



# Chinese Perspectives on the Modernisation of the Energy Charter Treaty

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# Chinese Perspectives on the Modernisation of the Energy Charter Treaty<sup>1</sup>

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## 1. Introduction

This research paper is conducted as part of the Chinese perspective on the consultation process to modernise the Energy Charter Treaty (ECT). At the end of 2017, the modernisation exercise resulted in the commencement of consultations on the potential need and/or usefulness of updating, clarifying or modernising the ECT itself. The consultation is presently on going, with the focus being on observer countries and stakeholders from the energy industry addressing a list of topics included in recent International Investment Agreements and topics derived from the ECT itself.<sup>2</sup> The key task of this paper is to critically assess and analyse as to whether the topics listed in CCDEC2017 23 are of special relevance for China in light of the country's potential accession to the ECT, and to further identify as to which benefits accession to the ECT would bring to China.

The exchange and cooperation between China and the Energy Charter have had some important progress in recent years. The increasing bilateral activities between China and the Energy Charter has facilitated a better understanding of strategic on both sides. In May 2015, the Director of the National Energy Administration, Mr. Nur Bekri, led the Chinese delegation to the Ministerial Conference on the International Energy Charter in The Hague, the Netherlands, where he signed the International Energy Charter Declaration on behalf of the Chinese government.<sup>3</sup>

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<sup>1</sup> *The contents of this work are the authors' sole responsibility. They do not necessarily represent the views of the China Electricity Council - International Energy Charter Joint Research Centre, or of any of its members.*

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<sup>2</sup> This list of topics is contained in CCDEC 2017 23 (Energy Charter Conference, 28 November 2017), available at: <https://energycharter.org/fileadmin/DocumentsMedia/CCDECS/2017/CCDEC201723.pdf>.

<sup>3</sup> National Energy Administration (NEA), 'China Signs New International Energy Charter Declaration' [中国签署新的国际能源宪章宣言], available at: [http://www.nea.gov.cn/2015-05/29/c\\_134282011.htm](http://www.nea.gov.cn/2015-05/29/c_134282011.htm);

Pursuant to the Declaration, China will further deepen the cooperation with the Energy Charter, thereby making an crucial step towards international energy governance for China.<sup>4</sup> All states signing the International Energy Charter Declaration, including China, will be invited to participate in the process of modernisation of the ECT, in hope of reaching a consensus on the updated treaty terms and provisions.<sup>5</sup> The participation of China in the modernisation of the ECT is of particular importance for both China and the ECT, because it offers opportunities to enhance mutual learning and allows more in-depth communications on issues such as limits and benefits of treaty protection under the ECT. Despite of the increasing exchange and cooperative activities between China and the ECT, the Chinese government agencies, enterprises, relevant research institutions and think tanks still have limited knowledge about the provisions under the ECT and their applicability in the investment arbitration. To date, China has yet to decide whether or not it will accede to the ECT. The limited knowledge thereof has been considered to be one of the significant factors that has noticeably affected China's willingness to accede to the ECT.<sup>6</sup>

At present, the scholarly debate about whether China should accede to the ECT centres on what benefits and impacts China's accession to the ECT will bring to China, in light of the modernisation of the ECT, as well as China's increasing outbound activities in the area of energy related investment, particularly under the Belt and Road Initiative (referred to below as the BRI).<sup>7</sup> From a general point of view, China's accession to the ECT is considered by the Chinese

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An overview of the International Energy Charter is available at:

<https://energycharter.org/process/international-energy-charter-2015/overview/>

<sup>4</sup> NEA, above n 3.

<sup>5</sup> Ibid.

<sup>6</sup> Daojiong Zha, 'Whether China shall Accede to the Energy Charter Treaty?' [中国要不要加入《国际能源宪章条约》?] (The Paper, January 2015), available at:

[https://www.thepaper.cn/newsDetail\\_forward\\_1298825](https://www.thepaper.cn/newsDetail_forward_1298825)

<sup>7</sup> On the debate on China's accession to the ECT, see for example, Wenhua Shan et al., 'Cost-benefit Analysis of China's Accession to the Energy Charter Treaty under the background of the "Belt and Road Initiative"' ["一带一路"建设背景下中国加入《能源宪章条约》的成本收益分析] (2016) 1 Chinese Review of International Law 39; Zhonghong Bai and Yuanzheng Pan, 'Advantages and Disadvantages of China's Accession to the Energy Charter Treaty' [中国加入《能源宪章条约》的利弊论] (2010) 10 Ecological Economy 75; Zhuwei Wang, 'Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China' (Energy Charter Secretariat 2015) 41, available at: [http://www.energycharter.org/fileadmin/DocumentsMedia/Thematic/China\\_and\\_the\\_ECT\\_2015\\_en.pdf](http://www.energycharter.org/fileadmin/DocumentsMedia/Thematic/China_and_the_ECT_2015_en.pdf) 0Af;

scholars and commentators as a “double-edged sword” that will benefit China in a number of ways but would also enable foreign investors to bring investment arbitration against the Chinese government for possible breach of the ECT provisions.<sup>8</sup> Because of China’s increasing reliance on energy supply through imports, Chinese scholars and commentators have advocated for a more active role of China in international energy governance.<sup>9</sup> For many Chinese scholars, deepening the cooperation with the Energy Charter and the subsequent accession to the ECT is often regarded as a viable option to achieve this goal.<sup>10</sup> However, the fundamental questions remain whether accession to the ECT will best serve China’s strategic vision to the extent possible.

The benefits that accession to the ECT will bring to China has been articulated by a number of Chinese scholars.<sup>11</sup> To recap, the ECT contains robust legal protection provisions that aim to reduce regulatory and political risks confronted by investors.<sup>12</sup> As the only multilateral treaty that is specifically crafted for energy trade and investment activities, the ECT has adopted substantive protection standards that allow investors from one state to initiate investment arbitration against a host state, thereby protecting foreign investors against political and legal risks, such as expropriation and unfair treatment.<sup>13</sup> The protection and remedy provided by the ECT will allow Chinese investors to expand operations in states that are signatories to the ECT.<sup>14</sup> In a nutshell, the stable and predictable environment created by the ECT goes in line with the need of the Chinese government’s strategic movement towards outbound energy investment under the BRI.

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<sup>8</sup> Zha, above n 6; Bai and Pan, above n 7; see also Desheng Hu, ‘How Should China Deal with the Energy Charter Treaty’ [中国应该如何对待《能源宪章条约》] (2017) 6 *Journal of Political Science and Law* 78; Xun Ma, ‘Analysis of International Energy Dispute Resolution Mechanism - Taking the Energy Charter Treaty as an Example’ [浅析国际能源争议解决机制—以《能源宪章条约》为例] (2009) 4 *Ecological Economy* 58; Wenhua Shan, Report on the Compatibility of Chinese Laws and Regulations with the Energy Charter Treaty (Energy Charter Secretariat, October 2-15), available at: [https://energycharter.org/fileadmin/DocumentsMedia/CONEXO/20151127-Compatibility\\_of\\_Chinese\\_Laws\\_and\\_Regulations\\_with\\_ECT\\_Report.pdf](https://energycharter.org/fileadmin/DocumentsMedia/CONEXO/20151127-Compatibility_of_Chinese_Laws_and_Regulations_with_ECT_Report.pdf);

<sup>9</sup> Yang, above n 6; see also Shumei Yue, ‘Innovation on the Legal Mechanisms of China’s Participation in International Energy Cooperation’ [中国参与国际能源合作的法律机制创新研究] (2009) 4 *Hebei Law Journal* 96.

<sup>10</sup> Zha, above n 6; Shan et al., above n 7; Shan, above n 8.

<sup>11</sup> Bai and Pan, above n 7; Ma, above n 8; Shan et al., above n 7.

<sup>12</sup> *Ibid.*

<sup>13</sup> Shan et al., above n 5; see also Wei Cao, ‘Energy Charter Treaty and China’ [能源宪章与中国] (2003) 10 *International Petroleum Economics* 29.

<sup>14</sup> Bai and Pan, above n 7; Ma, above n 8; Shan et al., above n 7.

As pointed out by the BRI policy framework, outbound energy investment has been given strategic importance in China to expand cross-border energy infrastructure projects and to further extend energy connectivity.<sup>15</sup> A key objective of the vision under the BRI is to secure energy supply through imports to fuel China's economic growth.<sup>16</sup> For example, among the Belt and Road countries, Central Asia countries play important roles. At present, transit projects between China and Central Asia include oil and gas pipelines and Central Asia is argued to be the core region under the BRI, in particular for investment and infrastructure connectivity in the energy sector.<sup>17</sup> In addition to these investments in the transit projects, Chinese energy companies have also increased their investment portfolio in energy production, such as coal-fired plants and hydro dams, as well as renewable energy.<sup>18</sup> According to the existing studies, Chinese outbound energy investment has covered most aspects of the energy sector and has 'a presence in almost every major region of the world'.<sup>19</sup> Minimising the political and legal risks associated with the increasing Chinese outbound energy investment has become a real challenge for both the Chinese government and enterprises.<sup>20</sup>

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<sup>15</sup> National Development and Reform Commission (NDRC), Ministry of Foreign Affairs, Ministry of Commerce of the People's Republic of China, with State Council Authorization, 'Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road Affairs' (2015) 4-5, available at: [http://en.ndrc.gov.cn/newsrelease/201503/t20150330\\_669367.html](http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html) (referred to below as Vision and Action of the BRI)

<sup>16</sup> Ibid.

<sup>17</sup> Zewei Yang, 'Energy Cooperation between China and Central Asian Countries in the Context of "Silk Road Economic Belt": Status Quo, Defects and Reconstruction' [共建“丝绸之路经济带”背景下中国与中亚国家能源合作法律制度：现状、缺陷与重构] (2016) 1 The Law Journal 18; Han Wang, 'Towards a Corporative Framework for A China-Central Asia Energy Transit Community' (Energy Charter Secretariat Knowledge Centre Occasional Paper Series 2016), available at: <http://www.energycharter.org/fileadmin/DocumentsMedia/Occasional/China-Central Asia Energy Transit Community.pdf>

<sup>18</sup> Xiaomei Tan, 'China's Overseas Investment in the Energy/Resources sector: Its Scale, Drivers, Challenges and Implications' (2013) 35 Energy Economics 750; Kevin P. Gallagher et al., 'Fueling Growth and Financing Risk: The Benefits and Risks of China's Development Finance in the Global Energy Sector' (Boston University Global Economic Governance Initiative Working Paper 002.05/2016), available at: [https://www.bu.edu/pardeeschool/files/2016/05/Fueling-Growth.FINAL\\_version.pdf](https://www.bu.edu/pardeeschool/files/2016/05/Fueling-Growth.FINAL_version.pdf);

<sup>19</sup> Gallagher et al., above n 18.

<sup>20</sup> Zewei Yang, 'Dispute Resolution Mechanism for Transnational Energy Pipeline Transportation' [跨国能源管道运输的争议解决机制] (2007) 12 The Law Journal 84; Zewei Yang, 'Constructing the "21st Century Maritime Silk Road": Risks and Legal Countermeasures' [“21世纪海上丝绸之路”建设的风险及其法律防范] (2018) 1 Global Law Review 163

The political and legal risks associated with inbound energy investment is also a present issue in China, largely due to the ongoing process of energy sector reform driven by domestic policy imperatives, such as the coal-to-gas conversion to achieve decarbonisation goals.<sup>21</sup> Some Chinese scholars argue that these risks are to be exacerbated in the process of deepening China's energy sector reform.<sup>22</sup> The Chinese government is in the process of legislative and policy reforms to transform the energy sector towards resilience, sustainability and decarbonisation.<sup>23</sup> The legislative and policy changes will likely to affect consistency of Chinese laws and policy related to inbound energy investment. China's accession to the ECT carries a potential risk of foreign investors bringing investment arbitration against the Chinese government.<sup>24</sup>

Despite the risks, some Chinese scholars and commentators envisage the opportunities for China to reform the energy related legislative and policy framework in China to be more compatible with the energy-specific trade and investment agreement – the ECT.<sup>25</sup> This allows the Chinese government to reduce the domestic law and policy hurdles surrounding the debate over China's accession to the ECT and maximise the protection of Chinese outbound investors in the energy sector. China's participation in the modernisation of the ECT is therefore considered to be a crucial move towards better understanding of the treaty provisions under the ECT and their relevance with Chinese situations. In light of the efforts made towards the modernisation of the ECT, this paper discusses and examines the topics and issues identified by the modernisation process of the ECT, to the extent possible, with the relevant Chinese stakeholders and commentators. By doing so this paper aims to contribute to the understanding about the relevance of the modernisation process of the ECT with China. Given that the scope of the paper is very limited, it fails to further examine issues such as the applicability of the ECT provisions in China.

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<sup>21</sup> Zha, above n 6.

<sup>22</sup> Ibid; see also Hu, above n 8.

<sup>23</sup> See for example, Anatole Boute and Hao Zhang, 'The Role of the Market and Traditional Regulation in Decarbonising China's Energy Supply' (2018) 30(2) *Journal of Environmental Law* 261.

<sup>24</sup> Zha, above n 6; Shan, above n 7.

<sup>25</sup> Ibid; see also Chunhua Cheng, 'Transformation of the Energy Charter Treaty and Global Energy Governance: History, Causes and Impacts' [能源宪章转型与全球能源治理: 历程、原因及影响] (2015) 11 *Journal of Social Sciences* 55.

The methodology of this research paper constitutes both desk research and empirical studies. This desk research draws from some of scholarly work already undertaken in the field of China and the ECT.<sup>26</sup> The desk research also contains some close examinations of the recent Chinese bilateral investment treaties (BITs) and free trade agreements (FTA) to provide some specific examples of the issues identified by the listed topic under the document CCDEC 2017 23. Because of the topics of relevance are very specialised and in some cases, require a certain level of investigation into the technicality of the issues at hand, empirical studies were conducted to supplement essential information as to whether the topics and issues identified by the ECT are of relevance to China. The empirical studies were semi-structured interviews conducted on site, each around an hour in duration. The interviewees are all relevant stakeholders and professionals from the government agencies, think tanks, Chinese energy state-owned enterprises (mainly oil, gas and electricity), professional agencies, such as law firms and arbitration tribunals, as well as research institutions. For ethical reasons, the interviews were conducted under conditions of anonymity.<sup>27</sup> Essentially, the interviews were used to gain insights and provide leads. For example, some interviewees highlighted some recent trends of treaty making in China by referring to some particular BITs or FTAs. The subsequent examination of these BITs and FTAs allow further articulation of the listed topics. The viewpoints referred to in this research paper from the interviews are not attributed to any individuals.

The research paper is structured as follows. Part two focuses on the Chinese perspective of the modernisation of the ECT, with each of the listed topic addressed specifically from the Chinese perspectives. Part three concludes the research paper by identifying some of the recent trends of Chinese BITs and shedding some light on the BRI and prospects of China's accession to the ECT.

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<sup>26</sup> See above n 7 and 8.

<sup>27</sup> Given that the group of interviewees is relatively small and because of the research ethics requirement to protect identity of the interviewees, the comments made by the interviewees have been generalised in a way to discuss and examine the listed topics without attributing any specific information to any individual. In cases where the comment referenced in this report is made by an individual, the general affiliation of the interviewee is provided so as to prevent that his opinion is receiving too much weight in the narrative and analysis. To distinguish the backgrounds of the interviewees, unless otherwise specified in the text or footnotes, "Chinese stakeholders" referred to in this report include people from government agencies and state-owned enterprises (SOEs); "Chinese commentators" are people from other institutions identified in the methodological approach.



## 2. Chinese Perspectives of the List of Modernisation Topics<sup>28</sup>

In order to articulate the Chinese perspectives on the listed topics under the CCDEC 2017 23, this part is organised following the sequence of the topics identified (in bold and italic) in current investment policy tendencies incorporated in international investment agreements. Under each topic the Chinese perspectives are then discussed and the relevant issues are further analysed by referring to both interview feedbacks and the recent Chinese BITs and FTAs.

***Preamble:*** *there is a trend in some recent IIAs to provide further context to the disciplines by referring to other public policy interests (such as sustainable development, transparency, environmental and labour standards as well as universal values as human rights).*

Policy interests, such as transparency, human rights, environmental and labour standards, are included in China's BITs and FTAs in recent years. For example, the China-Japan-South Korean BIT (2012) and China-South Korean FTA Investment outline comprehensive transparency provisions, requesting contracting parties to ensure that its laws, regulations, policies and administrative procedures are publicly available.<sup>29</sup> Both China-Japan-South Korea BIT (2012) and China-South Korean FTA Investment Chapter (2015) state that:

“1. Each Party shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative procedures and administrative rulings and judicial decisions of general application as well as international agreements to which the Party is a party and which pertain to or affect investment activities. The Government of each Party shall make easily available to the public, the names and addresses of the competent authorities responsible for such laws, regulations, administrative procedures and administrative rulings.

2. When a Party introduces or changes its laws or regulations that significantly affect the implementation and operation of this Chapter, the Party shall endeavour to provide a reasonable interval between the time when such laws or regulations are published or made publicly available and the time when they enter into force, except for those laws

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<sup>28</sup> Modernisation of the Energy Charter Treaty, Decision of the Energy Charter Conference (CCDEC 2017 23), 28 November 2017.

<sup>29</sup> China-Japan-South Korean BIT (2012), China-South Korean FTA Investment and China-Canada BIT (2012).

or regulations involving national security, foreign exchange rates or monetary policies and other laws or regulations the publication of which would impede law enforcement.

3. Each Party shall, on the request by the other Party, within a reasonable period of time and through existing bilateral channels, respond to specific questions from, and provide information to, the latter Party with respect to any actual or proposed measure of the former Party, which might materially affect the interests of the latter Party and its investors under this Chapter.”<sup>30</sup>

As for sustainable development and environmental measures, both China-Japan-South Korean BIT (2012) and China-South Korean FTA Investment Chapter (2015) state that”

“Each Contracting Party recognizes that it is inappropriate to encourage investment by investors of another Contracting Party by relaxing its environmental measures. To this effect 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.”<sup>31</sup>

Similarly, China-Canada BIT (2012) states:

“Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures:

- (a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- (b) necessary to protect human, animal or plant life or health; or

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<sup>30</sup> China-Japan-South Korean BIT (2012), Article 10; China-South Korean FTA Investment Chapter (2015), Article 12.8.

<sup>31</sup> China-Japan-South Korean BIT (2012), Article 23; China-South Korean FTA Investment Chapter (2015), Article 12.16.

(c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”<sup>32</sup>

Labour standard is mentioned in China-New Zealand FTA stating that both parties shall enhance their communication and cooperation on labour matters through their MOU on Labour Cooperation which addressed about laws, policies and practices.

The above examples indicate the trend in Chinese BITs and FTAs to cover public policy interests such as sustainable development, transparency, environmental and labour standards as well as universal values as human rights. Two Chinese interviewees from a Chinese national oil company and a government agency respectively acknowledged the importance of the above policy interests to Chinese investors and highlighted the importance for China’s BITs and FTAs to match international standards.<sup>33</sup> Inclusion of these policy interests reflects a common aspiration to promote sound standard, policies and practices in China and its counterparts. These BITs and FTAs enumerate a set of shared commitments, recognising that it is inappropriate to encourage trade or investment by weakening transparency, environmental and labour standard.

Regarding the ECT’s coverage of public policy interests, both stakeholders also expressed mixed concerns because it could also impose potential restriction on China.<sup>34</sup> It is understood that particular aspects in the ECT, such as environment, are soft law.<sup>35</sup> Limited enforceability in soft law could imply limited restriction on China which is an important factor for Chinese consideration of accession. However, the two interviewees from Chinese national oil company and Chinese government agency pointed out that Chinese energy policy makers and investors are unlikely to be familiar with the nature and implication of soft law. Instead, they shared common concerns if ECT sets down specific requirements on the above aspects because there is a possibility that the Chinese government and investors may not be able to meet them and might

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<sup>32</sup> China-Canada BIT (2012), Article 33.

<sup>33</sup> Interview with a former employee from a Chinese national oil company on 17 May 2018; Interview with an interviewee from a government agency on 17 May 2018.

<sup>34</sup> Ibid.

<sup>35</sup> The Energy Charter Treaty (2014), Article 19

have to face dispute or penalty.<sup>36</sup> Therefore, for Chinese authorities, the inclusion of disciplines, standards or universal values could be restriction instead of protection. It would be controllable if the above requirements are limited in a bilateral framework instead of a multilateral one.<sup>37</sup>

Both interviewees pointed out that the Chinese authorities might doubt whether international institutions like the International Energy Charter can protect their national interests.<sup>38</sup> They tend to focus on the risks of signing the ECT instead of how the ECT could protect investments and companies. In particular, the Chinese authorities were alarmed by the news that the ECT had been used in the Yukos case in 2014.<sup>39</sup> They were concerned that the Chinese government could face the same repercussions as the Russian government did in this case. In contrast, the Chinese authorities were comfortable with signing the International Energy Charter in 2015. In other words, China wishes to remain unobligated and to be able to ‘exit’ whenever it feels compelled to do so.

**Covered investments, Article 1(6); and covered investors, Article 1(7):** *Some recent IIAs require covered investments to fulfil specific characteristics (such as commitment of capital, an effective contribution to the host State’s economy, and a certain duration) and/or include a legality requirement (compliance with domestic laws, including anticorruption/bribery regulations). In addition, ECT annexes on energy products and materials could be updated and the definition of ‘economic activity in the energy sector’ (which is relevant to the type of covered investments under the ECT) could be clarified; some recent IIAs include additional criteria for the definition of covered investors (a company must have its “seat” and engage in “real/substantial business” activities in the home State, exclusion of individuals with dual nationality –including that of the host State–, exclusion of investors whose ultimate beneficiary is a national of the host State).*

Both Article 1(6) and 1(7) address the requirement of fulfilling specific characteristics which are also observed in recent Chinese BITs. China’s BITs tend to apply the asset-based definition of investment that include both direct investment as well as intangible investments, such as intellectual property.

Specific characteristics or legal requirement for covered investments are observed in recent FTAs. For example, Article 12.1 of FTA between China and South Korea identifies investment as:

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<sup>36</sup> Interview with a former employee from a Chinese national oil company on 17 May 2018, Interview with an interviewee from a government agency on 17 May 2018.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

“[m]eans every kind of asset that an investor owns or controls, directly or indirectly, which has the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.”<sup>40</sup>

FTA between China and Australia in 2015 states that covered investment subject to the Party’s relevant laws, regulations and policies.<sup>41</sup>

As for covered investor, China’s BITs and FTAs adopt commonly used definition of investors and additional requirement is observed in recent ones. For example, FTA between China and South Korea states:

“A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of the latter Party and to its investments if the enterprise is owned or controlled by an investor of a non-Party or of the denying Party, and the enterprise has no substantial business activities in the territory of the latter Party.”<sup>42</sup>

An interviewee from the Chinese government agency pointed out that the above special characteristics and requirements in Article 1(6) and 1(7) could narrow the scope of “investment”.<sup>43</sup> This could be a challenge for investors to fit their investments into such “definitions” before a project is commenced. However, Chinese policy makers prefer a narrowed scope of investment because it could reduce China’s chance of breaching the standards. Besides, Chinese policy makers and investors might not know how to reach the conditions like “effective contribution to the host state’s economy”.<sup>44</sup> Effectiveness is difficult to justify. There are concerns that the investors could be punished if the “effective contribution” is not met or that the host state could utilise this condition as a bargaining chip.<sup>45</sup>

Article 1(6) and 1(7) address a specific coverage of both investment and investors and there is also a need to update the definition of covered “economic activity in the energy sector”. Although such coverage, namely economic activity concerning the exploration, extraction, refining,

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<sup>40</sup> China-South Korea FTA (2015), Article 12.1.

<sup>41</sup> China-Australia FTA (2015), Article 9.1.

<sup>42</sup> China-South Korea FTA (2015), Article 12.15

<sup>43</sup> Interview with an interviewee from a government agency on 17 May 2018.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

production, storage, land transport, transmission, distribution, trade, marketing, or sale of ‘energy materials and products, has no major conflict with Chinese energy investment strategy, as indicated in Chinese white paper *China’s Energy Policy 2012*<sup>46</sup> and Belt and Road documents<sup>47</sup>, but it might not be fully aligning with the needs of Chinese investors. An interviewee from a Chinese national oil company argued that there are changes in “economic activity in the energy sector”, such as the eastward shifting of oil market and the US shale gas revolution, from time to time which could make the contribution of ECT less relevant to China.<sup>48</sup> Current global energy landscape is understood to be guided by trade and is more globalised. An interviewee from Chinese government agency argued that the ECT was created to coordinate and protect supply and demand relationship and to promote energy cooperation in a regional market.<sup>49</sup> Although ECT is useful to the extent that it covers the investment done between China and the regions covered by the treaty, in particular Central Asia, most disputes China encountered in these regions are still resolved under the BIT and other frameworks. More importantly, the global energy market China facing nowadays is much more flexible. There are more alternatives if a supplier or buyer is not available.<sup>50</sup> For example, in order to diversify its gas supply, China is increasing its gas import from Russia and the US which are not members of the ECT.<sup>51</sup> It is unlikely that ECT’s covered investment and investors could be relevant to China’s gas investment with two of the largest suppliers, namely Russia and the US. In addition, China’s oil and gas investment in Europe is comparatively small, making the ECT looks less relevant.<sup>52</sup>

Moreover, an interviewee specialised in EU-Asia relationship added that the regional and political environment in Asia is different from that in Europe.<sup>53</sup> Compared to Asia, EU is a

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<sup>46</sup> NDRC, ‘China’s Energy Policy 2012’ [中国的能源政策(2012)] (2012), available at: <http://www.scio.gov.cn/zfbps/ndhf/2012/Document/1233790/1233790.htm>

<sup>47</sup> Vision and Action of the BRI, above n 15.

<sup>48</sup> Interview with a former employee from a Chinese national oil company on 17 May 2018

<sup>49</sup> Interview with an interviewee from a government agency on 17 May 2018.

<sup>50</sup> Ibid.

<sup>51</sup> Jiaqi Lu and Ye Qi, ‘U.S. Gas to China: Positive Energy for Bilateral Relations’ (Brookings Institute, 2018) available at: <https://www.brookings.edu/2018/05/31/u-s-gas-to-china-positive-energy-for-bilateral-relations/>

<sup>52</sup> Interview with an interviewee from a government agency on 17 May 2018.

<sup>53</sup> Interview with a Chinese commentator, who is specialising in EU-Asia relationship, from a Chinese university on 19 June 2018.

united entity in which its members share common consensus on particular principles, laws and ideologies in particular.<sup>54</sup> Comparatively speaking, it is easier to call for collective actions among EU member states. However, Asian countries are relatively disunited with diverse cultures, languages and ideologies. It could be argued that more diversities exacerbate regulatory risks which increases the relevance of the ECT as an investment protection instrument. Theoretically, the ECT provides an option to enhance energy cooperation and coordination in Asia where there is lack of thereof. However, in practice, it is also more difficult to convene Asian countries to work collectively. Although China and other Asian countries would agree with the principles, such as open and fair market, underpinning the ECT, they may not consider them as the sole top policy priority as the ECT does.<sup>55</sup> Therefore, Chinese stakeholders consider the motivation of adopting the ECT as a way to coordinate the supply and demand relationship to be limited.

**Protection of pre-investment:** *currently ECT Article 10(4-6) only provides voluntary soft commitments regarding pre-investment and the obligation to negotiate the supplementary treaty to cover pre-investment. Several recent IIAs include pre-investment with or without being subject to the dispute resolution mechanisms (either investor-State or State-State).*

Protection of pre-investment are covered by some China's BITs and FTAs. For example, China-Canada BIT (2012) extends the Most-Favoured Nation Treatment to the pre-investment phase:

“Each Contracting Party shall accord to investors of the other Contracting Party treatment no less favourable than that it accords, in like circumstances, to investors of a non-Contracting Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

Each Contracting Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments of investors of a non-Contracting Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.”<sup>56</sup>

Similar terms are also observed in FTA between China and Australia:

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<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> China-Canada BIT (2012), Article 5.

“Australia shall accord to investors of China treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.”<sup>57</sup>

In the Sixth China-US Strategic and Economic Dialogue, National Treatment is included in the Shanghai Pilot Free Trade Zone.<sup>58</sup> In FTA between China and South Korea,

“Each Party recognizes that it is inappropriate to encourage investment by investors of the other Party by relaxing its environmental measures. To this effect each 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.”<sup>59</sup>

While pre-investment are included in China’s recent BITs and FTAs, Chinese stakeholders are also concerned about how pre-investment is protected and how dispute is resolved. At different stages of investment, from establishment to acquisition and even operation, an interviewee from Chinese national oil company pointed out that Chinese companies normally find their negotiation with foreign counterparts difficult despite strong financial support from the Chinese government.<sup>60</sup> Studies pointed out that, different from foreign teams, Chinese lawyers are seldom involved in the Chinese negotiation team, resulting in contentious issues. The Chinese negotiation team could be in disadvantage in joint venture negotiations if they do not have sufficient legal backup.<sup>61</sup> Chinese enterprises appear to be weak in background research of their investment target, and they always appear to be in difficult position in face of unfavourable terms in negotiations, especially in recent cases of gas shortage of China-Central Asia gas

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<sup>57</sup> China-Australia FTA (2015), Article 9.3.

<sup>58</sup> The Sixth China-US Strategic and Economic Dialogue (2014), Session II.

<sup>59</sup> China-South Korea FTA (2015), Article 12.1.

<sup>60</sup> Interview with an interviewee from a Chinese government agency on 17 May 2018.

<sup>61</sup> Pervez Ghauri and Tony Fang, *The Chinese Business Negotiation Process: A Socio-cultural Analysis* (University of Groningen, 1999); Tony Fang ‘Negotiation: the Chinese Style’ (2006) 21(1) *Journal of Business & Industrial Marketing* 50.



cooperation.<sup>62</sup> Chinese authorities and investors might not be familiar with how to rely on or how to apply ECT to resolve dispute and expect an effective mechanism.<sup>63</sup>

Regarding ECT's voluntary soft commitments of pre-investment, an interviewee from Chinese government agency questioned the effectiveness of protection. He pointed out that, other than the neutral arbitral tribunals recognised by China, such as the Stockholm Chamber, the promotion and dispute resolution of Chinese pre-investment could also be done via China Council for the Promotion of International Trade in Beijing.<sup>64</sup> This council has been involved in the promotion, formulation of rules, negotiation and dispute resolution of different stages of Chinese investments since 1952. Although the legal experience of China Council for the Promotion of International Trade is not comparable with ECT, it could be more effective in promoting and protecting investment because its bilateral and direct approach involves fewer parties.

***Fair and Equitable Treatment (FET), Article 10(1): some IIAs qualify the FET standard by reference to the minimum standard of treatment of aliens under customary international law. There is also a trend either to state the FET standard through an open-ended list of FET obligations or to replace the general FET clause with an exhaustive list of what the Parties would consider as breaching the standard.***

Fair and Equitable Treatment is included in China's recent BITs, such as China-Canada BIT (2012), China-Japan-South Korean BIT (2012), the Fifth China-US Strategic and Economic Dialogue, as well as the China-South Korean FTA (2015).<sup>65</sup> In these BITs and FTA, fair and equitable treatment towards investments is covered in accordance with international law. Treatment or substantive rights beyond that which is required by the international law minimum standard are not required. For example, China-Canada BIT states:

- “1. Each Contracting Party shall accord to covered investments fair and equitable treatment and full protection and security, in accordance with international law.
2. The concepts of “fair and equitable treatment” and “full protection and security” in paragraph 1 do not require treatment in addition to or beyond that which is required by

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<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> Interview with an interviewee from a Chinese government agency on 17 May 2018.

<sup>65</sup> China-Canada BIT (2012) Article 4, China-Japan-South Korean BIT (2012), Article 5; the Fifth China-US Strategic and Economic Dialogue and China-South Korean FTA Investment Chapter (2015), Article 12.5.

the international law minimum standard of treatment of aliens as evidenced by general State practice accepted as law.”<sup>66</sup>

Similarly, FTA between China and South Korea explains the concept of “fair and equitable treatment” as followed:

“For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:

(a) “fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process of law.”<sup>67</sup>

It is observed that FET in China’s BITs and FTAs includes the requirement not to deny justice in civil, administrative and criminal proceedings but several recent BITs also include further elaboration. For example, China-Tanzania BIT states that “investors of one Contracting Party shall not be denied fair judicial proceedings by the other Contracting Party or be treated with obvious discriminatory or arbitrary measures”<sup>68</sup>.

An interviewee from a think tank pointed out that an exhaustive list of obligation will narrow down the discretion that arbitrators could have.<sup>69</sup> An exhaustive list explicitly lists what the parties would consider as breaching the standard and hence could limit the uncertainties Chinese parties would face. In other words, it is a clear list which the Chinese parties could follow to avoid penalties due to breaching of standards. An exhaustive list of obligation could save the time of disputing parties and arbitrator of establishing the relevant content of international law. It is notable that any open-ended list of obligations or exhaustive list longer than the minimum

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<sup>66</sup> China-Canada BIT (2012), Article 4.

<sup>67</sup> China-South Korea FTA (2015), Article 12.5.

<sup>68</sup> China-Tanzania BIT (2013), Article 5.2.

<sup>69</sup> Interview with a Chinese commentator from a Chinese think tank on 19 June 2018.

standard is unlikely to be preferred by Chinese stakeholders as it implies extra obligations (as compared with minimum standard).<sup>70</sup>

**Most Constant Protection and Security, Article 10(1):** *the trend is to state that it refers only to physical security.*

Protection and security is covered by China's recent BITs, such as China-Canada BIT (2012), China-Japan-South Korea BIT (2012) and the FTA between China and New Zealand.<sup>71</sup> Similar to FET, they do not require treatment in addition to the requirement accorded in accordance with generally accepted rules of international law. For example, China-Japan-South Korea BIT in 2012 states:

“Each Contracting Party shall accord to investments of investors of another Contracting Party fair and equitable treatment and full protection and security. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond any reasonable and appropriate standard of treatment accorded in accordance with generally accepted rules of international law.”<sup>72</sup>

Protection and security in China-South Korean FTA (2015) requires each Party to provide the level of police protection required under customary international law.<sup>73</sup> The trend is to state that it refers only to physical security is not observed. Yet, an interviewee from a think tank pointed out that a limited definition of protection could limit the uncertainties arbitrators could face in establishing relevant content from international law and Chinese parties would face and reduce China's chance of entering arbitration.<sup>74</sup>

**Umbrella clause, Article 10(1):** *whereas the ECT contains a broad unqualified clause (but providing also the possibility of exclusion from dispute settlement), some new IIAs state that the clause covers only “written commitments” or that the obligations must be “entered into” with respect to specific investments. Other state that the umbrella clause cannot be used to bypass specific contractual dispute settlement mechanisms.*

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<sup>70</sup> Ibid.

<sup>71</sup> China-Canada BIT (2012), Article 4; China-Japan-South Korean BIT (2012), Article 5; and China-New Zealand (2008), Article 143.

<sup>72</sup> China-Japan-South Korean BIT (2012), Article 5.

<sup>73</sup> China-South Korean FTA Investment Chapter (2015), Article 12.5.

<sup>74</sup> Interview with a Chinese commentator from a Chinese think tank on 19 June 2018.

The umbrella clause under the Chinese BITs has taken a number of different forms. Some early Chinese BITs, such as the China-Australia BIT concluded in 1988, referred to only “written obligations” as to the scope of application of the investment treaty.<sup>75</sup> As compared to some BITs concluded by other states that extend, for example, the jurisdiction to “any dispute relating to investments”,<sup>76</sup> the 1988 China-Australia BITs provided greater specificity as to their scope of application through identifying more precisely the types of obligations covered by the clause.

The extent of subject matter jurisdiction under the recent Chinese BITs has taken a much uniform scope as to the application of the treaty. The most recent China-Australia FTA covers only disputes relating to an “*obligation under this agreement*” in two situations that are explicitly specified in the clause.<sup>77</sup> The two situations include “a measure of the other Party is inconsistent with its obligations under this Agreement”, or “the other Party has otherwise failed to carry out its obligations under this Agreement”.<sup>78</sup> The China-South Korea FTA uses identically worded provisions when scoping the obligations undertaken by the parties.<sup>79</sup> Similarly, the China-New Zealand FTA defines the boundary of the dispute settlement mechanism to be applied only “to the avoidance or settlement of disputes between the Parties *concerning their rights and obligations under this Agreement*”.<sup>80</sup>

The crucial and fundamental issue in respect of umbrella clauses that concerns the Chinese stakeholders is the scope and nature of the obligations undertaken. The generic language used in some of the early BITs carried a potential risk of treaty interpretation that was inconsistent when disputes were brought to arbitral tribunals, particularly in cases where almost identically worded umbrella clauses were dealt with.<sup>81</sup> The different interpretations of umbrella clauses in a number of cases has raised particular concerns as to whether an umbrella clause encompasses contractual claims and, if so, under what circumstances.<sup>82</sup> The inconsistency of treaty interpretation by

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<sup>75</sup> China-Australia BIT (1988), Article 11.

<sup>76</sup> For example, Mexico-Switzerland BIT (1995), Article 10.

<sup>77</sup> China-Australia FTA (2015), Article 15.2.

<sup>78</sup> Ibid.

<sup>79</sup> China-South Korea FTA (2015), Article 20.2 (a) and (b).

<sup>80</sup> China-New Zealand FTA (2008), Article 184 (1).

<sup>81</sup> Interview with a professional from a Beijing based arbitration tribunal on 6 June 2018.

<sup>82</sup> Ibid; see also Anthony C. Sinclair, ‘The Origins of the Umbrella Clause in the International Law of Investment Protection’ (2004) (20)4 *Arbitration International* 411; Elnur Karimov, ‘Umbrella Clauses within Energy Charter Treaty’ (2018) 4(1) *Baku State University Law Review* 80.

different arbitral tribunals over the umbrella clauses has been the main driver that underlies the process of narrowing down the scope of the umbrella clause in China.

**Most Favoured Nation (MFN), Article 10(7):** *Some new IIAs state that the MFN obligation requires comparison of investors/investments that are “in like circumstances” or “like situations” and may include criteria for such comparison.*

There are several variations of the Most Favoured National (MFN) provision in the Chinese BITs.<sup>83</sup> Among the various forms of MFN in the Chinese BITs, a distinction can be made between whether the MFN clause incorporates a criterion of comparison between foreign investors.<sup>84</sup> A close examination of the recent Chinese BITs demonstrate that an increasing number BITs state that a comparison will be made between investors or investments located “in like circumstances or situations”. For example, the China-New Zealand FTA stipulates, in paragraph 1 of Article 139, that:

“Each Party shall accord to investors, investments and activities associated with such investments by investors of the other Party treatment no less favourable than that accorded, *in like circumstances*, to the investments and associated activities by the investors of any third country with respect to admission, expansion, management, conduct, operation, maintenance, use, enjoyment and disposal.”<sup>85</sup>

Another typical example of using “in like circumstances” in the MFN clause can be found in the recent China-Australia FTA. Article 9.4 stipulates in paragraph 1 that:

“Each Party shall accord to investors of the other Party, and covered investments, in relation to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory, treatment no less favourable than that it accords, *in like circumstances*, to investors and investments in its territory of investors of any non-Party.”<sup>86</sup>

While the adoption of the MFN clause with a criterion of comparison is not controversial in the Chinese BITs, the use of the MFN clause in practice still leaves many questions open to

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<sup>83</sup> Interviews with Chinese stakeholders and commentators on 21 and 23 May 2018.

<sup>84</sup> Ibid.

<sup>85</sup> China-New Zealand FTA (2008), Article 139 (1).

<sup>86</sup> China-Australia FTA (2015), Article 9.4 (1).

further clarification and interpretation.<sup>87</sup> The fact that what constitutes “in like circumstances” is not specified further in the Chinese BITs and the interpretation lacks official guidance, Chinese stakeholders recognise that this kind of legal form used to define criteria of comparison requires necessary interpretation on a case by case basis and the criteria of interpretation may vary significantly in practice.<sup>88</sup> When it comes to defining the comparators in a specific case, questions can be asked so as to define “like circumstances”. These questions include, for example, does criteria of comparison only include economic considerations? does it suffice that two investors operate in the same sector, produce the same product or in competition? does aspect of environmental protection, safeguarding of public health or reducing the impact on human populations work as relevant factors?<sup>89</sup> Answering to these questions requires further interpretations made by relevant body, such as the joint committee established by some of the Chinese BITs, or it is a question to be considered by the tribunal.

**National Treatment (NT), Article 10(7):** *Some recent IIAs state that the NT standard applies only to investors/investments “in like circumstances” or “like situations”, and may set out criteria for comparison.*

The Chinese stakeholders acknowledged that the objective of the national treatment provision under the ECT and the Chinese BITs is to prohibit discrimination against foreign investors and investments, in law and in fact, on the basis of nationality.<sup>90</sup> National treatment “in like circumstances” has been increasingly adopted by the Chinese BITs with other countries in recent years. For example, the recent China-Australia FTA concluded in June 2015 stipulates in Article 9(3) that:

“1. Australia shall accord to investors of China treatment no less favourable than that it accords, *in like circumstances*, to its own investors with respect to the establishment,

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<sup>87</sup> Interviews with Chinese stakeholders on 21 and 23 May 2018.

<sup>88</sup> Ibid; see also Congli Xu, ‘From Substantive to Procedural: The Debate over the Scope of Application of the Most Favoured Nation Clause’ [从实体到程序:最惠国待遇适用范围之争], (2007) 2 *Studies in Law and Business*, 41-50; Danni Liang, ‘The Application of the Most Favoured National Clause under the International Investment Treaties – Analysis on the case *Ekran Berhad v. People’s Republic of China*’ [国际投资条约最惠国待遇条款适用问题研究——以“伊佳兰公司诉中国案”为中心的分析], (2012) 2 *Studies in Law and Business*, 98-103.

<sup>89</sup> Interviews with Chinese stakeholders and commentators on 21 and 23 May 2018.

<sup>90</sup> Ibid.

acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

2. China shall accord to investors of Australia treatment no less favourable than that it accords, *in like circumstances*, to its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory.

3. Australia shall accord to covered investments treatment no less favourable than that it accords, *in like circumstances*, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

4. China shall accord to covered investments treatment no less favourable than that it accords, *in like circumstances*, to investments of its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory.”<sup>91</sup>

Similarly, Article 12(3) in the China-South Korea FTA provisions in paragraph 1 that:

“Each Party shall in its territory accord to investors of the other Party and to covered investment treatment no less favourable than that it accords *in like circumstances* to its own investors and their investments with respect to investment activities.”<sup>92</sup>

Although the scope of national treatment might be different in terms of protection coverage to investment or investors, the question remain unresolved is the standards that can be applied to compare investors/investments “in like circumstances”. The Chinese commentators consider the application of the national treatment clause shall be carried out in two stages.<sup>93</sup> The first stage involves an assessment of whether a contracting party has accorded less favourable treatment to investors/investments on the basis of their nationality. If so the second stage

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<sup>91</sup> China-Australia FTA (2015), Article 9(3).

<sup>92</sup> China-South Korea FTA (2015), Article 12 (3).

<sup>93</sup> Interviews with Chinese commentators from professional institutions on 21 and 23 May 2018.

evaluates whether the said investors/investments were “in like circumstances” with domestic investors or investments that were accorded more favourable treatment.<sup>94</sup>

The implementation of the national treatment clause through the abovementioned stages requires a comparison of standards of a Party’s treatment of domestic investors/investments with that of the other contracting Party. If the standards, whether in law or in practice, does not treat foreign investors or investments less favourably than domestic investors or investments on the basis of nationality, then there is no violation of the national treatment provision.<sup>95</sup> Only if some evidence of less favourable treatment on the basis of nationality are discovered and presented, the question of which investors are “in like circumstances” shall be examined.<sup>96</sup>

While the substantive and procedural requirements of national treatment seem to be rather simple, the circumstances relating to the comparison of “in like circumstances” will vary case by case and there is hardly any universal criteria available to ensure such comparisons.<sup>97</sup> In practice, comparisons of “in like circumstances” are conducted with respect to investors/investments on the basis of characteristics that are relevant for purposes of the comparison. The relevant investigation is not limited, for example, to whether investors or investments produce the same product. More often, the question of “in like circumstances” may also involve the geographical locations that different investors/investments are located. The Chinese stakeholders highlighted that the objective is to ensure the consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic investors and investments they should appropriately be compared.<sup>98</sup> In addition to the comparable characteristics, it is also critical to exclude from consideration those characteristics that are not relevant to such comparisons.<sup>99</sup>

**Compensation for Losses, Article 12:** *Several IIAs contain rules on standard of compensation and calculation of compensation, to be based on fair market value (going as far as suggesting the use of certain valuation criteria).*

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<sup>94</sup> Ibid.

<sup>95</sup> Ibid.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid.



The methods of determining compensation have reached a large degree of uniformity in terms of the substantive rules in the Chinese FTAs in the past decade.<sup>100</sup> Early Chinese BITs often define compensation and its implementation in a general approach. For instance, the China-Costa Rica FTA stipules in Article 5 titled “Damage and Compensation for Losses” that “[i]f an investor of one Contracting Party is investing in the territory of the other Contracting Party and suffers losses as a result of a war, national emergency, rebellion, riot or other similar event occurring in the territory of the other Contracting Party, the other Contracting Party shall grant restitution and compensation for losses. The measures taken for restitution or compensation should not be lower than the better ones for the treatment of investors in the host country or any third country.”<sup>101</sup> The problem is that determining the level of compensation through this approach lacks sufficient guidance, and potentially prone to government manipulation of the process of compensation.<sup>102</sup> Despite of this general provision related to compensation, there are signs that recent Chinese BITs are adopting more specific measures to ensure that compensation is determined in an open and reasonable manner, and to reflect as accurately as possible the market value of the investment that is subject to expropriation.<sup>103</sup>

The compensation referred to above is calculated based on the fair market value of the expropriated investment immediately before the expropriation measures were taken. The fair market value is decided with appropriate measures not to reflect any change in value due to the expropriation becoming publicly known earlier. The China-Peru FTA, provisions in paragraph 2 of Article 133 that: “[t]he compensation mentioned in subparagraph 1(d) of this Article shall be equivalent to the fair market value of the expropriated investments immediately before the expropriation took place (“the date of expropriation”), convertible and freely transferable.”<sup>104</sup> The compensation shall be paid without unreasonable delay.”<sup>105</sup>

In addition, some recent Chinese BITs specify further about issues in relation to interest occurred due to the expropriation and arrangements with respect to payment. The standard practice is that

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<sup>100</sup> Interview with an interviewee from a government agency on 8 June 2018.

<sup>101</sup> Agreement on Promotion and Protection of Trade and Investment Between the People’s Republic of China and the Republic of Costa Rica, signed on 24 October 2007 in Beijing.

<sup>102</sup> Interview with an interviewee from a government agency on 8 June 2018.

<sup>103</sup> Ibid.

<sup>104</sup> China-Peru FTA (2009), Article 133 (2).

<sup>105</sup> Ibid.

the compensation will also include interest at the prevailing commercial rate from the date the expropriation was done until the date of payment. In terms of the payment, it is required that compensation shall be paid without delay and shall be effectively realizable and freely transferable. It shall be paid in the currency of the country of the affected investor, or in any freely convertible currency accepted by the affected investor.

An example of this regard is the China-South Korea FTA which covers extensively the substantive rules about compensation as a result of expropriation measures. Paragraphs 2 and 3 of Article 12.9 reads:

“The compensation shall be equivalent to the fair market value of the expropriated investments at the time when the expropriation was publicly announced or when the expropriation occurred, whichever is the earlier. The fair market value shall not reflect any change in market value occurring because the expropriation had become publicly known earlier.

The compensation shall be paid without delay and shall include interest at a commercially reasonable rate, taking into account the length of time from the time of expropriation to the time of payment. It shall be effectively realizable and freely transferable and shall be freely convertible, at the market exchange rate prevailing on the date of expropriation, into the currency of the Party of the investors concerned, and into freely usable currencies.”<sup>106</sup>

Under circumstances that the fair market value is denominated in a currency that is not freely usable, the common practice is that the compensation paid will be converted into the currency of payment at the market rate of exchange prevailing on the date of payment. Such practices also require the amount of currency for payment shall be no less than (a) the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus (b) interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.<sup>107</sup>

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<sup>106</sup> China-South Korea FTA (2015), Article 12.9 (2) and (3).

<sup>107</sup> See for example China-New Zealand FTA (2008), Article 145 (4).

Despite of these clear rules setting out the substantive rules for compensation, investors affected by expropriation will also have a right of access to the courts of justice or the administrative tribunals or agencies of the Party making the expropriation to seek a prompt review of the investors' case and the amount of compensation in accordance with the principles set out in the relevant provisions.<sup>108</sup>

**Protection against unlawful expropriation, Article 13:** *Most of new IIAs establish specific criteria for indirect expropriation, including what does not constitute indirect expropriation. There are some other IIAs that omit a reference to, or explicitly exclude, indirect expropriation from their scope.*

Most of recent Chinese BITs adopt relevant provisions to regulate expropriation and substantive rules in relation to compensation as a result of expropriation measures. A standard expropriation provision in the Chinese FTAs reads as follows:

“Neither Party shall expropriate, nationalize or take other equivalent measures (“expropriation”) against investments of investors of the other Party in its territory, unless the expropriation is:

- (a) for a public purpose;
- (b) in accordance with applicable domestic law;
- (c) carried out in a non-discriminatory manner;
- (d) not contrary to any undertaking which the Party may have given;

and

- (e) on payment of compensation in accordance with paragraphs 2, 3

and 4”<sup>109</sup>

Unless explicitly mentioned,<sup>110</sup> the element of “other equivalent measures” is seen and interpreted as the inclusion of indirect expropriation in the scope.<sup>111</sup> While a clear definition of

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<sup>108</sup> China-South Korea FTA (2015), Article 12.9 (4).

<sup>109</sup> China-New Zealand FTA (2008), Article 145(1).

<sup>110</sup> See for example, China-Peru FTA (2009), where expropriation is defined as “[n]either Party shall expropriate or nationalize, either directly or indirectly through measures equivalent to expropriation or nationalization (hereinafter referred to as “expropriation”) against investments of investors of the other Party in its territory, unless the following conditions are met:...”.

indirect expropriation is rarely visible in most recent Chinese BITs, an exception has been found in the China-South Korea FTA regarding how direct and indirect expropriations are perceived by the Chinese policymakers. In the Annex of the China-South Korea FTA, expropriation actions are defined by excluding what does not constitute an expropriation. The definition reads: “[a]n action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right in a covered investment.”<sup>112</sup> Expropriation actions are further distinguished by how the transfer of title happens, leading to expropriation consequences. The first situation is direct expropriation, where investments are nationalised or otherwise directly expropriated through formal transfer of title or outright seizure.<sup>113</sup> The second situation is indirect expropriation, where an action or a series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.<sup>114</sup> The determination of whether an action or a series of actions by a Party constitutes an indirect expropriation requires a case-by-case, fact-based inquiry.<sup>115</sup> The inquiry is carried out in a specific fact situation and ought to consider the below factors, among others, when deciding whether an indirect expropriation establishes: (a) the economic impact of the action or series of actions, although the fact that such action or series of actions has an adverse effect on the economic value of investments, standing alone, does not establish that an indirect expropriation has occurred; (b) the extent to which the action or series of actions interferes with distinct and reasonable expectations arising out of investments; and (c) the character and objectives of the action or series of actions, including whether such action is proportionate to its objectives.

Despite of the listed factors, in some rare circumstances, the two parties also share the consensus that non-discriminatory regulatory actions adopted by the Party for the purpose of legitimate public welfare objectives can exclude the application of indirect appropriation, even if when an action or a series of actions by a Party is extremely severe or disproportionate in light of its purpose.<sup>116</sup>

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<sup>111</sup> Interview with an interviewee from a government agency on 11 June 2018.

<sup>112</sup> China-South Korea FTA (2015), Annex 12-B.

<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

<sup>115</sup> Interview with an interviewee from a government agency on 11 June 2018.

<sup>116</sup> China-South Korea FTA (2015), Annex 12-B.

**Transfers related to investments, Article 14:** *some IIAs include an exception for serious balance-of-payments difficulties, temporary safeguard measures taken for monetary or exchange rate policy, or prudential measures taken to ensure stability of financial system and situation of economic crises.*

One of the key focus of ECT is the protection related to financial issues. China's concern about financial stability and economic crisis are also reflected in its BITs and FTAs. For example, in the China-Japan-South Korea BIT (2012), contracting parties can take prudential measure to limit transfer to protect themselves from unfavourable financial situation.<sup>117</sup> The China-Japan-South Korea BIT states:

“Contracting Party may delay or prevent such transfers through the equitable, non-discriminatory and good faith application of its laws relating to:

- (a) bankruptcy, insolvency or the protection of the rights of creditors;
- (b) issuing, trading or dealing in securities, futures, options or other derivatives;
- (c) criminal or penal offenses;
- (d) ensuring compliance with orders or judgments in adjudicatory proceedings; or
- (e) reports of transfers of currency or other monetary instruments.”<sup>118</sup>

Financial stability is one of the key concerns of Chinese stakeholders. When international energy cooperation via multilateral approaches was first mentioned by the Chinese government in the 2007 Energy White Paper on China's Diplomacy as a response to high oil prices in the mid-2000s,<sup>119</sup> international energy cooperation via multilateral approaches continues to appear in China's white paper on energy policy and diplomacy until now.<sup>120</sup> Financial crisis in the late 2000s alarmed and led China to address global energy governance. In the BOAO Forum of 2011,

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<sup>117</sup> China-Japan-South Korea BIT (2012), Article 13.

<sup>118</sup> China-Japan-South Korea BIT (2012), Article 13.

<sup>119</sup> Ministry of Foreign Affairs of the People's Republic of China (PRC MFA), 'White Paper on China's Diplomacy 2007' [中国外交 (2007)] (2007).

<sup>120</sup> State Council of the People's Republic of China, 'White Paper on China's Energy Situation and Policy' [中国的能源状况与政策] (2007), available at: <http://www.scio.gov.cn/zfbps/ndhf/2007/Document/307873/307873.htm>; Ministry of Foreign Affairs, 'White Paper on China's Diplomacy 2008' [中国外交 (2008)] (World Affairs Press, 2008); NDRC, above n 46.

the former deputy premier of the State Council, Zeng Peiyan, pointed out that, in order to prevent a new global economic crisis caused by sharp fluctuations in the prices of energy and resources, a stability mechanism in the global energy resource market should be established under the framework of the G20 nations.<sup>121</sup> On 16 January 2012, when Premier Wen Jiabao attended the World Future Energy Summit in Abu Dhabi, he argued for the establishment of a global energy market governance mechanism under the framework of the G20 to effectively ensure energy security,<sup>122</sup> specifically by setting up a mechanism that would include energy-supplying, consuming, and transit countries based on a principle of ensuring mutual benefits. These laid out the policy intention of enhancing financial stability for investment through international energy organisations.

An interviewee from a Chinese national oil company pointed out that although ECT offers protection for transfers in investment, there are concerns if ECT could cover investment in Renminbi, especially when China has been expanding energy investment in Russia and Central Asia and has strong will in using Renminbi in their future investments.<sup>123</sup> According to ECT, transfer of investment refers to conduct in a freely convertible currency, which means “a currency which is widely traded in international foreign exchange markets and widely used in international transactions.”<sup>124</sup> This is a concern for Chinese stakeholders because Renminbi remains the only major currency that is still not freely convertible. Its official trade is limited to the boundary of mainland China and the offshore trading hub of Hong Kong. Ahead of its entry into the IMF’s Special Drawing Rights basket, China took a series of important steps to liberalise Renminbi. Early in 2009, international investors were allowed to use Renminbi to settle trade and investment in China.<sup>125</sup> In the 13th Five-Year Plan, the Chinese Government put forth a policy to increase the flexibility of the Renminbi exchange rate, improve the Renminbi exchange rate index

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<sup>121</sup> Zeng Peiyan, ‘ZENG Peiyan Proposed GMSERM’ (Beijing, 11 July 2011), available at: <http://english.boaoforum.org/mtzxxwzzen/2154.jhtml>

<sup>122</sup> UPI, ‘China Urges Global Energy Cooperation’, United Press International (16 January 2012), available at: [http://www.upi.com/Business\\_News/Energy-Resources/2012/01/16/China-urges-global-energy-cooperation/UPI-77361326740422](http://www.upi.com/Business_News/Energy-Resources/2012/01/16/China-urges-global-energy-cooperation/UPI-77361326740422)

<sup>123</sup> Interview with an interviewee from a Chinese national oil company on 17 May 2018.

<sup>124</sup> Energy Charter Treaty, Article 14.

<sup>125</sup> Ministry of Commerce of the People’s Republic of China (MOFCOM), Circular on Issues Relevant to Cross-border Direct Investment with Renminbi (Text of the MOFCOM Circular, No.889 (2011)).

with respect to a reference basket of currencies and develop channels for Renminbi and foreign currency policy transmission.<sup>126</sup> The Chinese government attempts to make systematic steps to make Renminbi more convertible and freely usable, so as to steadily promote Renminbi's internationalisation.<sup>127</sup> However, it is believed that China will be likely to retain its firm hold on Renminbi for years to come. As such, there are some concerns if Renminbi could fit in ETC's definition of a "freely convertible currency". If not, transfer between China and the host countries in Renminbi might not be covered by the ECT.<sup>128</sup>

**Regarding State's rights to regulate:** *a number of recent IIAs include an operational article on the State's right to regulate to achieve legitimate policy objectives (in some cases such article includes a non-stabilisation clause or other clarifications).*

The Chinese stakeholders seek to bring clarity to the issue by examining how two of the most commonly used investment protection provisions, namely the provisions in relation to fair and equitable treatment (or minimum standard of treatment in some Chinese BITs), and expropriation, would affect state's right to regulate.<sup>129</sup> At the outset, several stakeholders highlighted that the term itself is, to some extent, misleading.<sup>130</sup> For any BITs that China has entered into with other countries, the investment protection agreement never entails a waiver of the state's right to regulate.<sup>131</sup> Rather, the right to regulate in this context refers to the state's ability to legislate and adopt laws and/or regulations that will affect relevant investment without carrying the risk of having to pay damages to investors as the result of a dispute based on the Chinese BIT.<sup>132</sup>

The reason why the abovementioned articles are highlighted because they not only have a high occurrence in the investment disputes, but also they could impose the greatest potential impact on the state's right to regulate.<sup>133</sup> The "fair and equitable treatment" article protects investors from being, inter alia, "treated unfairly or inequitably in any legal or administrative proceeding

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<sup>126</sup> Section 3, The 13th Five-year Plan for Economic and Social Development of China (2016-2020), available at: <http://en.ndrc.gov.cn/policyrelease/201612/P020161207645766966662.pdf>

<sup>127</sup> Ibid.

<sup>128</sup> Interview with an interviewee from a Chinese national oil company on 17 May 2018.

<sup>129</sup> Interviews with interviewees from government agencies on 24 May 2018.

<sup>130</sup> Ibid.

<sup>131</sup> Ibid.

<sup>132</sup> Ibid.

<sup>133</sup> Ibid.

affecting the investments of the investor”.<sup>134</sup> The protection of investors against fundamental breach of due process in judicial and administrative proceedings and targeted discrimination is often understood and interpreted to safeguard investors’ legitimate expectations.<sup>135</sup> Such expectations are to be based on the laws, regulations and government commitments that attracted the investment.<sup>136</sup> As an essential practice under the customary international investment law, the fair and equitable treatment clause entails a necessary and sufficient level of protection of investors under the domestic legal system. However, from the Chinese stakeholders’ point of view, the fair and equitable treatment, as a general principle of the investment protection agreement, needs to be supplemented by a clear definition of circumstances under which the state will be liable.<sup>137</sup> For the moment, in order to prevent the clause of fair and equitable treatment from being abused in practice, the Chinese BITs often incorporate a clause that explicitly state “[a] violation of any other article of this Chapter [related to investment] does not establish that there has been a violation of this Article [fair and equitable treatment].”<sup>138</sup>

The second article that could affect state’s right to regulate is related to expropriation. As discussed above, the provision regarding expropriation prevents states from nationalising or expropriating private property with formal transfer of title or outright seizure (direct expropriation), or by legislation or other means causing the investor to lose control of the investment, even without formal transfer of title or outright seizure (indirect expropriation). The provision against direct expropriation is broadly consistent with the Chinese law, while the provision against indirect expropriation, under relevant Chinese BITs, provides investors from the given country with some additional protection. As commented by the Chinese stakeholders, the right to regulate discussion in the current context has two distinct elements, namely (a) the right to regulate foreign investment to promote domestic development, priorities and linkages; and (b) the right to regulate and to protect the public welfare from possible negative impacts, both individual and cumulative, of foreign and domestic investments equally.<sup>139</sup>

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<sup>134</sup> China-New Zealand FTA (2015), Article 143 (2).

<sup>135</sup> Interviews with interviewees from government agencies on 24 May 2018.

<sup>136</sup> Ibid.

<sup>137</sup> Interviews with interviewees from government agencies on 24 May 2018.

<sup>138</sup> See for example, China-New Zealand FTA (2008), Article 143 (5); China-South Korea FTA (2015), Article 12.5 (3).

<sup>139</sup> Interviews with interviewees from government agencies on 24 May 2018.



Given how recent Chinese BITs have unfolded on this particular issue, both of these contexts are now critically important to some of the recent Chinese FTAs, and also the future negotiations of the BITs.<sup>140</sup> There is no doubt that both direct and indirect expropriation, once determined, will trigger both substantive and procedural rules leading to compensation. However, in the event of state's right to regulate, the boundary between the "right to regulate" and "indirect expropriation" is often the subject that needs some further inquiry and clarification.<sup>141</sup> As explicitly pointed out by the relevant Chinese BITs, as shown in the above section, such an inquiry shall be carried out on a case by case basis.<sup>142</sup> So far the distinction made between the two provisions is not clearly indicated but there is a general exclusion clause that enables, in some rare circumstances, the state's right to regulate without carrying the risk of compensation. The circumstances in this regard include two essential and indispensable elements: the first one being regulatory actions that are non-discriminatory; and the second being that such regulatory actions are for the purpose of legitimate public welfare objectives. Satisfying these two criteria, among other factors that may arise on a particular case, can exclude the application of indirect appropriation, even if when an action or a series of actions by a Party is extremely severe or disproportionate in light of its purpose.<sup>143</sup>

In addition to the general exclusion of state's right to regulate from indirect expropriation, some recent Chinese BITs also adopt more specific provisions with respect state's right to regulate, particularly in the area of regulations related to technical standards and environmental protection. The China-South Korea FTA, for instance, has a dedicated chapter to reaffirm the state's sovereign right to establish its own levels of environmental protection and its own environmental development priorities, and to adopt or modify its environmental laws and policies.<sup>144</sup> Paragraph 2 of Article 16.5 explicitly states that "it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in its environmental laws, regulations, policies and practices".<sup>145</sup> As to the regulation related to technical standards, the China-Australia FTA

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<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

<sup>142</sup> China-South Korea FTA (2015), Annex 12-B.

<sup>143</sup> See above topic related to 'protection against unlawful expropriation'.

<sup>144</sup> China-South Korea FTA (2015), Article 16.3 (1).

<sup>145</sup> China-South Korea FTA (2015), Article 16.5 (2).

has incorporated a clause that enables the state to adopt new standards, technical regulations and conformity assessment procedures.<sup>146</sup>

**Denial of benefits, Article 17:** *some IIAs specify that the denial of benefits clause can also be invoked once Investment proceedings have started.*

As mentioned by the Chinese stakeholders, central to the question of application of denial of benefits clause is whether such provisions can be only applied prospectively, or retroactive application of the denial of benefits clause is also allowed.<sup>147</sup> A noticeable difference in this regard is how and when the denial of benefits clause has been applied by tribunals hearing ordinary investment dispute cases and tribunals hearing cases in relation to energy investment cases under the ETC.<sup>148</sup>

Three arbitral awards rendered in recent years that are in relation to the application of denial of benefits clause by the respondent country have caught attention of relevant Chinese stakeholders.<sup>149</sup> The three cases are *Rulelec & GAI v. Bolivia*; *Pac Rim Cayman LLC v. El Salvador*; and *Plama Consortium Ltd. v. Bulgaria*. The core issue concerning these cases is when and how the invocation of the denial of benefits clause takes place. The tribunals hearing the first two cases agreed that, unless otherwise provided in the treaty, the States were entitled to deny the benefits afforded in the respective treaties after such benefits are claimed by the investor. What it means for the host countries is that the denial can be activated retrospectively if the benefits are claimed by the investors.

However, tribunals hearing the last case has reached a rather different conclusion. The tribunal found that, in accordance with the object and purpose of the ECT, the host State must give notice

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<sup>146</sup> China-Australia FTA (2015), Article 6.2 (4).

<sup>147</sup> Interviews with interviewees from government agencies on 25 May 2018.

<sup>148</sup> Ibid; some Chinese scholars have written on the different applications of the denial of benefits clause under the hearing ordinary investment cases and cases in relation to energy investment disputes under the ETC. See for example, Xiaojing Zhang, 'The Denial of Benefits Clause in the Investment Treaties – Reflections on the Application of the Clause in the Case of *Amto v. Ukraine*' [投资条约中的利益否决条款研究 - 由“艾美特公司诉乌克兰案”引发的思考], (2012) 6 *Studies in Law and Business* 101; Xun Ma, *Examining the Denial of Benefits Clause in the International Investment Treaty* [国际投资条约中的“利益拒绝”条款研究], (2013) 1 *Journal of Ocean University of China (Social Sciences Edition)* 99; Yuping Wang, [“拒绝授惠”条款在国际投资仲裁中的适用及发展], (2016) 19(1) *Wuhan University International Law Review* 329.

<sup>149</sup> Interviews with interviewees from government agencies on 25 May 2018. These cases were also discussed by the Chinese scholars in the above journal articles.

and expressly exercise its right under Article 17(1), and such right will only have prospective effect. Article 17 (1) of the ECT provides that:

“Each Contracting Party reserves the right to deny the advantages of this Part [III] to:  
(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.”

The tribunal noted that Article 17(1) requires that the host country “properly” notify the investor in advance of the potential effects of this provision. Therefore, and contrary to position adopted in the cases of GAI and Pac Rim Cayman, the denial should be invoked before the benefits are being claimed by the investor. The award of the tribunal hearing the Plama case has been followed by other ECT tribunals deciding on the application of Article 17(1).

The decisions described above highlight a diverging jurisprudence as to how and when denial of benefits clauses should be invoked by respondent States. Although each of the aforementioned treaties has been concluded between different parties and in distinct contexts, the provisions contained therein are very similar. The question concerning the Chinese stakeholders is whether future tribunals will follow the approach adopted by the tribunals in the two cases of *Rulelec & GAI v. Bolivia* and *Pac Rim Cayman LLC v. El Salvador* or by the growing line of ECT case law considering the denial of benefits right under Article 17(1).<sup>150</sup>

To address this issue, the recent Chinese BITs have opted for clearer statement as to whether expressly and prior notification is required when the denial of benefits clause is invoked.<sup>151</sup> Two distinguished examples can be found here in the recent Chinese BITs. The first one is Article 9.6 of the China-Australia FTA, which reads:

“A Party may deny the benefits of this Chapter to an investor of the other Party and to investments of that investor if the investor is an enterprise:  
(a) owned or controlled either by persons of a non-party or of the denying Party; and  
(b) that has no substantive business operations in the territory of the other Party.

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<sup>150</sup> Interviews with interviewees from government agencies on 25 May 2018.

<sup>151</sup> *Ibid.*

A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of the other Party and to investments of that investor if persons of a non-party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-party or a person of the non-party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or its investments.”<sup>152</sup>

The China-South Korea FTA also stipulates the provision of denial of benefits in this way.<sup>153</sup> This provision is also very similar to the provisions contained in the US-Bolivia BIT and the US-Central America Free Trade Agreement upon which the above two landmark cases were brought to tribunals and the retrospective application of the clause was allowed and supported by the arbitral awards.<sup>154</sup> The China-New Zealand FTA, however, requires that the application of the clause is subject to prior notification and consultation,<sup>155</sup> while the rest of the provision contains similar elements so as to allow a party to deny the benefits of the treaty to certain investors that lack a sufficient connection to the BIT party in which they are incorporated.

The conclusion that may be drawn from the different article formulations in the Chinese BITs is that denial of benefits clauses play increasing important roles in the Chinese BITs and they are used to serve different purposes in a treaty specific context.<sup>156</sup> As such, if the treaty in question is silent as to the timeline for the invocation of a denial of benefit clause, there is no obligation for the host country to deny the benefits of the treaty before the request for arbitration is filed.

**Article 20, transparency:** *Under article 20 ECT, judicial decisions and administrative rulings of general application made effective by Contracting Parties must be published promptly. Article 27 of the ECT requires states to communicate to the Secretariat the arbitral award in a State-State dispute, but no transparency requirement exists under the ECT regarding investment disputes. On the contrary, many recent IIAs include an obligation to apply UNCITRAL rules on transparency.*

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<sup>152</sup> China-Australia FTA (2015), Article 9.6.

<sup>153</sup> China-South Korea FTA (2015), Article 12.15.

<sup>154</sup> See for example, *Guaracachi America, Inc. and Rurelec PLC v. Plurinational State of Bolivia* (UNCITRAL (PCA Case No. 2011-17)), Award (J.M. Júdece, President, M. Conthe, R.E. Vinuesa), 31 January 2014.

<sup>155</sup> China-New Zealand FTA (2008), Article 149.

<sup>156</sup> Interviews with interviewees from government agencies on 25 May 2018.

The issue of transparency has been one of the key topics under the Chinese BITs and in most of the recent Chinese BITs, an individual chapter is often dedicated to the issue of transparency and its scope of application under the respective investment treaty.

Although transparency is often seen as an important issue that is often correlated with the broader concepts of the rule of law and good governance, there is still a lack of consensus as to what transparency means exactly under the context of investment treaty.<sup>157</sup> As highlighted by the relevant Chinese stakeholders, the definition and application of the concept of transparency may vary considerably, depending on the specific context in which it is adopted and applied, in particular under the recent BITs that have been concluded between China and other countries.<sup>158</sup>

The scope of transparency and its application under the Chinese BITs have a few dimensions. The first dimension is its common application under the treaty obligations to require the host state to provide adequate information, to the extent possible, to foreign investors on its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by the specific BIT. This is regarded as the most common form of transparency requirement under the Chinese BITs and all the recent Chinese BITs examined are claimed to contain such a provision.<sup>159</sup> In addition to this standard requirement to publish all relevant measures by the host state to ensure that the interested persons of the other party and the other party to become acquainted,<sup>160</sup> some recent FTAs also push a step further to allow the interested persons and the other party a reasonable opportunity to comment on any proposed measures respecting the matter of the treaty.<sup>161</sup>

The second dimension of transparency under the Chinese BITs refers to the prompt communications between the two parties with respect to the concerns that any proposed measures may materially affect the operation the treaty.<sup>162</sup> For example, in the China-New Zealand FTA, paragraph 2 of Article 172 requires that a party shall, within 30 days of receipt of the request from the other party, provide information and respond to questions pertaining to any

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<sup>157</sup> Interviews with Chinese stakeholders and commentators on 24 May and 7 June 2018.

<sup>158</sup> Ibid.

<sup>159</sup> Ibid.

<sup>160</sup> For example, China-Peru FTA (2009), Article 167.

<sup>161</sup> China-Australia FTA (2015), Article 13.2 (2); China-South Korea FTA (2015), Article 18.1 (2).

<sup>162</sup> Interviews with Chinese stakeholders and commentators on 24 May and 7 June 2018.

actual or proposed measure.<sup>163</sup> As observed by the Chinese commentators, transparency towards not only the publication of measures itself but also enabling communications between the contracting parties is to ensure transparent processes related to the measures undertaken so as to reduce the potential disputes that may arise out of these measures.<sup>164</sup>

The third dimension relates to the transparency in the administrative proceedings and, if any, its subsequent processes of review and appeal. The recent China-Australia FTA and China-South Korea both adopt the transparency provisions that ensure all laws, regulations, procedures and administrative rulings of general application to which the treaty applies are administered “in a consistent, impartial, objective and reasonable manner”.<sup>165</sup> The two FTAs also extends the application of the transparency requirement to the review and appeal processes and procedures to strive for prompt, impartial and independent review and corrections of final administrative actions regarding matters covered by the treaty.<sup>166</sup>

Meanwhile, although there is no direct evidence as to the reference or inclusion of the UNCITRAL rules on transparency in the Chinese BITs, there is also lack of explicit exclusion of opting for the UNCITRAL as the forum for dispute settlement under the treaties examined. On the contrary, some Chinese BITs, by its default setting, opt for the investor-state disputes to be settled by either ICSID or UNCITRAL.<sup>167</sup> As the transparency rules under the UNCITRAL are intrinsically linked to the UNCITRAL arbitration rules, the choice of UNCITRAL as the forum means that the UNCITRAL rules on transparency will apply automatically. However, the UNCITRAL rules on transparency has some limitations in its application in China. The rules were revised and came into effect in 2014 and Chinese BITs concluded before or shortly after that were very much silent as to retroactive applications of the rules. Meanwhile, views among the Chinese stakeholders towards the newly established United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (known as the “Mauritius Convention on Transparency”) are divided.<sup>168</sup> The divided opinions have further reduced the scope of application of the UNCITRAL rules on transparency in China for the BITs concluded before 1

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<sup>163</sup> China-New Zealand FTA (2008), Article 172 (2).

<sup>164</sup> Interviews with Chinese stakeholders and commentators on 24 May and 7 June 2018.

<sup>165</sup> China-Australia FTA (2015), Article 13.4 and China-South Korea FTA (2015), Article 18.3.

<sup>166</sup> China-Australia FTA (2015), Article 13.5 and China-South Korea FTA (2015), Article 18.4.

<sup>167</sup> China-New Zealand FTA (2008), Article 153 (1).

<sup>168</sup> Interviews with Chinese stakeholders and commentators on 24 May and 7 June 2018.

April 2014.<sup>169</sup> The reason is that if both parties (including China) are signatories to the Mauritius Convention, they will be deemed for having agreed to apply the UNCITRAL rules on transparency. Some commentators insisted that mandatory application of the transparency rules could only be acceptable on the basis of protection and they shall not be applied to BITs that do not include such provisions.<sup>170</sup> Mandatory application of the new rules on transparency face a significant challenge in China.

**Treaty interpretation:** *Recent IIAs establish mechanisms (eg. Joint Committee) for binding joint interpretations. Some IIAs also allow interpretations by non-disputing Parties.*

To ensure consistency and smooth implementation of the Chinese BITs, a joint committee or commission comprising ministerial level officials of the contracting Parties has been established under a number of Chinese BITs.<sup>171</sup> The tasks of the joint committee vary from case to case but the general responsibilities include overseeing operation of the BITs, resolving disputes that may arise regarding the interpretation or application of the BITs, as well as issuing binding interpretations of the treaty provisions.

The China-Peru FTA provides an example of the role of the joint commission in overseeing operation of the bilateral agreement. The contracting parties establish the Free Trade Commission, comprised of ministerial level officials of the Parties or their appointees with the same decision ability. One of the key responsibilities that the Commission is tasked with is “to resolve disputes that may arise regarding the interpretation or application of this Agreement, in accordance with dispute settlement arrangements” and “to issue interpretations of the provisions of this Agreement”.<sup>172</sup> Similarly, other Chinese FTAs, such as the China-New Zealand FTA and China-Costa Rica FTA, also adopt the joint commission to consider matters relating to the implementation of the agreement, including treaty interpretation arrangements.<sup>173</sup>

The Chinese commentators pointed out that it is not surprising to find out that the consensus based approach of treaty interpretation has been an integral part of the investment treaty.<sup>174</sup> In addition, some recent FTAs are more expressly when it comes to the fact that whether the

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<sup>169</sup> Ibid.

<sup>170</sup> Ibid.

<sup>171</sup> Interview with an interviewee from a government agency on 6 June 2018.

<sup>172</sup> China-Peru FTA (2009), Article 170.

<sup>173</sup> China-New Zealand FTA (2008), Article 180; China-Costa Rica FTA (2010), Article 135.

<sup>174</sup> Interview with an interviewee from a government agency on 6 June 2018.

interpretation of the treaty issued by the joint commission would have a binding effect on the tribunals.<sup>175</sup> Under the article of Governing Law of the China-Australia FTA, it is provisioned that: “[a] joint decision of the Parties, acting through the Committee on Investment, declaring their interpretation of a provision of this Agreement shall be binding on a tribunal of any ongoing or subsequent dispute, and any decision or award issued by such a tribunal must be consistent with that joint decision”.<sup>176</sup>

Apart from the active roles of the joint committee on treaty interpretation and the given binding effect of an interpretation on a tribunal, a tribunal is also able to request a joint interpretation by the parties concerned. An example of this approach can be found in the China-New Zealand FTA in which a specific clause, titled “Interpretation of Agreement”, has been designed to reduce ambiguities of the effect and status of treaty interpretation. On request of the state party, the tribunal shall “request a joint interpretation of the Parties of any provision of this Agreement that is in issue in a dispute” and the Parties shall “submit in writing any joint decision declaring their interpretation to the tribunal within 60 days of delivery of the request”.<sup>177</sup> Once the request for an interpretation is delivered, the joint decision issued by the Parties is binding on the tribunal, and any award must be consistent with that joint decision. If the Parties fail to issue such a decision within 60 days, the tribunal shall decide the issue on its own account.

In addition to the treaty interpretation by the joint commission/committee, it is also evident that non-disputing party has also been granted the right towards treaty interpretation. For example, the China-Australia FTA grants the non-disputing party the right to make oral and written submissions to the tribunal regarding the interpretation of the chapter in relation to investment.<sup>178</sup> The treaty further provides that all joint interpretations of the treaty by the state parties will have binding effects on the investment tribunals.<sup>179</sup> It also offers the respondent state the possibility to adopt a joint decision with the non-disputing party that the measure at issue is “non-discriminatory and made for legitimate public welfare objectives” (such as protection of public health, safety, the environment, public morals or public order), and accordingly does not fall

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<sup>175</sup> Ibid.

<sup>176</sup> China-Australia FTA (2015), Article 9.18.

<sup>177</sup> China-New Zealand FTA (2008), Article 155.

<sup>178</sup> China-Australia FTA (2015), Article 9.16 (2).

<sup>179</sup> China-Australia FTA (2015), Article 9.11 (2).



within the jurisdiction of the arbitral tribunal.<sup>180</sup> Article 9.18 (3) which is entitled ‘Governing Law’ also contains clear provision that a “decision between the respondent and the non-disputing Party that a measure is [non-discriminatory and taken for legitimate public welfare objectives] shall be binding on a tribunal and any decision or award issued by a tribunal must be consistent with that decision”.<sup>181</sup>

Furthermore, under the China-Australia FTA, when a respondent asserts that certain measures fall within the annexed schedules of non-conforming measures, the tribunal shall, “on request of the respondent, request the interpretation of the parties on the issue”.<sup>182</sup> This interpretation will be binding on the tribunal and “on the tribunal of any dispute subsequent to the date of the joint decision”.<sup>183</sup>

**Prevention of frivolous claims:** *some IIAs allow the respondent to file a preliminary objection that a claim is manifestly without legal merits (similar to ICSID arbitration rules but inexistent under UNCITRAL or SCC rules); and to address the issue of unfounded claims as a matter of law.*

Prevention of frivolous claims is of growing importance from the Chinese perspectives. Along with the adoption of provisions with respect to stricter jurisdictional requirements and conditions on submission of an arbitration, Chinese stakeholders have raised concerns about mechanism that are necessary and essential to prevent frivolous claims, for example the recent development in various instances that included disincentives to frivolous claims by early dismissal mechanisms and cost-shifting provisions.<sup>184</sup>

Although the International Centre for Settlement of Investment Disputes (ICSID) adopted a mechanism to summarily dismiss manifestly unmeritorious claims more than 10 years ago,<sup>185</sup> the early dismissal mechanisms are far from being adopted universally by other arbitration rules.<sup>186</sup> It is commonly recognised by the Chinese commentators that stipulating an early dismissal

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<sup>180</sup> Ibid.

<sup>181</sup> China-Australia FTA (2015), Article 9.18 (3).

<sup>182</sup> China-Australia FTA (2015), Article 9.19 (1).

<sup>183</sup> China-Australia FTA (2015), Article 9.19 (2).

<sup>184</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018.

<sup>185</sup> ICSID Arbitration Rules, Rule 41(5). The amendment to the ICSID Convention, Regulations and Rules, including Rule 41(5), became effective on 10 April 2006.

<sup>186</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018. For example, the recent 2016 Singapore International Arbitration Centre (SIAC) Investment Arbitration Rules also provide for a similar mechanism in rule 25.

mechanism in the investment treaties itself enables the state to provide for a possibility for early dismissal of cases that are manifestly without legal merit, in particular those that are not brought under the ICSID Arbitration Rules.<sup>187</sup> Recognising the importance of early dismissal mechanism, the China-New Zealand FTA has sought to control the choice of investors to submit a claim based on rules of either ICSID or UNCITRAL, which allows the possibility that ICSID rules may apply in case of frivolous claims.<sup>188</sup> In addition, the China-New Zealand FTA, perhaps for the first time, inserts an explicit provision which enables the early dismissal mechanism. A state party is empowered to, within 30 days after the constitution of the tribunal, “file an objection that a claim is manifestly without merit or is otherwise outside the jurisdiction or competence of the tribunal”.<sup>189</sup> When submitting an objection, the state party shall specify as precisely as possible the basis for the objection. Despite of the fact that such an early dismissal mechanism is extremely difficult to applicable in practice, the possibility of empowering investment treaty tribunals to do so irrespective of the applicable arbitration rules could act as a disincentive for claimants without meritorious claims.

In addition, some Chinese commentators also highlighted the role of cost-shifting provisions as another useful approach to disincentivise claimants with unmeritorious claims.<sup>190</sup> Following the trend that a growing number of investment treaty tribunals that have applied the loser pays principle, some states have stipulated explicit provisions related to cost-shifting in their investment treaties.<sup>191</sup> The cost-shifting provisions are designed to condemn the losing party that has brought a frivolous claim or has engaged in serious procedural misconduct to pay the entire costs of the proceedings. The benefit is that the increasing possibility of bearing potential high cost as the result of bringing unmeritorious claims allow states to deter investors from doing so. However, due to various reasons the Chinese BITs so far have yet been able to insert such provisions in the treaty making process,<sup>192</sup> except for a much softer provision in the China-New Zealand FTA that the tribunal may, if warranted, award the prevailing party “reasonable” costs

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<sup>187</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018.

<sup>188</sup> China-New Zealand FTA (2008), Article 153 (1).

<sup>189</sup> China-New Zealand FTA (2008), Article 154 (2).

<sup>190</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018.

<sup>191</sup> Ibid; for example, South Korea-Vietnam FTA (2015), Article 9.23 (5).

<sup>192</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018.

and fees incurred in submitting or opposing the objection.<sup>193</sup> Instead, sufficient caution has been given to both the substantive and procedural rules under the dispute settlement mechanisms to ensure efficient consultation and arbitral processes.<sup>194</sup>

### **3. BRI and Prospects of China's Accession to the ECT**

The examination of the recent Chinese BITs and FTAs indicates the trend of Chinese perceptions towards reasserting control over state's consent to investment arbitration. Specifically, as explained by UNCTAD, “[g]overnments have entered into a phase of evaluating the costs and benefits of IIAs and reflecting on their future objectives and strategies as regards these treaties...”.<sup>195</sup> As a result, it seems that the Chinese BITs and FTAs have paid particular care to both the scope of the substantive protections being granted to foreign investors and to any advance consent to investment treaty arbitration for any disputes arising with foreign investors.

There are various ways through which China has sought to reassert control over the consent to investment arbitration and in most cases the listed topics identified by the ECT as part the modernisation process are of strong relevance with China. The analysis of recent Chinese BITs and investment chapters of the FTAs, including model treaties, shows that China stakeholders are fully aware of, for example, using the devised tools to filter or provide for disincentives for frivolous claims. They have also demonstrated a growing interest in developing tools to ensure that their positions are going to be heard throughout and after the arbitral process - specifically through submissions by non-disputing party and the potential appeal mechanisms.

The Chinese stakeholders have divided viewpoints as to the practical impact of this trend of reassertion over consent to arbitration under the bilateral treaty making process. Some predict that one possible impact could be that, because of the additional jurisdictional barriers, costs and time duration associated with the dispute resolution provisions, some investors are likely to be more cautious about initiating investor-state investment arbitration.<sup>196</sup> The impact of this outcome are two-sided. On the one hand, the increasing hurdles and costs caused by the dispute

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<sup>193</sup> China-New Zealand FTA (2008), Article 154 (4).

<sup>194</sup> Interviews with Chinese stakeholders and commentators on 9 June 2018.

<sup>195</sup> UNCTAD, World Investment Report 2015, available at: [http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf), 124.

<sup>196</sup> Interviews with Chinese stakeholders and commentators on 24 and 25 May 2018.

resolution provisions under the Chinese BITs and FTAs are going to significantly reduce the state's participation in the arbitration process. On the other hand, the Chinese investors that are investing abroad are also presented with the additional hurdles to protect their investments, particularly in countries that have entered into a BIT or FTA with China in recent years. Another possible outcome of the increasing reassertion could be that sophisticated investors will be better off by increasingly structuring their investments abroad in a way that such investments will be protected by a treaty that is perceived as offering increased protections and fewer jurisdictional hurdles. However, as the trend of reassertion over state's consent to arbitration is arguably going to be further developed in China through its future BITs and FTAs, the increasing web of the Chinese investment treaties will make it more difficult for investors to recourse to investor-state investment arbitration in the years and probably decades to come.

At the outset, the reassertion over state's consent to arbitration makes the multilateral approach for dispute resolution less attractive, due to the preference of the state to ensure greater control over the end result of the arbitral process. However, due to the fact that most of the countries involved in the BRI – often from Europe and Central Asia – have ratified the ECT, China's accession to the ECT would avoid the renegotiation of BITs with a large number of countries. While the BRI presents clear opportunities for Chinese investors, there are a number of challenges facing Chinese investors, in particular the risk associated with the investments. The Eurasian region is associated with various operational and investment risks, and these risks, together with various potential political, economic, and social factors, tend to drive investors to engage in careful planning for the future. It is necessary to create a web of investment-treaty protections in order to reduce the risks associated with the Chinese investments, in particular in the energy sector. Currently, the existing bilateral and multilateral mechanisms that have been developed for protecting investments in the energy sectors are considered to be insufficient for protecting Chinese investments from being exposed to risks in the region. An interviewee from a Chinese national oil company recognised the energy investment risks in Eurasia and the difficulties that China is facing in order to control the risks.<sup>197</sup>

Since the first generation BITs are less protective of Chinese investors and the new era of investment treaties are becoming more restrictive in terms of dispute resolution, China could

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<sup>197</sup> Interview with an interviewee from a Chinese national oil company on 18 May 2018.

potentially join a multilateral investment treaty such as the ECT, and set up mechanisms of cooperation with international organisations at different levels. Energy companies, such as oil companies and grid companies, are fully aware of the limitations of protection under the existing framework and the extensive protection they could potentially obtain, in particular the pipeline and transmission projects in Central Asia.<sup>198</sup> As for Chinese investment in power sector, the most active areas, such as the Southeast Asia or South America, the countries in the areas have not been ECT members.

Yet, it is notable that mutual learning is required for China to fully accept ECT and such a process of learning takes time.<sup>199</sup> China's accession to the ECT requires a process of policy change which is difficult in China. As argued by Hay, a policy change is always triggered by crisis.<sup>200</sup> From the perspective of policy makers, crisis implies necessity of modifying the existing policy. However, whether the crisis is of sufficient degree to modify the existing policy depends on the perceptions of Chinese authorities. Entities at the frontline of investment, such as national oil companies, which are responsible for the investment and management, have already started to sense the potential risks associated with the transnational energy projects.<sup>201</sup> The challenging part is that Chinese authorities tend to remain status quo, considering there is no immediate urgency, if the potential risks are not posing any immediate threat to the smooth operation of the Chinese energy investments.<sup>202</sup> Nevertheless, multilateral cooperation is one of the main points which has already been emphasised under the BRI via growing transnational investments. It is just a matter of time for Chinese energy cooperation in BRI to turn to multilateralism.

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<sup>198</sup> Ibid.

<sup>199</sup> Interview with a former employee from a government agency on 18 May 2018.

<sup>200</sup> Colin Hay "Narrating Crisis: The Discursive Construction of the Winter of Discontent", 30(2) *Sociology* (1996), 253-277.

<sup>201</sup> Interview with an interviewee from a Chinese national oil company on 18 May 2018.

<sup>202</sup> Ibid.

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