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FOREIGN INVESTMENT

The E.U.—China bilateral investment treaty

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More than five years after the United States ("U.S.") and China agreed to start negotiations of a bilateral investment treaty ("BIT"), the launch of the negotiations between the European Union ("E.U.") and China towards a BIT was announced at the Sixteenth China-E.U. Summit held in Beijing on 21 November 2013.

1. Why the E.U. and China Need a BIT

Despite the value of trade flows of goods and services between the E.U. and China exceeds E.U.€1 billion every day. Investment between the E.U. and China – although growing considerably over the past two decades – shows great potential. China accounts for less than 5% of European investments abroad, whereas foreign direct investment ("FDI") from China represents less than 3% of the total FDI inflows into the E.U. Both the E.U. and China hope that with this comprehensive BIT, together with the domestic economic reforms in China and the E.U.'s efforts to overcome the financial crisis will alleviate the clear discrepancy between the levels of trade and investment and will give a new impetus to the existent mutually beneficial cooperation.

The E.U.-China treaty will be the E.U.'s first ever standalone investment agreement since FDI became its exclusive competence under the Lisbon Treaty in 2009. Once it enters into force, the new agreement will streamline the existing BITs between China and 27 of the 28 E.U. Member States (all, except Ireland). These agreements, which are differing from one another in certain specific content, were signed during the 1980s and 1990s and are no longer compatible with the current investments levels, the economic reality in countries, their domestic interests and their status in the international arena.

From the E.U. perspective, a recent report highlights that barriers to European investors in China exist at all levels and in different forms. Problems such as obligations to set up joint ventures with local partners, mandatory transfer of technology and local content requirements negatively accentuate the lack of a predictable and secure economic environment affecting existing and prospective investors. There are problems that cannot be solved by the current BITs between the E.U. Member States and China.

Similarly, from a Chinese perspective, the aforementioned BITs reflect mainly European interests at a moment when China's economic development was lagging behind and the country was desperately seeking to boost FDI. They are also seen as an inadequate tool to reduce the increasing protectionist sentiment against Chinese investment in Europe.

Furthermore, the Government of China seems to be using the negotiations with the U.S. and the E.U. to consolidate the opening of its domestic markets to greater competition and import international standards into its legal system.

2. Main Provisions

With this new BIT, the E.U. and China intend to address the following issues in a comprehensive manner:

- To improve the legal certainty for investors in the host country;
- To expand the existing standards of protection of investment;
- To reduce barriers for investors when investing in the host country; and
- To increase the flow of FDI between them.

While still unknown at this stage, it is likely that both parties intend to achieve those goals by inserting a number of provisions that will make the E.U.-China BIT compelling to foreign investors:

2.1. Non-discrimination

The non-discrimination principle constitutes a cornerstone in different fields, specifically international economic law and investment. The principle is split into two variants: the national treatment ("**NT**") and the most favored nation ("**MFN**") clauses.

On one hand, NT is the essential standard that the E.U. and China will grant to ensure equal competitive opportunities to foreign investors behind their borders, by extending foreign

investors treatment as favorable as that accorded to national investors in like circumstances. On the other hand, under the MFN clause, both parties will extend to those investors and investments covered by the BIT, treatment which is no less favorable than that which they could accord to foreign investors of any third country.

The MFN and NT clauses in the E.U.-China BIT are also likely to cover the pre-establishment phase of the investment by conferring rights on the investor both at the moment when the investment will be effectively materializing and prior to that stage.

The above obligations are expected to apply to all sectors and sub-sectors, which means that no existing or future measures may discriminate against the investor against another foreigner, unless China or the E.U. introduce specific reservations in connection with market access (see sub-section 2.7.). In this sense, from the investors' perspective, the conditions to entry will be more transparent and predictable, as the regime will be regulated by the agreement itself and not subject to changes by both Parties.

2.2. Treatment of Investors

The obligation to (a) accord fair and equitable treatment, and (b) provide full protection and security of investments appear in the great majority of agreements involving investment issues. Both concepts, specifically that of fair and equitable treatment, have been broadly interpreted by arbitral tribunals. As a result, in order to balance the State's public policy space and the investor's legitimate expectations, the E.U. and China will most probably include a list of scenarios under which host countries are allowed to adopt policies that are not necessarily in line with the aforementioned principles.

2.3. Expropriation

To date, virtually all BITs in force contain a clause on expropriation. Given that direct expropriation – a mandatory legal transfer of the title to the property or its outright physical seizure – is today very rare, the agreement between the E.U. and China will mainly focus on the regulation of the notion of indirect expropriation.

Like in the E.U.-Canada Comprehensive Trade and Economic Agreement ("**CETA**") and the U.S. BIT Model of 2012 – the one followed in the U.S.-China BIT negotiations, the E.U.-China BIT is expected to add an Annex enclosing a definition of "indirect expropriation", which involves total or near-total deprivation of the investor's fundamental attributes of property in its investment, including the right to use, enjoy and dispose of it, without formal transfer of title or outright seizure.

The concept of expropriation is being examined in a dispute (relating to the nationalization of the investor's shareholding in Fortis in the aftermath of the 2008 global financial crisis) involving a Chinese investor, Ping An, and Belgium under the Belgium-China BIT.

2.4. Other Provisions

Other relevant provisions for the protection of investors are likely to be included under the E.U.-China BIT:

- ƒ The transfer of funds into or out of the country, without delay, at a market rate of exchange;
- ƒ The abolition of performance requirements;
- ƒ The elimination of restrictions on the appointment of senior management of the board of directors; and
- ƒ The subrogation by insurance or other third-party companies.

Finally, the E.U. is willing to impose a fair level playing field to all State-owned companies that could play a part in the implementation of the agreement. However, the actual mechanism to complement this policy is unknown and remains subject to negotiation.

2.5. Dispute Settlement

While European and Chinese investors could resort to the domestic judiciary with any concerns they may have or to make good any damage suffered, this may not always guarantee that they will be adequately protected. As a result, the E.U. BIT will provide for some type of international dispute-settlement mechanism to enforce its rules and resolve disputes brought by either the affected country or private parties (the so-called Investor-State Dispute Settlement or "ISDS").

Typically, ISDS is only permitted when the claimant can prove that there has been a breach of one of the investment protection obligations – among others, non-discrimination, and fair and equitable treatment or expropriation – which has resulted in loss or damage. The arbitration rules to be applied in the E.U.-China BIT should be those of ICSID or its Additional Facility, the

United Nations Commission on International Trade Law ("UNCITRAL") or another body or set of rules agreed between the parties to the dispute. Before a claim will be submitted to an arbitration tribunal, however, the investor and the challenged state will be expected to seek amicable settlement, through a pre-defined procedure and within a set time frame. Only when the dispute could not be resolved through consultation, the investor could submit a claim to an international arbitration tribunal.

Nonetheless, the ISDS mechanism remains a controversial issue currently attracting great criticism in connection with negotiations leading to international

agreements with investment protection clauses. It is expected then that, following the trend initiated by the E.U.-Canada CETA, the BIT will bring a number of innovative ISDS-related elements.

First of all, ISDS will be bound by conditions for full transparency: all documents submitted by the parties as well as those produced by the arbitral tribunals will be publically available on a

website; all hearings will be open to the public and their transcripts published; and interested parties, such as NGOs and trade unions, will be able to make submissions.

Other particular features to be brought within the E.U.-China BIT in this regard are, for example, that an investor will not be entitled to bring multiple claims against the host country; an ISDS tribunal will be prohibited from ordering the reversal of domestic laws; a list of internationally

recognized and pre-determined arbitrators will be established; a system will be inserted to prevent frivolous or unfounded claims being submitted by private parties; costs will be borne by the unsuccessful party; claims by shell companies will not be permitted; and, interestingly, an appellate mechanism for the reversal or annulment of arbitral tribunals' awards is foreseen.

2.6. Right to Regulate

Also, the BIT between the E.U. and China will not be allowed to jeopardize the ability of host states to regulate FDI in the public interest. Strong additional guarantees, in the lines of the E.U.-Canada CETA, will be introduced to make sure that the investment protection provisions fully preserve the right of governments to regulate and implement public policy objectives and avoid any abuse of these rules, either with the negotiation of a general exception clause or by the insertion of exceptions in each clause.

2.7. Market Access

The E.U. and China BIT will also provide for market access in certain sectors. The more open attitude towards foreign investments shown by the Chinese government and the E.U.'s willingness may lead to the acceptance of an enhanced market access on the basis of a "*negative*

list" approach. With this "*negative list*" there is a general obligation from which a country can "*opt-out*" certain sectors or sub-sectors from the application of some of the clauses or principles found in the agreement, such as MFN or NT.

As a result, China and the E.U. would be legally bound to open their markets unless they list the sectors considered to be sensitive. Thus, in principle, all sectors would be open to foreign investment except for those specifically in the agreement. For example, one of the sectors which is expected to be excluded from any provisions granting access to E.U. and Chinese markets is *audiovisual*.

3. Road Ahead: Level Playing Field

Both parties' aim to complete the negotiations no later than two and a half years after the first round of negotiations took place in Beijing on 21-23 January 2014. So far, there have been three rounds of negotiations (in addition to the first one on 21-23 January 2014 in Beijing, a second round took place in Brussels on 24-25 March 2014 and a third one in Beijing on 17-19 June 2014) between both countries.

The E.U.-China BIT is important as it will bring benefits to the economic operators of both sides and is considered a stepping-stone for a future free trade agreement between both countries. Also, together with the other major agreements being presently negotiated, such as the E.U.-U.S. TTIP or the China-U.S. BIT, this agreement will be a milestone in achieving a global framework on investment policy covering the majority of worldwide investment flows.

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