

THE ASIA-PACIFIC ARBITRATION REVIEW 2010



Published by Global Arbitration Review
in association with

Sidley Austin LLP



www.GlobalArbitrationReview.com

Wider prospects for ICSID arbitration under China's BITs

Stanimir Alexandrov, Marinn Carlson, Jennifer Haworth McCandless and Geoffrey Antell
Sidley Austin LLP

Despite the economic downturn, cross-border investment throughout Asia remained strong in 2008. Notably, intra-regional investment, particularly investment originating from Hong Kong and mainland China, grew in 2008. FDI outflows from China to its Asian neighbours more than doubled from US\$22 billion in 2007 to US\$52 billion in 2008.¹ Similarly, inbound investment to both mainland China and Hong Kong also continued to grow in 2008.²

As the region, and China in particular, continues to be a powerful force of both inbound and outbound investment, the legal protections afforded under investment treaties to Asian investors abroad, and to foreign investors in Asia, continue to be important for investors and governments. Given the significant role of both Chinese investors abroad and foreign investors in China, one of the most notable developments for investment treaty arbitration over the past year is the Decision on Jurisdiction and Competence in the case of *Tza Yap Shum v the Republic of Peru* (*Tza Yap Shum*), which involved an investment treaty between China and Peru.³

Background – investment treaty (ICSID) arbitration under China's BITs

China has an extensive network of bilateral investment treaties (BITs), with more than 90 BITs in force with a diverse grouping of developed and developing countries in Asia and far beyond. BITs provide foreign investors with legal protections against government mistreatment. Importantly, BITs typically allow foreign investors to enforce such promises directly against the government in international arbitration, such as arbitration under the auspices of the World Bank's International Centre for Settlement of Investment Disputes (ICSID).

However, with the exception of a few recent 'modern' BITs,⁴ the majority of China's treaties have generally been thought to be of little immediate use to foreign investors, because they provide only limited rights for an investor to resort to international arbitration if China breaches its treaty obligations to such investors. Now, that perception may change as a result of the recent *Tza Yap Shum* decision (which was brought under the 1994 China-Peru BIT).

In the vast majority of its BITs, China has consented only

to allow investors to seek investor-state arbitration in fora such as ICSID if the dispute involves 'the amount of compensation for expropriation.'⁵ For all other disputes, China's BITs typically provide that an investor may seek arbitration only 'if the parties to the disputes so agree.'⁶ Without such ad hoc consent to international arbitration, the BITs direct investors to local courts. To date, no such arbitrations based on post hoc consent by China have been registered with ICSID, the most popular forum for BIT arbitration.

On 19 June 2009, the ICSID tribunal in the case of *Tza Yap Shum* released its Decision on Jurisdiction and Competence, which may change the perception of China's early generation of BITs and their clauses limiting international arbitration to 'the amount of compensation for expropriation'. The *Tza Yap Shum* decision is the first published investor-state arbitration decision under a Chinese BIT. It is the first time that a tribunal has interpreted the scope of China's limited arbitration clause. Prior to the issuance of the tribunal's decision, many thought that tribunals could only determine the amount due to an investor after an acknowledged expropriation, but not whether an expropriation had occurred in the first instance. The tribunal in *Tza Yap Shum* asserted a broader scope for its jurisdiction, determining that it could also assess whether the claimant had suffered an expropriation at the hands of the government (in this case, the Peruvian government).

As a result, the tribunal's decision suggests that the broad network of Chinese BITs may provide greater protections than previously thought. This will be of particular interest not only to foreign investors making investments into China, but also to Chinese investors making investments abroad.

Overview of the *Tza Yap Shum* decision

Tza Yap Shum, a Chinese national resident in Hong Kong, was the majority shareholder of TSG Peru SAC (TSG), a Peruvian food products company and one of the largest manufacturers and distributors of fish flour in Peru. Claimant alleged that in 2004 the Peruvian Tax Administration initiated actions against his investment that resulted in the total destruction of TSG's operations. In particular, Mr Tza alleged that the Peruvian Tax Administration imposed unlawful and arbitrary tax liens on his company's accounts that prevented it from operating. As a result, his investment was no longer economically viable.

Peru asserted three main objections to the tribunal's jurisdiction. First, it argued that Mr Tza did not qualify as an investor under the China-Peru BIT because he was a resident of Hong Kong. Second, Peru asserted that Mr Tza's investment was not protected because it was held indirectly through investments in

1 United Nations Conference on Trade and Development, *World Investment Report* (2009) at Figure II.9. Available at www.unctad.org/en/docs/wir2009_en.pdf.

2 United Nations Conference on Trade and Development, *World Investment Report* (2009) at Figure II.7. Available at www.unctad.org/en/docs/wir2009_en.pdf.

3 *Tza Yap Shum v The Republic of Peru*, ICSID Case No. ARB/07/6, Decision on Jurisdiction and Competence, 19 June 2009 (*Tza Yap Shum* decision).

4 See, eg, bilateral investment treaties between China and Germany (signed 1 December 2003) and the Netherlands (signed 26 November 2001).

5 See, eg, Agreement Between the Government of the Republic of Peru and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments (signed 9 June 1994) (China-Peru BIT) at article 8(3).

6 See, eg, China-Peru BIT at article 8(3).

the British Virgin Islands. Third, Peru argued that the tribunal only had jurisdiction to determine the value of the expropriated property, and not whether an expropriation had actually occurred in violation of the treaty. In response, Mr Tza argued, *inter alia*, that, pursuant to the most-favoured nation clause, the tribunal was required to apply the substantive protections of the Peru–Colombia bilateral investment treaty, which includes a much broader dispute resolution clause allowing investor–state arbitration for disputes related to protection and the application of the fair and equitable treatment standard (among other provisions).

Residency

Peru argued that because Mr Tza was a resident of Hong Kong, he was not entitled to protections of a BIT between Peru and China. Notably, Peru argued that because Hong Kong is a Special Administrative Region with broad autonomy – including the right to enter into international treaties – Mr Tza could not seek protection under a Chinese treaty. The tribunal rejected this logic, concluding that nationality was fundamentally a question of domestic law and, under Chinese law, ‘Hong Kong residents of Chinese descent and born in Chinese territories (including Hong Kong) are Chinese nationals.’⁷

However, because certain of China’s BITs may exclude Hong Kong from their coverage, investors from Hong Kong should carefully review any such BITs to ensure that they include sufficiently broad language before relying on them for investment protections. As an additional note of caution, the *Tza Yap Shum* decision only addresses the nationality of a natural person, not issues surrounding corporate ownership or nationality. Corporate investors must always examine carefully both the BIT in question and the law of their home state in order to determine whether or not they satisfy the nationality criteria as a matter of domestic law.

Indirect investments

Peru also argued that Mr Tza failed to make a covered investment in Peru because Mr Tza made his investment through a shell company established in the British Virgin Islands. Mr Tza owned 100 per cent of the BVI entity, which in turn owned 100 per cent of the Peruvian company. Peru argued that indirect investments were not covered by the BIT.

The tribunal concluded that such a structure was permitted under the China–Peru BIT, and flatly rejected Peru’s argument, saying that ‘[t]he Tribunal would expect such a limitation would have been included explicitly in the BIT.’⁸ However, the tribunal warned that a number of other BITs entered into by China with third parties do include such explicit limitations.⁹ Thus, investors should carefully examine any potential restrictions on indirect investment prior to structuring their investments in order to ensure maximum protection from a Chinese (or indeed any) BIT.

Expropriation

In probably the most significant argument on jurisdiction, Peru argued that Mr Tza’s claims fell outside of the scope of article 8(3) of the Peru–China BIT, which provides that ‘[i]f a dispute involving the amount of compensation for expropriation cannot be settled within six months . . . it may be submitted at the request of either party to the international arbitration.’

Specifically, Peru argued that it had consented to arbitration under the BIT ‘[o]nly if the investor alleges that the State accepting the investment expropriated his investment and the domestic courts determine that the investment was, in fact, expropriated.’¹⁰ Peru further clarified its position, arguing that ‘the only type of dispute that may be settled by ICSID arbitration is that involving the amount of compensation owed to the investor, once the occurrence of an illegal expropriation has been confirmed.’¹¹ Peru asserted that the negotiating history of the BIT supported this view and presented witness statements from former negotiators supporting its position.¹² Peru further argued that indirect expropriation is not covered by the BIT.

Mr Tza argued that Peru’s interpretation of the BIT was ‘literal and formalistic’ and urged a broader reading of the BIT.¹³ Of particular note, he argued that ‘it would be inappropriate to interpret the BIT as requiring a preliminary determination by Peruvian courts regarding the legality of an alleged expropriation, especially since, according to the analysis of Claimant, Peruvian law does not recognize or provide legal action in case of indirect expropriation.’¹⁴

The *Tza Yap Shum* tribunal sided with Mr Tza and held that it was required to analyse more than simply the amount of compensation due. It based its determination on a number of factors, including the text of the treaty, as well as the negotiating history and the object and purpose of the treaty. Specifically, the tribunal concluded that in order ‘to give meaning to all the elements of the article [on expropriation], it must be interpreted that the words “involving the amount of compensation for expropriation” includes not only the mere determination of the amount but also any other issues normally inherent to an expropriation, including whether the property was actually expropriated in accordance with the BIT provisions and requirements, as well as the determination of the amount of compensation due if any.’¹⁵

The tribunal primarily based its determination on the text of the treaty, using the interpretive guidance provided in the Vienna Convention on the Law of Treaties. The tribunal first examined the meaning of the phrase ‘a dispute involving the amount of compensation for expropriation’ and determined that ‘the broadest interpretation, happens to be the most appropriate.’¹⁶ In particular, the tribunal focused on the use of the word ‘involving’ and determined that it was not limiting, but rather should be read to include disputes related to the amount due, not simply the amount itself.¹⁷ The tribunal identified a number of such potential issues, including ‘whether (i) an instance of expropriation, nationalization, or similar measure has taken place; (ii) the same has met the requirement of public interest; (iii) the same has followed an appropriate domestic legal procedure; (iv) there has been discrimination, (v) compensation will be paid, (v) (sic) such compensation has been equivalent to the value of investment expropriated, paid in a convertible and freely transferable currency and without unreasonable delay.’¹⁸

In addition, the tribunal found support for its interpretation by looking at the ‘fork in the road’ provision in article

7 *Tza Yap Shum* decision at para 60.

8 *Tza Yap Shum* decision at para 107.

9 *Tza Yap Shum* decision at paras 109–110.

10 *Tza Yap Shum* decision at para 131.

11 *Tza Yap Shum* decision at para 134.

12 *Tza Yap Shum* decision at paras 134–137.

13 *Tza Yap Shum* decision at para 140.

14 *Tza Yap Shum* decision at para 142.

15 *Tza Yap Shum* decision at para 188.

16 *Tza Yap Shum* decision at para 150.

17 *Tza Yap Shum* decision at para 151.

18 *Tza Yap Shum* decision at para 152.

8(3), which requires an investor to make an irrevocable choice between taking its dispute to local courts or to international arbitration under the BIT. The tribunal explained that the effect of the fork in the road provision was that ‘if an investor submits a dispute to the competent tribunal of the Contracting State accepting the investment, the investor may not have access to ICSID arbitration at all.’¹⁹ The tribunal thus reasoned that Peru’s argument that the tribunal must defer to local courts as to whether an expropriation had occurred would effectively prevent investors from ever seeking ICSID recourse, since such recourse would be conditioned on seeking a judgment from a local court, which, as a result of the fork in the road provision, would make ICSID arbitration impossible. Thus, the tribunal concluded that investors must be able to have all claims related to the expropriation heard by an international arbitral tribunal.

The tribunal found additional support for its interpretation in the negotiating history of the treaty. Both sides put forth testimony of negotiators and submitted written negotiating history in order to support their interpretation. The tribunal concluded that the negotiating history supported its broader interpretation, based on statements of negotiators, proposed revisions that were not adopted by the BIT parties, and other BITs entered into by the parties.²⁰

Finally, the tribunal also examined other arbitration decisions and awards. While no Chinese BIT’s ‘amount of compensation for expropriation’ language had yet been interpreted, several investor-state tribunals have interpreted similar provisions with respect to other countries’ BITs, and reached conflicting conclusions. In some cases – notably *Saipem v Bangladesh*²¹ and *Telenor Mobile Communications AS v Hungary*²² – the tribunals found that they had ‘jurisdiction to try the disputes regarding the existence and/or lawfulness of an expropriation.’²³ Others, however, reached the opposite conclusion.²⁴ The tribunal reviewed these decisions, and concluded that the weight of the evidence in the immediate case was consistent with the decisions establishing a broader scope of jurisdiction.²⁵

Thus, the tribunal’s decision reinforces the possibility that investors relying on China’s BITs may bypass local courts and proceed directly to international arbitration if a dispute arises with the host government regarding expropriation of the investment. An investor need not first procure confirmation from a local court that an expropriation has occurred. Rather, under the reasoning of the *Tza Yap Shum* tribunal’s decision, an investor may bring all disputes related to expropriation directly before an international tribunal under the Chinese BIT. While prior tribunals’ decisions are not formally binding on future investor-state BIT tribunals, they can have significant persuasive force, particularly as multiple decisions begin to accumulate on one side of an issue.

19 *Tza Yap Shum* decision at para 157.

20 See *Tza Yap Shum* decision at paras 162-172.

21 ICSID Case No. ARB/05/07, Decision on Jurisdiction (21 March 2007).

22 ICSID Case No. ARB/04/15, Decision on Jurisdiction (13 September 2006).

23 *Tza Yap Shum* decision at para 173. See also *Franz Sedelmaier v The Russian Federation*, Ad Hoc Award (7 July 1998) (Stockholm, Sweden).

24 See, eg, *Berschader v The Russian Federation*, SCC Case No. 080/2004, Award (21 April 2006) and *RosInvest UK Ltd v The Russian Federation*, SCC Case No. V070/2005, Award (October 2007).

25 *Tza Yap Shum* decision at paras 173-186.

Most favoured nation (MFN)

While the *Tza Yap Shum* tribunal read the China-Peru BIT’s dispute settlement provision expansively, it read the most favoured nation (MFN) clause narrowly. The MFN clause requires that the host government’s treatment of investments covered under the BIT ‘shall not be less favourable than that accorded to investments and activities associated with such investments of investors of a third party.’ Mr Tza argued that the MFN provision operated to incorporate the protections afforded to investors of a third party through other treaties (in this case the Peru-Colombia BIT) into the China-Peru BIT. In particular, Mr Tza argued that the dispute resolution clause of the Peru-Colombia BIT, which allows for investor-state arbitration of ‘any dispute of [a] legal nature,’ must also be afforded to Mr Tza. Thus, Mr Tza argued that ‘he is entitled to submit to the Arbitral Tribunal not only disputes related to expropriations, but also disputes related to protection and fair and equitable treatment.’²⁶

Peru argued that the MFN provision could not incorporate additional arbitration protections as the BIT was complete without amendment. In addition, Peru argued that it had not consented to arbitration of these matters.²⁷

The tribunal sided with Peru, citing the plain meaning of the text, and using the interpretive principles established by the Vienna Convention on the Law of Treaties. The tribunal concluded that it could not import the dispute resolution provision from the Peru-Colombia BIT into the China-Peru BIT. In part, it based its decision on the specificity of the limitation in the Peru-China BIT, reasoning that such specific limitations should trump more general obligations found in the MFN clause. The tribunal concluded that ‘the specific wording of Article 8(3) [discussing the scope of consent to investor-state arbitration] should prevail over the general wording of the MFN clause in Article 3.’²⁸ The tribunal relied heavily on the recent decision in *Plama v Bulgaria*,²⁹ which interpreted the MFN clause narrowly, while at the same time differentiating its opinion from other recent awards which interpreted the MFN clause more broadly based on the facts of the case.³⁰

The tribunal’s decision in *Tza Yap Shum* marks the first time (at least as a matter of public record) that an investor has brought a claim under a BIT with China. The *Tza Yap Shum* tribunal afforded an expansive reading to the China-Peru BIT’s arbitration provision, allowing investors to bypass local courts and have their disputes arising from expropriatory actions addressed directly in international arbitration. While the tribunal did not allow the investor to import an even broader dispute resolution clause by means of the MFN clause, the expanded scope of the arbitration provision is still notable.

If other tribunals follow the *Tza Yap Shum* decision’s approach, many of China’s BITs will be more powerful, and may provide more meaningful legal protections for foreign investors than previously anticipated. As additional ICSID cases are brought under Chinese BITs, foreign investors in China, and Chinese investors abroad, should monitor developments closely to ensure that they can take advantage of all available BIT protections.

Given the continued growth of both outbound investment

26 *Tza Yap Shum* decision at para 191.

27 *Tza Yap Shum* decision at para 192.

28 *Tza Yap Shum* decision at para 216.

29 *Tza Yap Shum* decision at para 220.

30 *Tza Yap Shum* decision at paras 217-219.

from Chinese investors and inbound investment into China, the protections afforded by BITs with China continue to be of particular importance to both investors and governments throughout the Asian region. The wider prospects for arbitra-

tion suggested by the tribunal's decision in *Tza Yap Shum* provides direction for investors to carefully evaluate available treaty protections before investing in Asia, or making investments from Asia into other countries around the world.



Sidley Austin LLP
1501 K Street, NW
Washington, DC 20005
Tel: +1 202 736 8000
Fax: +1 202 736 8711

Stanimir Alexandrov
salexandrov@sidley.com

Marinn Carlson
mcarlson@sidley.com

Jennifer Haworth McCandless
j.haworth.mccandless@sidley.com

www.sidley.com

Sidley Austin LLP's international arbitration practice is comprehensive and truly global in reach, with experience in arbitral fora ranging from Washington to London to Hong Kong and Singapore.

In addition to a full international commercial arbitration practice, Sidley is particularly known for its substantial practice in the high-profile field of investor-state (investment treaty) arbitration. Sidley represents multinational companies as claimants, and sovereign governments as respondents, in disputes over government actions that allegedly injure foreign investments.

In tandem with its investor-state arbitration practice, the international arbitration team advises Sidley's corporate clients on structuring multinational transactions to take advantage of the protections and arbitration options that investment treaties have to offer.

Sidley's investment treaty team includes lawyers who have served in government negotiating, and overseeing negotiations of and disputes under, bilateral and multilateral investment treaties. Sidley lawyers serve as arbitrators in investor-state disputes, have been appointed by governments to serve on standing rosters of arbitrators, and have taught courses and seminars in investment treaty arbitration.



Stanimir A. Alexandrov

Sidley Austin LLP

Stanimir A. Alexandrov focuses his practice in the areas of international dispute resolution, including investor-state arbitration and international commercial arbitration, and resolution of trade disputes before the World Trade Organization (WTO). He has represented private parties and governments in arbitration before the International Centre for Settlement of Investment Disputes (ICSID), as well as in ICC, UNCITRAL and AAA international arbitrations. He has also represented governments in WTO disputes. Mr. Alexandrov has been appointed to the ICSID's Panel of Arbitrators and Panel of Conciliators and serves as an arbitrator in a number of cases under the arbitration rules of ICSID, the London Court of International Arbitration and UNCITRAL. He has appeared as an expert witness in international arbitration on investment treaty interpretation. Mr. Alexandrov was vice minister of foreign affairs of Bulgaria, where he managed Bulgaria's relations with the European Union, the United Nations, the Organization for Security and Cooperation in Europe and NATO and was responsible for all legal work of the Foreign Service. Prior to that, he served as deputy chief of mission of the Embassy of Bulgaria in Washington, DC, where he negotiated trade and investment agreements and worked with the World Bank and the IMF. He is a professor at the George Washington University Law School, where he teaches courses on international law and dispute settlement. Mr. Alexandrov speaks and publishes widely and is listed as a leading practitioner in industry publications such as *Chambers and Partners*, *The Legal 500* and *PLC Cross-Border Dispute Resolution Handbook*.



Geoffrey D. Antell

Sidley Austin LLP

Geoffrey D. Antell is an associate in the Washington, DC, office of Sidley Austin LLP. He focuses his practice on international trade and dispute resolution law. Mr. Antell graduated from Harvard Law School, where he was editor-in-chief of the *Harvard International Law Journal*. During law school he received a Chayes International Public Service Fellowship in support of his work as a legal intern in the office of the US trade representative in Geneva in 2005.



Marinn Carlson

Sidley Austin LLP

Marinn Carlson is a partner in the Washington, DC, office of Sidley Austin LLP, where she focuses her practice in international dispute settlement, with an emphasis on trade policy and investment disputes, including investor-state arbitration and WTO disputes. She has represented foreign investors as well as respondent governments in ICSID arbitrations under investment treaties and trade agreements, including NAFTA. She has represented corporate clients in a range of institutional (eg, ICC, Zurich Chamber) and ad hoc (eg, UNCITRAL) international commercial arbitrations. She has also represented clients in US litigation with international ramifications, and as *amici curiae* in foreign affairs, intellectual property, and commerce clause cases before the United States Supreme Court and various courts of appeal. She counsels clients in sectors ranging from financial services to infrastructure development on the implications of international trade and investment rules for their global operations. Ms. Carlson has spoken at conferences and taught classes,

workshops and seminars on many topics in international arbitration, including investor-state arbitration caselaw and practice as well as arbitration advocacy skills. She is a member of the executive committee of the Foundation for International Arbitration Agency (FIAA), as well as the current budget chair and past programme committee co-chair of the American Society of International Law, and she serves on the board of visitors of Dartmouth College's John Sloan Dickey Center for International Understanding.



Jennifer Haworth McCandless

Sidley Austin LLP

Jennifer Haworth McCandless is a partner in the Washington, DC, office of Sidley Austin LLP, where she focuses her practice in the area of international dispute resolution, including international arbitration and disputes before the World Trade Organization (WTO). In arbitration, she has advised and represented private and sovereign clients in proceedings before ICSID and its Additional Facility, as well as in ad hoc arbitration such as under the UNCITRAL Arbitration Rules. She has also advised and represented private parties and governments in WTO disputes. In addition, she has counselled clients on the selection of arbitration clauses to be included in investment treaties and in international commercial agreements. Ms. Haworth McCandless has also advised clients on domestic court litigation involving US trade practice. Ms. Haworth McCandless has spoken on issues concerning international arbitration and investor-state dispute resolution including at seminars and workshops sponsored by American University's Washington College of Law, the US Council for International Business's Young Arbitrators Forum, and the international law section of the DC Bar. In addition, Ms. Haworth McCandless has served for a number of years as the chair of the joint swearing-in ceremony for the US Court of International Trade and the US Court of Appeals for the Federal Circuit sponsored by the international law section of the American Bar Association.