profile.html>.

253 See *Sinosure's History*, available at <http://www.sinosure.com.cn/sinosure/english/history.htm>.

the territory of a contracting country, such agency will be subrogated in the rights of the investor and will thus be in a position to trigger the protections of the treaty itself.<sup>254</sup>

Consistent with China's new status as a net outward investor,<sup>255</sup> it may fully embrace the investor-state arbitration system moving forward. It has signalled of late that it may do so, through the above-described evolution of its investment protection treaties.

#### IV. QUO VADIS?

As laid out above, China's transition to become a major contributor of outward FDI has led to a profound reformation of its investment treaty regime. The data amply establish the extent to which China has departed from being a purely capital-importing country, in an effort to sustain its rapid economic growth, to a capital-exporting country, catching up with Europe and the USA.<sup>256</sup> At the same time, a closer analysis of the data reveals that the picture is in some respect more complicated than what is commonly presented.<sup>257</sup> As a general comment, the size of China's outward FDI stock was merely US\$ 730 billion in 2014, significantly smaller than that of the USA, with over US\$ 5 trillion. Also, although much has been made of China's takeover of Africa in that it 'is trying to establish firm control to resources-rich countries',<sup>258</sup> China comes in only in third place among developing country investors, behind Malaysia and South Africa<sup>259</sup> and is furthermore in the view of one commentator *de facto* limited to financing infrastructures in 'remote locations often with poor quality'.<sup>260</sup>

By juxtaposing the economical raw data with the actual practice of China vis-à-vis the international legal regime respecting investment treaty, one cannot help but notice the correlation between the language adopted in its IIAs and the clear movement from its positioning on the investment spectrum. Although China had an active BIT program since the early 1980s, it was of an extremely limited applicability. Without China's consent to arbitration of investor-state disputes, BITs were 'toothless'.

Under the second generation of IIAs which began in 1998, investors finally disposed of a dispute resolution mechanism to ensure that the promised treaty protections were upheld. As explained above, however, it remains to be seen whether such investors could recoup any potential losses incurred as a result of a treaty violation as (i) no investor ventured in the uncharted territory of investment treaty arbitration against China yet, and (ii) even if an arbitration had been carried out under a China IIA, China's position on the unenforceability of non-ICSID investor-state arbitral

254 See, e.g., China–Barbados BIT, Art. 7. For an example of subrogation clause in third-generation IIA, see China–Japan–Republic of Korea TIT, Art. 14.

255 See above Section A.

256 *ibid.*

257 *ibid.*

258 Huiping Chen, *Sino-African BITs practice: a new legal paradigm?* Paper at 3, Taipei Conference on International and Comparative Law (forthcoming).

259 See UNCTAD, above n 11, at 40.

260 Chen, above n 254, at 4.

awards and its lack of domestic legal mechanisms allowing enforcement of awards against state assets could deflated even the boldest investor.

In its third generation of IIAs, China comes of age with respect to adherence to the international legal regime for investment protection and solidifies its economic prominence in the likes of the USA and European countries. China sees itself as a provider of outbound flows of investment and as a participant in the international legal regime. Accordingly, it seems to align its view as to the fundamental tenets of investor-state protection and adopts the hallmarks of European Union or USA IIAs. Notably, and in keeping with the USA practice observed under the 2004 US Model BIT, China has largely accepted ICSID arbitration of disputes against investors (including under ICSID's Additional Facility),<sup>261</sup> abandoned umbrella clauses, subjected FET and FPS protections to customary norms of international law and even operated a paradigm shift by agreeing to the concept of a pre-establishment NT on the basis of a negative list.<sup>262</sup> It also ensured along the way that its SOEs, through which most of its foreign resources-oriented investments are channelled, are expressly covered by the investment protections that are owed to 'investors' as defined in these IIAs of third generation.

It remains to be seen, however, whether the position of China in its interaction with other mature home countries will result in a further adoption of recent investment protection standards and its engaging in a fifth generation of IIAs. For example, the 2012 US Model BIT anticipates resorting to a future multilateral appellate mechanism,<sup>263</sup> provides for transparency of arbitral proceedings,<sup>264</sup> recognizes the obligations of states under domestic labor laws,<sup>265</sup> and establishes that environmental concerns may justify non-precluded measures.<sup>266</sup> In the light of global efforts toward encouraging 'sustainable' foreign direct investment, spearheaded by the OECD<sup>267</sup> and UNCTAD,<sup>268</sup> it is possible that China will jump on the bandwagon and follow along the lead of other capital-exporting nations. There is some indication that China may decide to do so upon review of some recent treaties in which, for example, environmental measures do enjoy a basic level of observance.<sup>269</sup> If this is the future trajectory of China's IIAs, then there is hope for a largely uniform international investment law and policy regime.

261 See, e.g., Art. 15 of the China–Japan–Republic of Korea TIT.

262 See above Section IIIB(2).

263 Art. 28.

264 Art. 29.

265 Art. 13.

266 Art. 12.

267 See OECD, *OECD 2011 Guidelines for Multinational Enterprises*, available at <http://www.oecd.org/daf/inv/mne/48004323.pdf>.

268 See 'Investment policy framework for sustainable development', in UNCTAD, *World Investment Report 2012: Towards a New Generation of Investment Policies* (Geneva: UNCTAD, 2012).

269 See, e.g., China–Japan–Republic of Korea Treaty, Art. 23 ('each Contracting Party should not waive or otherwise derogate from such environmental measures as an encouragement for the establishment, acquisition or expansion of investments in its territory.').