

# The EU–China Bilateral Investment Treaty: a challenging first test of the EU’s evolving BIT model

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Published online: 7 July 2016  
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**Abstract** The EU–China Bilateral Investment Treaty (BIT) is a genuine landmark in bilateral trade and investment relations and the evolution of the EU’s Common Commercial Policy. However, negotiating a BIT with China presents distinct challenges, primarily due to the radical differences that exist between the EU and China’s legal frameworks, their differing values and levels of development, and the structural features of their economic models. The EU’s evolving BIT model is still in the very early stages of its development, and China remains generally cautious on consent to international arbitration tribunals. This paper makes a novel contribution to the literature on EU–China investment law in several respects. Firstly, it provides an up-to-date account of how the negotiations for an EU–China BIT have been shaped by competitive externalities, i.e. current developments in the negotiation of Free Trade Agreements or BITs between the EU or China and third parties, or equally those among third-parties excluding both the EU and People’s Republic of China. It thus provides a broader context for understanding the pursuit of an EU–China BIT, framing the initiative in terms of mutual regard for external competitive pressures which threaten both parties with the prospect of disadvantage vis-à-vis key competitors in the others’ market for investment. Secondly, it traces the motivations for a BIT between the EU and China by examining recent bilateral investment and trade disputes, illustrating the potential that a BIT might hold to mitigate future tensions. Thirdly, it frames the proposed BIT in terms of the EU broader trade policy and trade diplomacy goals on China.

**Keywords** EU BITs · International arbitration tribunals · Investor state dispute settlement · EU–China investment

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## 1 Introduction

The newly proposed EU–China Bilateral Investment Treaty (BIT) is the EU’s first investment-only agreement, marking a new concentration of investment protection powers at the supranational level.<sup>1</sup> The agreement is a genuine landmark in bilateral trade and investment relations and the evolution of the Union’s Common Commercial Policy.

However, negotiating a BIT with China presents distinct challenges, primarily due to the radical differences that exist between the EU and China’s legal frameworks, their differing values and levels of development, and the structural features of their economic models. Such differences present coordination challenges in terms of the design and negotiation of an EU–China BIT, but also distinct justifications for its pursuit and implementation. Negotiations for an EU–China BIT will require an innovative and flexible approach to international arbitration and market access provisions. The EU’s evolving BIT model is still in the early stages of its development, and China remains generally cautious on consent to international arbitration tribunals. This paper makes a novel contribution to the literature on EU–China investment law in several respects. Firstly, it provides an up-to-date account of how the negotiations for an EU–China BIT have been shaped by competitive externalities, i.e. current developments in the negotiation of FTAs or BITs between the EU or China and third parties, or equally those among third-parties excluding both the EU and PRC. It thus provides a broader context for understanding the pursuit of an EU–China BIT, framing the initiative in terms of mutual regard for external competitive pressures which threaten both parties with the prospect of disadvantage *vis-à-vis* key competitors in the others’ market for investment. Secondly, it traces the motivations for a BIT between the EU and China using recent examples of bilateral investment and trade disputes, illustrating the potential that a BIT might hold to mitigate future tensions. Thirdly, it frames the proposed BIT in terms of the EU’s broader trade policy and trade diplomacy goals on China. Section one assesses the legal and strategic implications of the phasing-in of FDI as an exclusive EU competence, noting the advantages and challenges such a development present in terms of harmonizing the EU’s BIT model on investment protection and international dispute settlement with EU law. Section two provides an overview of the existing legal framework on bilateral investment and considers which international arbitration tribunals might prove most salient for the proposed BIT. Section three provides an overview of current developments in bilateral investment relations, and explores the significant opportunities and underlying tensions that exist therein. Section three also frames the current pursuit of a BIT between the EU and China in terms of both parties’ broader strategic goals and evolving Free Trade Agreement (FTA) and BIT networks, linking these to common considerations on economic and legal competitive externalities. The conclusion

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<sup>1</sup> European Commission (Impact Assessment Report on the EU–China Investment Relations, Commission Staff Working Document, SWD 185 Europa website 2013). [http://ec.europa.eu/smart-regulation/impact/ia\\_carried\\_out/docs/ia\\_2013/swd\\_2013\\_0184\\_en.pdf](http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2013/swd_2013_0184_en.pdf). Accessed 2 June 2013; European Commission (Commission proposes to open negotiations for an investment agreement with China, Press Release 2013). [http://europa.eu/rapid/press-release\\_IP-13-458\\_en.htm](http://europa.eu/rapid/press-release_IP-13-458_en.htm). Accessed 2 June 2013.

contains recommendations for the effective negotiation and implementation of the agreement.

## 2 The evolving framework on bilateral investment

Since the removal of the Singapore issues from the Doha Agenda,<sup>2</sup> and the failure of initiatives such as the Organization for Economic Cooperation and Development (OECD) Multilateral Agreement on Investment (MAI), international investment law has continued to be governed in the absence of a general treaty guiding substantive or procedural aspects of international investment protection.<sup>3</sup> The importance of bilateral or regional trade agreements and BITs in establishing the customary rules of international investment law is thus likely to persist for the foreseeable future. BITs have two basic functions. They confer investors with mutually agreed substantive rights for the protection of their investments, and contain provisions on procedural rights, typically the ‘entitlement to submit investment-related disputes to arbitration offering investors a certain choice as to which arbitration regime to use.’<sup>4</sup> Substantive rights defined within a BIT include appropriate compensation for expropriation, guarantees of national treatment, fair and equitable treatment (FET) and most favoured nation (MFN) treatment.<sup>5</sup> However, uniform standards and definitions for substantive rights such as FET are not provided for in customary international law, and the wording of such provisions within a BIT can have a major impact on their interpretation within international arbitration tribunals.<sup>6</sup> The negotiation and design of BITs is thus crucial to improving conditions for investors in foreign markets. In this sense, the interposition of EU-level representatives in the pursuit and negotiation of investment treaties is arguably the most important modification of the Common Commercial Policy contained in the Lisbon Treaty. The EU–China BIT will play a key role in upgrading the conditions and standards for EU investors in China and Chinese investors in the EU through processes of legal definition and improved clarification of rights and obligations.

EU member states currently account for almost half of all BITs presently in force around the world.<sup>7</sup> Twenty-seven of the EU’s 28 member states currently hold their own independent bilateral investment treaties with China. In similar fashion to the EU and its member states, the failure of efforts to develop a comprehensive

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<sup>2</sup> WTO members decided in 1996 to set up working groups covering trade and investment, competition policy, and transparency in government procurement. Members agreed in 2004 to proceed with negotiations on only one of the original four Singapore issues, i.e. trade facilitation. WTO (Investment, competition, procurement, simpler procedures 2014). [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey3\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm). Accessed 18 November 2014.

<sup>3</sup> Heymann 2008, p. 508; Alschner 2014.

<sup>4</sup> Eilmansberger 2009, p. 386.

<sup>5</sup> *Id.*

<sup>6</sup> Radu 2008, p. 254.

<sup>7</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010, p. 4). [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

multilateral general treaty on investment protection has led China to pursue bilateralism. In recent years, China's foreign economic policy has developed to employ bilateral FTAs that adopt WTO-plus commitments. China is currently a signatory to 132 BITs, along with 17 other trade and investment agreements.<sup>8</sup> This places China second after Germany in terms of the number of BITs it has entered into.<sup>9</sup> By pursuing cross-regional FTAs/BITs, most notably with its Asia Pacific neighbours, China has demonstrated it is willing to award increased market-access and adopt binding WTO-plus commitments through bilateral agreements. Despite the fact of foreign direct investment becoming an exclusive EU competence through the Treaty of Lisbon,<sup>10</sup> EU member states' independent BITs with third countries will persist, and do not 'require automatic or implicit termination.'<sup>11</sup> EU members are, however, restricted from pursuing future agreements covering FDI.<sup>12</sup> An EU member state BIT with a third country remains valid up until the point at which the EU concludes a BIT or FTA covering investment with said third country. Considering the EU's current pace of FTA/BIT development, member state BITs will continue to persist in parallel with the development of EU-level BITs well into the future, with the ultimate goal being 'to replace them over time by EU-wide investment deals.'<sup>13</sup> At the same time, member states are free 'to negotiate bilateral investment agreements with countries not immediately scheduled for EU-wide investment negotiations.'<sup>14</sup> Allowing member states to continue to pursue bilateral investment treaties independently allows for the expansion and improvement of investment protection for European investors in third markets, without making such improvements conditional upon the pursuit of a corresponding EU-level BIT/FTA. Given the projected persistence of member state BITs in this fashion, it is worth noting that such BITs retain their status as national legal documents in the international arbitration tribunal context, where EU law is not the governing law. International arbitration tribunals interpret member state BITs as such, in a context where EU law does not directly come into play.<sup>15</sup> However, the European Commission (EC) can request modifications to member state BITs, if they are found by the European Court of Justice (ECJ) to be incompatible with EU law.<sup>16</sup> The Commission can also request modification to member state BITs as part of the EU

<sup>8</sup> UNCTAD (China—Full list of Bilateral Investment Agreements concluded 2013). [http://unctad.org/sections/dite\\_pceb/docs/bits\\_china.pdf](http://unctad.org/sections/dite_pceb/docs/bits_china.pdf). Accessed 13 August 2014; Herbert Smith Freehills (China sued by South Korean property developer at ICSID 2014). <http://hsfnotes.com/arbitration/2014/11/10/china-sued-by-south-korean-property-developer-at-icsid/>. Accessed 14 December 2014.

<sup>9</sup> Tillmann 2011, p. 97.

<sup>10</sup> EUR-Lex (Treaty on the Functioning of the European Union 12008E207, Official Journal 115, 2008). <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E207:en:HTML>. Accessed 12 November 14.

<sup>11</sup> Shan and Zhang 2011, p. 1068.

<sup>12</sup> *Id.*

<sup>13</sup> European Commission (EU takes key step to provide legal certainty for investors outside Europe, Europa Website 2012). <http://trade.ec.europa.eu/doclib/press/index.cfm?id=854>. Accessed 4 February 14.

<sup>14</sup> *Id.*

<sup>15</sup> Shan and Zhang 2011, p. 1068.

<sup>16</sup> *Id.*

ascension process, to ensure their consistency with the EU treaties.<sup>17</sup> However, individual member state BITs do not all ‘provide for the same high standards. This leads to an uneven playing field for EU companies investing abroad, depending on whether they are covered as a national under a certain Member State BIT or not.’<sup>18</sup> The Treaty of Lisbon integrated foreign direct investment as part of the Common Commercial Policy precisely to resolve such inconsistencies,<sup>19</sup> and to move beyond the stalemate experienced in trying to resolve investment issues through the EU–China Partnership and Cooperation Agreement (PCA).

## 2.1 Advantages of EU-level BITs

In 2011 the Commission published its new European International Investment Policy, which marked ‘a new frontier for the Common Commercial Policy.’<sup>20</sup> This new concentration of investment powers at the supranational level allows for the formal resolution of investment disputes bilaterally between the EU, represented by the Commission, and third parties, and the development of a consolidated and comprehensive offensive EU strategy on investment. The EU–China BIT will be a fitting first test of the EU’s new FDI competence.<sup>21</sup> Whether the pursuit of a BIT with China results in a strengthened common position, or inhibiting coordination problems among EU members and institutional elements, remains to be seen. It is hoped that ‘supporting the competitiveness of European enterprises will be best served by cooperation and by negotiations at the level of the Union... the thrust of the Union’s action should be to deliver better results as a Union than the results that have been or could have been obtained by Member States individually.’<sup>22</sup> Negotiating on investment at the EU-level presents significant advantages for foreign investors looking to invest in the EU in that EU-wide agreements ‘create consistency across the EU.’<sup>23</sup> Significantly, the emerging EU BIT model is seeking to go beyond the standards of member states existing BITs by including pre-

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<sup>17</sup> Radu 2008, p. 245.

<sup>18</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010, p. 5) [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

<sup>19</sup> European Commission (Dispute Settlement, Europa website 2014). <http://ec.europa.eu/trade/policy/accessing-markets/dispute-settlement/>. Accessed 2 August 14.

<sup>20</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010, p. 4). [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

<sup>21</sup> European Commission (Commission proposes to open negotiations for an investment agreement with China, Press Release 2013). [http://europa.eu/rapid/press-release\\_IP-13-458\\_en.htm](http://europa.eu/rapid/press-release_IP-13-458_en.htm). Accessed 2 June 2013.

<sup>22</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010, pp. 6, 7). [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

<sup>23</sup> European Parliament Directorate-General for External Policies (Negotiations on the EU–Canada Comprehensive Economic and Trade Agreement concluded, Policy Paper 2014, p. 7). [http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO\\_IDA\(2014\)536410\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO_IDA(2014)536410_EN.pdf). Accessed 14 November 2014.

establishment and other market-access provisions. Whereas member states BITs lack coverage on pre-establishment obligations, in line with the model advanced by the Abs-Shawcross Draft Convention, the evolving EU BIT model is clearly more ambitious, and closer to the North American model which seeks the inclusion of investment liberalization provisions in both BITs and FTAs as standard.<sup>24</sup> Having the Commission negotiate on investment provisions via self-standing investment agreements also helps shield European firms or EU member states that might be concerned about publicly bringing a case before an international tribunal. Many European companies are naturally hesitant to employ existing investor-to-state dispute settlement mechanisms, for fear of potential reprisals that could damage their position in foreign markets. The adoption of investment oversight powers by Brussels gives the EU's institutions authority to oversee bilateral investment where individual member state influence might not suffice, and mitigates the phenomenon of member states competing with one another in the pursuit of large-scale investments or public procurement projects through the commercial diplomacy elements of their independent national foreign policies.<sup>25</sup> The EU's institutions are thus poised to resolve the phenomenon of mutually competing member state foreign economic policies by consolidating investment protection through EU-level BITs, while ensuring both improved market-access and effective enforcement of investor's rights.

### *2.1.1 The EU's approach to international arbitration*

The EU's approach to international arbitration tribunals it at an early phase of its development. While advancing a comprehensive strategy on investment at the supranational level presents advantages, it does not discount the possibility of investment dispute settlement involving EU member states without the EU's involvement. Prior recourse to domestic courts before resorting to international arbitration tribunals is in fact recognized as preferable, though the judicial standards of national courts can vary significantly across potential BIT counterparts, and indeed in the judicial systems of EU members.<sup>26</sup> EU BITs have immense potential to address issues arising from inconsistencies across EU member states' BIT networks. Above and beyond exceeding the scope of member states' BITs, EU-level BITs confer the EU with substantive rights in external treaties. The conferral of such rights to Union representatives in international arbitration tribunals raises interesting questions in light of the recent investor-state dispute settlement (ISDS) controversies in relation to both the Trans-Atlantic Trade and Investment Partnership (TTIP) and the EU–Canada Comprehensive Economic and Trade Agreement (CETA). The

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<sup>24</sup> Eilmansberger 2009, p. 386.

<sup>25</sup> Casarini N (The Evolution of the EU–China relationship: From Constructive Engagement to Strategic Partnership, European Union Institute for Security Studies Occasional Paper 2006, p. 17). <http://www.iss.europa.eu/uploads/media/occ64.pdf>. Accessed 2 March 2013.

<sup>26</sup> European parliament Directorate-General for External Policies (Investor-State Dispute Settlements provisions in the EU's International Investment Agreements 2014, p. 90). <http://www.jura.fu-berlin.de/fachbereich/einrichtungen/oeffentliches-recht/lehrende/hindelang/Studie-fuer-Europaeisches-Parlament/Volume-2-Studies.pdf?1411545557>. Accessed 1 January 2015.

prospect of supranational representatives appearing before international arbitration tribunals immediately amends the status of both member states' national courts and the European Court of Justice (ECJ). During negotiations for both TTIP and CETA, particular EU member states, EU parliamentarians and civil society groupings raised concerns about the potential for cases to be brought against national governments as a result of EU agreements, as well as the rights of host states to regulate on environmental and social issues. Commission President Juncker sought to ease such concerns, stating 'my Commission will not accept that the jurisdiction of courts in the EU member states be limited by special regimes for investor-to-state disputes... The negotiating mandate foresees a number of conditions that have to be respected by such a regime as well as an assessment of its relationship with domestic courts.'<sup>27</sup> Though more a reference to whether or not to include ISDS in TTIP, such a statement appears to imply some potential incompatibility in the structure of future EU FTAs or BITs with international arbitration tribunals such as the ICSID and WTO Appellate Body, neither of which is subject to appeal or intervention by national courts. At the very least such a statement would undermine the guarantees afforded to investors through EU BITs. A core function of any arbitration tribunal is to limit the influence of national institutions in proceedings. The ICSID specifies that the Convention 'shall not be subject to any appeal or to any other remedy except those provided for in this convention.'<sup>28</sup> Guarantees that the jurisdiction of the courts of EU member states will not be limited by ISDS regimes may provide some pause for Chinese negotiators or investors in the context of the proposed BIT with the EU. It is also curious to invoke the powers of the national courts of EU members to contest foreign investors' rights as contained in EU BITs, which undermines the substantive guarantees provided therein.

EU BITs may again, however, exceed the standards and scope of the BITs of its member states by applying a new and innovative model to the very function of consent to international arbitration. On the interplay between arbitration tribunals, EU Law and member states' national laws, CETA contains some interesting innovations. The agreement specifies 'an ISDS tribunal is prohibited from ordering the reversal of domestic laws or regulations... Arbitrators are subject to a binding code of conduct (and) a roster of well-qualified and pre-vetted arbitrators will be established.'<sup>29</sup> CETA thus proposes the maintenance of a list of mutually agreed arbitrators, ensuring both parties 'have always agreed to at least two of the three arbitrators that will act under CETA and will have vetted them to ensure that they live up to the highest standards.'<sup>30</sup> In the event that an arbitrator is found not to

<sup>27</sup> Juncker JC Setting Europe in motion (Speech before the European Parliament, Europa website 2014). [http://europa.eu/rapid/press-release\\_SPEECH-14-705\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-14-705_en.htm). Accessed 6 December 2014.

<sup>28</sup> ICSID Article 53 s 6. <https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partA-chap04.htm>. Accessed 4 November 14.

<sup>29</sup> European Parliament Directorate-General for External Policies (Negotiations on the EU–Canada Comprehensive Economic and Trade Agreement concluded, Policy Paper 2014, p. 7). [http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO\\_IDA\(2014\)536410\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO_IDA(2014)536410_EN.pdf). Accessed 14 November 2014.

<sup>30</sup> European Commission (Investment provisions in the EU–Canada Free Trade Agreement 2014, p. 4). [http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc\\_151918.pdf](http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf). Accessed 4 December 14.

comply with the agreement's code of conduct for arbitration, based upon the ethical rules of the International Bar Association, said arbitrator can be replaced upon the order of the Secretary General of the ICSID.<sup>31</sup> It is reasonable to assume that such a structure guiding consent to arbitration does not suggest any distrust of particular ISDS tribunals on the part of EU or Canadian negotiators, but is rather designed to elevate a socially and commercially responsible code of conduct above the findings of any one tribunal against a host government acting in the public interest, so as to appease those concerned about ISDS provisions negotiated at the EU level. However, developing a mutually agreed upon code of conduct presents far greater challenges for negotiators in the context of negotiation for an EU–China BIT. Particular features of China's domestic law, China's hesitant and often limited utilization of international arbitration, and the internal blending of market and state-led economic models within the PRC, raises the issue of how a similar approach might be applied, and which particular arbitration tribunals will prove to be agreeable and suitable to both parties.

## 2.2 International arbitration tribunals

The vast majority of existing BITs in force contain consent to arbitration at the World Bank's International Centre for the Settlement of Investment Disputes (ICSID). China joined the ICSID convention in 1993.<sup>32</sup> Up until quite recently, China had only rarely included ICSID arbitration in its BITs, and done so only for compensation from expropriation and nationalization. The vast majority of China's first generation BITs proposed settling investor-state disputes through negotiations, or submission to the national court of the host state.<sup>33</sup> From the early 2000s onwards, China increasingly sought the inclusion of ICSID arbitration in its BITs, as it transitioned to becoming a major outward investor. This phenomenon is consistent with China's goal of utilizing legalism to ensure comparable rights for Chinese investors in foreign markets as those of more developed market economies. The first case of joining a case of international arbitration against a major Western power was the *US-Steel* dispute of 2002.<sup>34</sup> China's participation was actually requested by the European Communities, and hailed by Chinese political elites as a landmark development in terms of China's emergence as a participating power in the international arbitration arena. To date, two cases have been brought against the Chinese government through ICSID arbitration. The first was brought in 2011 by Ekran Berhad,<sup>35</sup> a Malaysian investment holding company, over the revocation of

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<sup>31</sup> *Id.*, p. 3.

<sup>32</sup> World Bank (ICSID Annual Report, REF K3826.6.I58 1993). [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/03/14/000333037\\_20130314125619/Rendered/PDF/758520AR0Box370nual0report00PUBLIC0.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/03/14/000333037_20130314125619/Rendered/PDF/758520AR0Box370nual0report00PUBLIC0.pdf). Accessed 26 November 14.

<sup>33</sup> Heymann 2008, p. 515.

<sup>34</sup> Case WT/DS248/9. Luo 2007, p. 801.

<sup>35</sup> Ekran Berhad v. People's Republic of China, ICSID Case No. ARB/11/15.



its Chinese subsidiary's 70 years land lease on a 900 acre site in Hainan.<sup>36</sup> The arbitration was suspended shortly after being registered and eventually discontinued 2 years later under unknown terms. In November 2014, Ansung Housing Co. Ltd, a Korean firm, filed a case for damages against the Chinese government after treatment of the company by the Shenyang-Xian county authorities led to severe delays with its investment plan for a golf country club and an eventual loss-making re-sale to a Chinese investor.<sup>37</sup> The first case of a Chinese investor submitting a case before ICSID for arbitration was that of a Hong Kong-resident Chinese national against the government of Peru in September 2006.<sup>38</sup> Tza, the majority shareholder in a Peruvian seafood manufacturing company, suffered a freeze on the company's bank accounts by the Peruvian tax authorities owing to an alleged tax debt of twelve million Peruvian New Sols. Tza claimed such measures constituted restriction on the transfer of capital and expropriation without compensation', prohibited under the terms of the China Peru-BIT.<sup>39</sup>

China's greater willingness to consent to international arbitration is a by-product of its emergence as a major international investor. The majority of China's investment flows have been of the South–South sort, focussing on developing states. Chinese investors seek improved access in foreign markets, and protection from arbitrary or discriminatory treatment. Against the backdrop of a persisting crisis in the EU, the EU's share of FDI stock in China has shown patterns of decline, most notably in 2012, while Chinese investors, enjoying comparatively robust domestic growth and capital reserves, have substantially increased their investment flows to Europe. As crisis-hit European states transition to becoming capital importers vis-à-vis China, Chinese investors will be increasingly likely to seek to refer investment disputes to ICSID arbitration. Ping An, China's second largest life insurance company, became the first mainland Chinese company to file a claim for arbitration before ICSID, citing the terms of the 2005 China–Belgium–Luxembourg BIT.<sup>40</sup> The claim related to losses of US\$ 2.2 billion against Fortis, a Dutch–Belgian group, after it went bankrupt and was nationalised in 2008.<sup>41</sup> In 2009 Ping An voted against the Belgian government's proposed sale of Fortis' Belgian banking unit to BNP Paribas of France.<sup>42</sup> Citing shareholders' legal rights, Ping An submitted the case

<sup>36</sup> Ku J (Enforcement of ICSID Awards in the People's Republic of China, 2013, p. 32). [http://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1305&context=faculty\\_scholarship](http://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1305&context=faculty_scholarship). Accessed 16 December 14; Herbert Smith Freehills (China sued by South Korean property developer at ICSID 2014). <http://hsfnotes.com/arbitration/2014/11/10/china-sued-by-south-korean-property-developer-at-icsid/>. Accessed 14 December 14.

<sup>37</sup> World Bank (Ansung Housing Co., Ltd. v. People's Republic of China', ICSID Case No. ARB/14/25, 2014). <https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/casedetail.aspx?CaseNo=ARB/14/25>. Accessed 14 December 14.

<sup>38</sup> Tza Yap Shum v. Republic of Peru, ICSID Case No. ARB/07/6. Shen 2011, p. 58.

<sup>39</sup> *Id.*

<sup>40</sup> Ping An Insurance Ltd. v. Kingdom of Belgium, ICSID ARB/12/29. <https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/casedetail.aspx?caseno=ARB/12/29>. Accessed 23 November 2014.

<sup>41</sup> Trakman 2013, p. 273.

<sup>42</sup> Ping An's 5 % holding made it the single largest shareholder in Fortis. Financial Times (Ping An in arbitration claim over Fortis 2012). <http://www.ft.com/intl/cms/s/0/87437290-0620-11e2-bd29-00144feabdc0.html#axzz3OXhKJFHx>. Accessed 2 December 2014.

for settlement through ICSID in September 2012. If arbitration at the ICSID is pursued, the courts of the investor or host state cannot intervene in proceedings, and findings are not subject to appeal.<sup>43</sup> Being a contracting party to the ICSID does not automatically oblige consent to settlement of an investment dispute.<sup>44</sup> Article 25(1) stipulates that both parties must submit their consent to jurisdiction in writing to the Centre.<sup>45</sup> Assuming the submission of such consent, China's newer BITs, such as those with Germany and the Netherlands, are not limited to compensation arising from expropriation or nationalization, as such 'consent encompasses all obligations in the respective BITs (including) disputes arising out of government agency arbitrary conduct and discrimination.'<sup>46</sup>

In terms of the WTO framework, China's membership in the WTO carries implicit investment related obligations under the General Agreement on Trade in Services (GATS), Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Agreement on Trade-Related Investment Measures (TRIMS). As a member, China can be brought before the WTO dispute settlement body (DSB). In similar fashion to the ICSID, WTO Appellate Body findings must be accepted unconditionally, and are not subject to appeal. Article 1:2 of the GATS covers services supply of 'one member, through commercial presence, in the territory of any other member' whereby mode 3 of supply is constituted 'by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and controlled company.'<sup>47</sup> On Most Favoured Nation (MFN) commitments, China retains current exemptions under the GATS in maritime transport, international transport and freight and passenger services.<sup>48</sup> The TRIPS agreement contains provisions covering the intellectual property rights of foreign investors and 'effective and expeditious procedures for the multilateral prevention and settlement of disputes between governments.'<sup>49</sup> Article 64 of the TRIPS agreement refers to

<sup>43</sup> World Bank (ICSID Convention rules and regulations 2014). [http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR\\_English-final.pdf](http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf). Accessed 3 October 2014; Heymann 2008, p. 510.

<sup>44</sup> Heymann 2008, p. 518.

<sup>45</sup> Article 25 (1), states 'the jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.' World Bank (Jurisdiction of the Centre 2001). <https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partA-chap02.htm>. Accessed 12 November 2014.

<sup>46</sup> Heymann 2008, p. 518.

<sup>47</sup> WTO (Definition of Services Trade and Modes of Supply 2014). [http://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s3p1\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm). Accessed 3 November 2014.

<sup>48</sup> WTO (Trade in Services, The People's Republic of China Final List of Article II MFN Exemptions GATS/EL/135 2002). [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S006.aspx?Query=\(@Symbol=%20gats/el/\\*\)%20and%20\(\(%20@Title=%20china%20\)%20or%20\(@CountryConcerned=%20china\)\)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(@Symbol=%20gats/el/*)%20and%20((%20@Title=%20china%20)%20or%20(@CountryConcerned=%20china))&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#). Accessed 2 January 2015.

<sup>49</sup> WTO (Agreement on Trade-Related aspects of Intellectual Property Rights 1999). [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips.pdf](http://www.wto.org/english/docs_e/legal_e/27-trips.pdf). Accessed 2 November 2014.

‘the provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding’.<sup>50</sup> Article 2 of the TRIMS agreement specifies that ‘without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.’<sup>51</sup> More fundamentally, WTO membership implies a commitment by members to open domestic markets to international trade and investment.<sup>52</sup>

However, China meeting its WTO commitments on MFN and national treatment is greatly complicated by the sheer size and complexity of its economy, the structure of central and local government relations, poor regulatory enforcement standards by local government, and the basic lack of a proper domestic legal and administrative infrastructure.<sup>53</sup> The parallel existence of market-based and planned economy systems in the form of special Economic Development Zones (EDZs) further complicates the picture for foreign investors, across which levels of government support and intervention differ greatly. China, for its part, remains fundamentally suspicious of the international economic order and WTO framework, which it sees as disadvantageous to developing countries, and dominated by a core group of advanced industrialized powers.<sup>54</sup> In addition to the ICSID and WTO frameworks, the World Bank’s Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) is a mediation service for investment dispute specializing in political risk insurance for investors.<sup>55</sup> China joined the MIGA in 1991 and the MIGA has since mediated in disputes between foreign investors and the Chinese government. The EU has funded insurance schemes through the MIGA, most notably in Bosnia and Herzegovina for an investment by Coca-Cola of the Netherlands.<sup>56</sup> The United Nations Commission on International Trade Law (UNCITRAL) has also played an important role in shaping the EU’s evolving approach to dispute settlement. In July 2014 the EU backed a UNCITRAL initiative to improve transparency in ISDS proceedings and ‘played a key role in drawing up these new transparency rules in the responsible Working Group of the UNCITRAL.’<sup>57</sup>

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<sup>50</sup> WTO (Dispute Prevention and Settlement 2014). [http://www.wto.org/english/tratop\\_e/trips\\_e/t\\_agm6\\_e.htm](http://www.wto.org/english/tratop_e/trips_e/t_agm6_e.htm). Accessed 10 October 2014.

<sup>51</sup> WTO (Agreement on Trade Related Investment Measures 1999, p. 139). [http://www.wto.org/english/docs\\_e/legal\\_e/18-trims.pdf](http://www.wto.org/english/docs_e/legal_e/18-trims.pdf). Accessed 4 January 2015.

<sup>52</sup> Yang 2009, p. 223.

<sup>53</sup> Eglin 1997, p. 498.

<sup>54</sup> Yang 2009, p. 224.

<sup>55</sup> Schill 2007, p. 83; Heymann 2008, p. 511.

<sup>56</sup> World Bank Group (MIGA and European Union Co-Insure Coca-Cola Project in Bosnia and Herzegovina, MIGA Press Release, 2000). <http://www.miga.org/news/index.cfm?stid=1506&aid=336>. Accessed 14 November 2014.

<sup>57</sup> European Commission (EU welcomes new UN Convention on transparency for investor-state dispute settlement, Press Release 2014). [http://europa.eu/rapid/press-release\\_IP-14-824\\_en.htm](http://europa.eu/rapid/press-release_IP-14-824_en.htm). Accessed 10 November 2014.

### 3 The EU and China's goals through the pursuit of a BIT

#### 3.1 Chinese investment in the EU

PRC investment in the EU is characterized by a low starting point just over a decade ago, with substantial increases recorded in recent years. Chinese outward FDI flows to Europe rose from approximately US\$1 billion per annum in 2004–2008 to \$3 billion per annum in 2009 and 2010, eventually reaching \$10 billion per annum in 2011.<sup>58</sup> China's total FDI stock in the EU reached €26.7 billion in 2012.<sup>59</sup> In terms of the number of investments, the figure has climbed dramatically, from a mere 20 in 2002, to more than 570 10 years later.<sup>60</sup> Whereas in the past PRC outward foreign direct investment (OFDI) into Europe sought to secure market access and natural resources, the more recent trend has been broader, including high-value asset purchases in European corporate entities and strategic investments in high-technologies and advanced manufacturing industries. PRC OFDI into Europe has also broadened geographically, from a past focus on core original EU-15 members, to a much more evenly distributed and intensified EU-wide trend, with notably increasing investment flows to newer Central and Eastern European members. Despite increasing at a rapid rate, PRC investors held a mere 0.67 % of FDI stocks in the EU in 2012, a minuscule figure compared to the US (39 %), Switzerland (13 %) and Japan (4 %).<sup>61</sup> Yet Chinese investments in Europe have stirred intense policy debate in EU policy circles. Managing investment ties with China presents particular strategic considerations which do not arise with other investors, mainly due to China's state-capitalist structure. Large-scale Chinese investments and sensitive technology disclosures have led European industry leaders and political representatives to voice concerns that such acquisitions carry too much strategic importance to be sold to Chinese companies, fearing such acquisitions will undermine European exporters' upper-hand in high-technology goods in the Chinese market.

A string of recent high-profile Chinese investments in Europe illustrate both the substantial potential benefits of Chinese investments in Europe, and the general wariness of European industry vis-à-vis Chinese investments. In March 2010 Zhejiang Geely Holding Group Ltd, a Chinese automobile manufacturer, acquired Sweden's Volvo from Ford Motors for \$1.3 billion. The deal was the first time a Chinese company had ever acquired a one hundred percent stake in a foreign rival.<sup>62</sup>

<sup>58</sup> Hanemann T and Rosen DH (China Invests in Europe: Patterns Impacts and Policy Implications, Rhodium Group LLC Report, 2012, p. 32).

<sup>59</sup> Escuela Superior de Administración y Dirección de Empresas (Chinese Investment in Europe 2014, p. 10). [http://itemsweb.esade.edu/research/esadegeo/ESADE\\_IN\\_PDF.pdf](http://itemsweb.esade.edu/research/esadegeo/ESADE_IN_PDF.pdf). Accessed 2 July 2014.

<sup>60</sup> Hanemann T and Rosen DH (China Invests in Europe: Patterns Impacts and Policy Implications, Rhodium Group LLC Report, 2012, p. 32).

<sup>61</sup> Eurostat (Both inward and outward FDI stocks rose by around 40 % between 2009 and 2012 for the EU 2014). [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-23012014-BP/EN/2-23012014-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23012014-BP/EN/2-23012014-BP-EN.PDF). Accessed 2 February 2014.

<sup>62</sup> New York Times (Chinese Carmaker Geely Completes Acquisition of Volvo From Ford 2010). <http://www.nytimes.com/2010/08/03/business/global/03volvo.html>. Accessed 1 January 2012.

Ford paid \$6 billion for Volvo in 1999. Under Chinese ownership, Volvo has maintained its European manufacturing facilities and achieved a record year in terms of sales volumes in 2013.<sup>63</sup> In June 2010, Cosco Holdings Ltd, a shipping firm owned by the Chinese government, agreed a deal to invest \$4.4 billion in the Greek shipping port of Piraeus, assuming control of half of the port and acquiring a 35 years container terminal lease. Traffic volumes on Cosco's half of the port proceeded to double within the first year, on one of the most strategically important shipping gateways in Southern Europe.<sup>64</sup> Also in June 2010, Fosun Group acquired 9.6 % equity interest in Club Méditerranée for €46 million, becoming the largest shareholder in the French vacation resorts company.<sup>65</sup> In November 2010, Tianjin Xinmao S&T Investment Corporation Ltd made a \$1.3 billion takeover bid for Draka Holding, a Dutch fibre-cable producer. This acquisition led then Industry Commissioner Antonio Tajani to oppose the deal in order to safe-guard European technological patents from acquisition via Chinese takeovers. 'I am totally against protectionism—Chinese, Russian, Brazilian, American investment, the door is open... But we have to make sure it's not a front for something else, in terms of taking our know-how abroad or national security.'<sup>66</sup> Commissioner Tajani requested the establishment of a foreign investment review process at the EU-level, which resonated with a generally protectionist mood in Brussels.<sup>67</sup> Draka was eventually merged with Italian energy and telecom cable producer Prymsian.<sup>68</sup>

European concerns about Chinese investment have extended beyond issues of technology disclosure or ownership. In 2012 Chinese telecommunication equipment maker Huawei doubled its share of the Western European telecoms equipment market to 19 %.<sup>69</sup> The same year, a US House of Representatives report accused Huawei and Zhongxing Telecommunication Equipment Corporation (ZTE) of stealing American intellectual property, and claimed their operations in the US

<sup>63</sup> Forbes Asia (Life after Ford: Volvo turnaround gains speed under Chinese billionaire owner 2014). <http://www.forbes.com/sites/russellflannery/2014/10/27/geely-in-swedish/>. Accessed 8 December 2014.

<sup>64</sup> New York Times (Under Chinese, a Greek port thrives 2012). [http://www.nytimes.com/2012/10/11/business/global/chinese-company-sets-new-rhythm-in-port-of-piraeus.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/10/11/business/global/chinese-company-sets-new-rhythm-in-port-of-piraeus.html?pagewanted=all&_r=0). Accessed 1 November 2012; Wall Street Journal (Bid dropped as EU raises China Wall 2011). <http://online.wsj.com/news/articles/SB10001424052748704415104576065313773996124>. Accessed 4 May 2012.

<sup>65</sup> Fosun (Club Med Project 2014). [http://www.fosun.com/site/site-adv/upload/i\\_dzhgb\\_en.pdf](http://www.fosun.com/site/site-adv/upload/i_dzhgb_en.pdf). Accessed 3 April 2014.

<sup>66</sup> Wall Street Journal (Bid dropped as EU raises China Wall 2011). <http://online.wsj.com/news/articles/SB10001424052748704415104576065313773996124>. Accessed 4 May 2012.

<sup>67</sup> Hanemann T and Rosen DH (China Invests in Europe: Patterns Impacts and Policy Implications, Rhodium Group LLC Report, 2012, p. 65). [http://rhg.com/wp-content/uploads/2012/06/RHG\\_ChinaInvestsInEurope\\_June2012.pdf?](http://rhg.com/wp-content/uploads/2012/06/RHG_ChinaInvestsInEurope_June2012.pdf?). Accessed 3 September 2012.

<sup>68</sup> Reuters (Prymsian clinches Draka bid to form cable leader 2011). <http://www.reuters.com/article/2011/02/04/us-draka-prysmian-idUSTRE7131H720110204>. Accessed 3 May 2012.

<sup>69</sup> Economist Magazine (European Commission threatens Chinese telecom firms 2013). <http://www.economist.com/news/business/21578077-european-commission-threatens-chinese-telecoms-firms-hold>. Accessed 3 June 2014.

posed a threat to national security.<sup>70</sup> Though neither is a state-owned enterprise, both companies have funding ties to Chinese state banks. The US House report claimed that both Huawei and ZTE are heavily subsidised by the Chinese state.<sup>71</sup> This prompted EU parliamentarians to raise the issue with the EC, querying whether the Commission intended to ‘start its own investigation, either independently or jointly with the Member States, to reassess the impact of business operations by Chinese companies, particularly ICT companies, and specifically Huawei and ZTE, on national security in the EU? If not, why not?’<sup>72</sup> In May 2013 the Commission announced its intention to investigate Chinese subsidisation of mobile-network equipment, encompassing Huawei and ZTE’s operations. Such cases highlight the challenges that lie ahead in negotiating a BIT with China. As European industrial interests remain sensitive to both strategic technology disclosures and the prospect of losing market share locally, it will continue to be difficult to balance the costs and benefits of Chinese investment in the EU.

### 3.2 China’s goals in the negotiation of a BIT with the EU

China’s major trading partners in East Asia and further afield have pursued bilateral trade and investment agreements in light of the failures of multilateral liberalization initiatives, as well as in the opportunistic pursuit of economic and political strategic advantages. FTAs have become a key component of China’s development agenda, with eleven FTAs in force, eight under negotiation and two under consideration.<sup>73</sup> China is eagerly seeking to open negotiations for a fully comprehensive FTA ‘but Europe’s reaction has been lukewarm.’<sup>74</sup> Given the sheer extent of China’s cost-competitive advantage, an EU–China FTA appears not to be in a majority of EU member states’ interest. In step with other emerging markets and industrialized peers in East Asia, China has pursued a bilateralist strategy driven by political and economic competitive pressures. This process has been spurred by external economic, political and legal competitive pressures, as China seeks to ensure non-discriminatory treatment in an environment of rapid FTA proliferation.<sup>75</sup> In political

<sup>70</sup> US House of Representatives Permanent Committee on Intelligence (Investigative Report on the US National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE 2013, p. 5). <https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/Huawei-ZTE%20Investigative%20Report%20%28FINAL%29.pdf>. Accessed 2 April 2013.

<sup>71</sup> The Obama administration also filed a claim with the WTO in relation to Chinese subsidies in the auto industry. New York Times (US Panel Cites Risks in Chinese Equipment 2012). [http://www.nytimes.com/2012/10/09/us/us-panel-calls-huawei-and-zte-national-security-threat.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/10/09/us/us-panel-calls-huawei-and-zte-national-security-threat.html?pagewanted=all&_r=0). Accessed 3 January 2013.

<sup>72</sup> European Parliament (EU assessment of security risks posed by Huawei Technologies and ZTE, Questions for written answer to the Commission 2012). <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2012-009222+0+DOC+XML+V0//EN>. Accessed 1 February 2013.

<sup>73</sup> As of December 2014. Ministry of Commerce of the People’s Republic of China (China FTA Network 2014). <http://fta.mofcom.gov.cn/english/index.shtml>. Accessed 2 December 14.

<sup>74</sup> European Parliament (Trade and Economic Relations with China 2014). [http://www.europarl.europa.eu/RegData/etudes/briefing\\_note/join/2014/522342/EXPO-INTA\\_SP%282014%29522342\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/briefing_note/join/2014/522342/EXPO-INTA_SP%282014%29522342_EN.pdf). Accessed 2 August 2014.

<sup>75</sup> Solís and Katada 2009, p. 24.

terms, FTAs are an important tool in the pursuit of influence and security goals. Economically, ‘FTAs enhance the efficiency and productivity of Chinese enterprises and to disseminate its acceptance as a market economy.’<sup>76</sup> Competitive calculations, principally concerns about the threat of being marginalized and suffering discriminatory treatment due to exclusion from preferential arrangements, has led China to board the FTA bandwagon as a relative latecomer.<sup>77</sup> China’s offensive FTA/BIT strategy seeks to offset economic and political competitive externalities by utilizing bilateralism to dilute key competitors’ economic and geostrategic influence in the shaping of economic integration in the Asia Pacific and to ‘promote FTA initiatives of its own preference.’<sup>78</sup> Similarly, BITs and FTAs covering investment play a key role in offsetting *legal* competitive externalities, as tools for shaping international economic rules. China has recently entered negotiations for BITs with both the US and EU, and signed a trilateral BIT with Japan and Korea. Although China seeks to enter FTAs with its main industrialized trading partners, such an option is not currently immediately available in the cases of either the US, EU or Japan. At the same time, EU–US negotiations on the TTIP, and negotiations for the EU–Japan EPA, threaten to leave China at a damaging competitive disadvantage. Though trilateral negotiations for an FTA with Japan and Korea were launched in May 2011, the process has been complicated by persisting political disputes with Japan. Nevertheless, a comprehensive trilateral BIT was signed in 2012.<sup>79</sup> As with competitive pressures to pursue FTAs, the pursuit of BITs with China’s main trading partners, where such partners are as yet unwilling to consider the possibility of a fully comprehensive FTA with China, is driven by *legal* competitive externalities. The EU’s recently concluded FTAs with China’s East Asian neighbours, i.e. South Korea and Singapore, carried comprehensive investment chapters providing clarity and legal guarantees for European investors. Likewise, ongoing EU FTA negotiations with Association of South East Asian Nations (ASEAN) members such as Malaysia, Vietnam and Thailand, if concluded, will similarly provide a robust legal framework for European investors through the Minimum Platform on Investment. Competitive externalities thus spur China to pursue BITs with its main trading partners, as a response to legal competitive pressures.<sup>80</sup> China will seek to avoid being at a disadvantage in attracting investment when neighbouring ASEAN members such as Vietnam provide

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<sup>76</sup> *Id.*

<sup>77</sup> Yang 2009, p. 221.

<sup>78</sup> Okano-Heijmans M (Trade diplomacy in EU–Asia relations: Time for a Rethink, Clingendael Report, 2014, p. 26). [http://www.clingendael.nl/sites/default/files/Trade%20Diplomacy%20in%20EU-Asia%20Relations%20-%20Clingendael%20Report%20\(Sept%202014\).pdf](http://www.clingendael.nl/sites/default/files/Trade%20Diplomacy%20in%20EU-Asia%20Relations%20-%20Clingendael%20Report%20(Sept%202014).pdf). Accessed 1 December 2014.

<sup>79</sup> Ministry of Foreign Affairs of Japan (Agreement among the governments of Japan, the republic of Korea, and the Government of the People’s Republic of China for the promotion, facilitation and protection of investment 2012). [http://www.mofa.go.jp/announce/announce/2012/5/pdfs/0513\\_01\\_01.pdf](http://www.mofa.go.jp/announce/announce/2012/5/pdfs/0513_01_01.pdf). Accessed 13 May 13.

<sup>80</sup> Yang 2009, p. 224; Solís and Katada 2009: 4.

comparable trade and investment opportunities for European firms, even if on a smaller scale.<sup>81</sup> Vietnam has sought to use its FTA to fast track the EU's recognition of market-economy status, a prize coveted by China, though such recognition has not been granted to date.

The pursuit of BITs by China carries additional strategic considerations for both the EU and China beyond those arising from external competition. China has transitioned from being an FDI recipient to becoming a substantial outward investor. Against the back-drop of a moribund European economy, the capital reserve volumes of state investment entities such as the Chinese Investment Corporation (CIC) make it increasingly likely that Chinese investment will play a key role in providing capital to Europe. Although China remains cautious on international arbitration, it is reasonable to anticipate that Beijing will increasingly seek to refer to international law to protect Chinese investors' rights in third countries.<sup>82</sup> The Chinese Communist Party (CCP) is understandably wary of allowing increased entry for European firms, many of which enjoy a comparative advantage over Chinese firms in terms of technological standards or brand identification. Increased foreign competition and marketization, particularly in the tradable goods and services sectors, has the potential to undermine China's industrialization process if domestic Chinese firms are ultimately unable to compete with European firms' standards. The trade-off for improved rights and guarantees overseas for China is liberalizing its state-owned sectors to foreign investors and addressing foreign objections to state-subsidization. EU negotiators will inevitably prioritize commercial interests, and seek improved market access concessions through the BIT. However, any concessions China agrees to in the BIT framework carry corresponding accumulated rights and benefits, echoing the PRC's strategic considerations upon ascension to the WTO.<sup>83</sup> The BIT will assist the Chinese Government in preventing arbitrary or discriminatory treatment for Chinese investors in the EU, at a time when Europe presents enormous opportunities for Chinese investors seeking to attain a foothold in the European market through the acquisition of operations in Europe or shareholdings in European firms, many of which continue to struggle beyond the crisis in the euro zone and actually *require* large foreign capital injections to prevent closure and ultimately sustain European jobs and industrial capacities. Improved rights and guarantees for Chinese investors in Europe ought to be a key bargaining tool for EU negotiators, since such guarantees are eagerly sought by the Chinese government and its investment entities, as well as China's business community.

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<sup>81</sup> Vietnam's comparable growth rates and levels of development make the country a key competitor for China in attracting European investment. Negotiations for an EU–Vietnam FTA were launched in June 2012, with the 9th round completed in September 2014. European Commission (EU and Vietnam complete ninth round of FTA talks 2014). <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1157>. Accessed 20 October 2014.

<sup>82</sup> Heymann 2008, p. 507.

<sup>83</sup> Eglin 1997, p. 499.



### 3.3 The EU's goals in the negotiation of a BIT with China

From a European perspective, the BIT has multiple functions. Crucially, the treaty will establish a more robust framework to oversee Chinese investments in the EU. Yet despite the often controversial nature of Chinese OFDI into Europe it is widely recognised that Europe is in fact in dire need of Chinese credit. Chinese investment allows for the 'recapitalisation of struggling companies, the opening up of the Chinese market to European companies and entry into third markets through alliances and joint investments.'<sup>84</sup> In a 2012 speech on EU–China investment then Trade Commissioner De Gucht stated 'investment provides access to capital to finance growth and restructuring. In Europe today, let us be frank: We need the money... China will make between 800 billion and 1.6 trillion Euros worth of new investments abroad between 2010 and 2020. That is a massive opportunity.'<sup>85</sup> The dual goals of facilitating much needed investment from China while guarding strategically sensitive European industries cannot be achieved by member states in a state of mutual competition with one another. Such efforts must be coordinated at the supranational level. As well as facilitating much needed credit from China, the BIT seeks to address barriers to EU OFDI into China. European manufacturers increasingly seek to base their production networks within mainland China, establishing a domestic base to serve China's growing consumer market.<sup>86</sup> Europe is an essential source of FDI for China, and the robust growth of the Chinese economy means that European investments have enjoyed a high rate of return. European companies, much like their US, Japanese and South Korean counterparts, have come to rely on Chinese labour in order to maintain their global cost-competitiveness. From modest levels in the early 1990s, European Community members' investment flows to China quickly surged to account for twice the levels of EU FDI to Central and Eastern Europe and fifteen times EU FDI in India by the early 2000s.<sup>87</sup> Yet China, the world's largest manufacturer, which accounts for 10 % of global GDP, has only 3 % of the world's stock of inward investment and 1.5 % of global outward holdings.<sup>88</sup> The EU currently accounts for 20 % of all FDI into China, behind both the United States and Japan.<sup>89</sup> At €118 billion, this represents just 2 % of total EU OFDI.<sup>90</sup> European companies have consistently complained of barriers to investment in

<sup>84</sup> Escuela Superior de Administración y Dirección de Empresas (Chinese Investment in Europe 2014, p. 29). [http://itemsweb.esade.edu/research/esadegeo/ESADE\\_IN\\_PDF.pdf](http://itemsweb.esade.edu/research/esadegeo/ESADE_IN_PDF.pdf). Accessed 2 July 2014.

<sup>85</sup> European Commission (EU–China Investment: A Partnership of Equals 2012). [http://europa.eu/rapid/press-release\\_SPEECH-12-421\\_en.htm?locale=en](http://europa.eu/rapid/press-release_SPEECH-12-421_en.htm?locale=en). Accessed 2 January 2013.

<sup>86</sup> Casarini N (The Evolution of the EU–China relationship: From Constructive Engagement to Strategic Partnership, European Union Institute for Security Studies Occasional Paper 2006, p. 12). <http://www.iss.europa.eu/uploads/media/occ64.pdf>. Accessed 2 March 2013.

<sup>87</sup> *Id.*

<sup>88</sup> European Commission (EU–China Investment: A Partnership of Equals 2012). [http://europa.eu/rapid/press-release\\_SPEECH-12-421\\_en.htm?locale=en](http://europa.eu/rapid/press-release_SPEECH-12-421_en.htm?locale=en). Accessed 2 January 2013.

<sup>89</sup> Escuela Superior de Administración y Dirección de Empresas (Chinese Investment in Europe 2014, p. 10). [http://itemsweb.esade.edu/research/esadegeo/ESADE\\_IN\\_PDF.pdf](http://itemsweb.esade.edu/research/esadegeo/ESADE_IN_PDF.pdf). Accessed 2 July 2014.

<sup>90</sup> Eurostat (Both inward and outward FDI stocks rose by around 40 % between 2009 and 2012 for the EU 2014). [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-23012014-BP/EN/2-23012014-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23012014-BP/EN/2-23012014-BP-EN.PDF). Accessed 2 February 2014.

China. These include joint venture requirements, equity caps, administrative barriers, local content obligations, inhibiting regulatory requirements, and technology disclosures. It is hoped that treaty-based investment facilitation will help balance China's trade and investment imbalances to both Europe and China's benefit. Increased investment in China enhances EU firms' global competitiveness and further embeds low-cost production networks that provide localized access to China's comparatively buoyant consumer market for European companies. As the EC's International Investment Policy specifies, 'the Union should go where its investors would like to go... markets with significant economic growth or growth prospects present a particular opportunity in the current increasingly competitive environment.'<sup>91</sup> It is in this sense that a BIT with China can be a key policy tool for enhancing the position of European goods exporters and service providers. BITs play a crucial role in attracting foreign investment and in the establishment of distribution networks for exporters by providing a robust legal framework establishing fair market access conditions for foreign investors.

European retailers and service providers seek the removal of barriers to investment which continue to hinder their market access in China. Services make up just 40 % of China's GDP, as compared to an average of 50 % for developing states generally, and 70 % of the EU's GDP.<sup>92</sup> Barriers to investment in the Chinese market have resulted in structural imbalances in bilateral trade, and comparatively lower levels of EU OFDI to China in the services sector, despite the fact that 'more than 65 % of EU (global) outward FDI are invested into the services sectors; and similarly more than 66 % of Chinese outward investment is going to services sectors.'<sup>93</sup> EU-China trade in services, valued at €49.9 billion, is a tenth of the value of bilateral trade in goods.<sup>94</sup> European services firms have looked to the EU's institutions to provide more robust legal protection in China, and sought guarantees to facilitate improved access to China's largely closed services market. The ESF has highlighted this particular need for greater legal protection in the Chinese market. 'The legal environment in which European companies are investing in China is sometimes unclear and should be made more legally secured... Given the importance of investment in establishing services suppliers in new markets, the European services industry is keen to increase the levels and the security of investment between the EU and China... services companies, often more than other

<sup>91</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010, p. 6). [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

<sup>92</sup> EU-China Trade Project (Services 2014). <http://www.euctp.org/index.php/en/services>. Accessed 2 November 2014.

<sup>93</sup> European Services Forum (European Services Industry's views on EU Investment Policy toward China 2011). <http://www.esf.be/new/wp-content/uploads/2011/10/ESF2011-07-Karel-De-Gucht-EU-China-Investment-Agreement-Final.pdf>. Accessed 2 February 2014.

<sup>94</sup> European Commission (Facts and figures on EU-China trade 2014). [http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc\\_144591.pdf](http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc_144591.pdf). Accessed 2 April 2014; Escuela Superior de Administración y Dirección de Empresas (Chinese Investment in Europe 2014, p. 29). [http://itemsweb.esade.edu/research/esadegeo/ESADE\\_IN\\_PDF.pdf](http://itemsweb.esade.edu/research/esadegeo/ESADE_IN_PDF.pdf). Accessed 2 July 2014.

types of exporters, require pre-establishment (of) investment access to be competitive in their target markets.<sup>95</sup>

The EU, like China, is highly sensitive to the prospect of failing to secure equivalent rights and guarantees for European investors as those provided for in BIT/FTAs with China and the EU's key competitors. Any concessions granted to either the EU or US as a result of their respective BITs with China will inevitably be sought by the other in turn. The US's own decision to proceed with negotiations for a BIT with China appears to have been reactive to the decision of the EU to do so. Formal agreement to open negotiations on a BIT between China and the EU was reached in November 2012.<sup>96</sup> Just eight months later, the US announced its intentions to pursue a BIT with China.<sup>97</sup> The EU's copy-cat strategy of matching or exceeding concessions made to the US in its Asia–Pacific FTAs, through parallel negotiation and policy mimicry, proved effective in the EU–Korea FTA (EUKOR) and EU–Singapore (EUSFTA) negotiations.<sup>98</sup> However, the EU has a longer tradition of mimicking US FTAs than it does BITs. The EU's new investment protection powers are in the early stages of their development, which may present unforeseen challenges for EU regulators in terms of matching the investment protection guarantees of key competitors' own BITs with China while maintaining consistency with EU law.<sup>99</sup> The application of the MFN clause will present complications, as the Union will seek to attain parity with other key industrialized competitors in the Chinese market such as the US, Japan or South Korea. With the trilateral China–Japan–Korea (CJK) BIT in force, and the Sino–US BIT still under negotiation, it is far from clear how the EU's own BIT with China can match the standards of, and be made consistent with, these other co-habiting BITs.

On political and social issues, the BIT presents further considerations in terms of whether the agreement will become politicized to serve the EU's trade diplomacy goals on China. The EU has increasingly engaged China on political issues over the past two decades, in tandem with China's growing importance as an economy and trading partner. The Union has developed a highly legalistic system of bilateral agreements for enhanced cooperation with significant trade diplomacy components. The PCA, for example, is particularly distinctive for the use of political-provision-based conditionality, which makes EU economic concessions and cooperation conditional upon PRC political and social commitments. Bilateral trade and investment agreements embody the legalistic way in which 'the EU attempts to link political and economic issues in agreements with third countries... (using) economic leverage to gain political concessions—

<sup>95</sup> European Services Forum (European Services Industry's views on EU Investment Policy toward China 2011). <http://www.esf.be/new/wp-content/uploads/2011/10/ESF2011-07-Karel-De-Gucht-EU-China-Investment-Agreement-Final.pdf>. Accessed 2 February 2014.

<sup>96</sup> European Commission (EU and China begin investment talks 2014). [http://europa.eu/rapid/press-release\\_IP-14-33\\_en.htm](http://europa.eu/rapid/press-release_IP-14-33_en.htm). Accessed 12 April 2014.

<sup>97</sup> US Treasury Department (US and China Breakthrough Announcement on the Bilateral Investment Treaty Negotiations 2013). <http://www.treasury.gov/connect/blog/Pages/U.S.-and-China-Breakthrough-Announcement-.aspx>. Accessed 24 October 2014.

<sup>98</sup> Elsig and Dupont 2012, p. 500.

<sup>99</sup> Eilmansberger 2009, p. 385.

including commitments to human rights and international law'.<sup>100</sup> The question arises as to whether the proposed EU–China BIT will carry the EU's stated commitments on issues such as ILO, the environment, or economic, social and cultural right. What impact of EU BITs on EU member state or third party government powers to regulate on such issues? To this day the EU has yet to develop a truly effective and consistent framework on Corporate Social Responsibility (CSR), either internally or for the activities of European companies operating overseas. The existing CSR regulatory framework is heavily reliant on 'the behaviour of individual consumers, on the vigilance of civil society organisations, and on the specific shape of market institutions, for their effectiveness.'<sup>101</sup> The EU's 2011 International Investment Policy document states that 'investment agreements should be consistent with the other policies of the Union and its Member States, including policies on the protection of the environment, decent work, health and safety at work, consumer protection, cultural diversity, development policy and competition policy.'<sup>102</sup> The 2013 impact assessment report on EU–China investment relations noted that, among societal economic interests queried during the prior scoping exercise for the BIT, 'views on the possible inclusion of social and labour standards into an investment agreement were split overall, (with) several respondents... stating that social and labour issues were outside the scope of an investment agreement and should not be covered.'<sup>103</sup> Such provision are not contained in the existing member state BITs with China.

The treatment of human rights and sustainable development via the PCA and EUCTP at least allows for such issues to be taken as secondary within the framework of stand-alone investment treaties, which arguably should prioritise commercial provisions. Such a decoupling of political and economic strategies would resonate with the preferences of European economic interests which eagerly seek legal certainty in the Chinese market, but fear any impasse on political demands will hamper progress within a framework that might intertwine political and economic demands. In a 2011 letter to then Trade Commissioner De Gucht, the European Services Forum specified that 'non-commercial issues, such as human rights, labour conditions, etc., should not be introduced into the investment protection negotiations. They were not dealt with in the existing member state BITs and should not be part of a possible EU level agreement. These important issues are part of the negotiations of the Partnership and Cooperation Agreement or dealt with in the framework of international conventions like ILO, etc. They should not in any

<sup>100</sup> Okano-Heijmans M (Trade diplomacy in EU–Asia relations: Time for a Rethink, Clingendael Report, 2014, p. 16). [http://www.clingendael.nl/sites/default/files/Trade%20Diplomacy%20in%20EU-Asia%20Relations%20-%20Clingendael%20Report%20\(Sept%202014\).pdf](http://www.clingendael.nl/sites/default/files/Trade%20Diplomacy%20in%20EU-Asia%20Relations%20-%20Clingendael%20Report%20(Sept%202014).pdf). Accessed 1 December 2014.

<sup>101</sup> Schutter 2008, p. 235.

<sup>102</sup> European Commission (Towards a comprehensive European international investment policy, COM2010343 Europa website 2010). [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147884.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147884.pdf). Accessed 2 February 2012.

<sup>103</sup> European Commission (Impact Assessment Report on the EU–China Investment Relations, Commission Staff Working Document, SWD 185 Europa website 2013). [http://ec.europa.eu/smart-regulation/impact/ia\\_carried\\_out/docs/ia\\_2013/swd\\_2013\\_0184\\_en.pdf](http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2013/swd_2013_0184_en.pdf). Accessed 2 June 2013.

case interfere with investment protection.’<sup>104</sup> There is thus a potential tension between the preferences of societal economic interests in the EU and the Union’s stated international commitments on political, social and environmental issues. Such a tension may yet present obstacles to the effective negotiation of a BIT with China.

## 4 Conclusion

Both the EU’s evolving status in international arbitration tribunals and China’s limited utilization of many international arbitration tribunals make it as yet unclear precisely what arbitration terms might be established in the EU–China BIT. The radical differences in both parties’ regulatory regimes and economic models will present substantial challenges in the implementation of FET, MFN and pre-establishment provisions going forward. The eventual arbitration terms of the BIT will depend to a large extent on the agreeable mutual preferences of both parties that can be made consistent with both the EU’s evolving status in international arbitration tribunals and China’s willingness to refer to international law within the treaty itself. It might be reasonable to expect a completely new and innovative approach to BIT development, potentially involving wholly novel negotiating modalities and appeal mechanisms. Such an approach would echo recent advances in the negotiation of EU FTAs. A 2014 European Parliament study on financial services in EU trade agreements noted ‘some innovations have occurred in the negotiating modalities of these agreements, with the adoption of hybrid and mixed approaches to scheduling commitments.’<sup>105</sup> ‘Hybrid’ negotiating modalities denotes the practice of listing committed sectors alongside scheduled commitments for reserved sectors, as was the case for the EU–Singapore and EU–South Korea FTAs.<sup>106</sup> However, on issues such as pre-establishment provisions in the services sector, the most salient cases for comparison may be the EU’s recently concluded FTA with Canada and the ongoing US–China BIT negotiations. The Canadian agreement was also the first EU agreements to include detailed ISDS provisions.<sup>107</sup> In the EU–Canada agreement, pre-establishment national treatment provisions are designated on the basis of a negative list of reserved sectors.<sup>108</sup> The US–China BIT is also evolving to include market-access provisions, and is an obvious benchmark for the EU to gauge China’s expected position in its negotiations with the Union.

<sup>104</sup> European Services Forum (European Services Industry’s views on EU Investment Policy toward China 2011). <http://www.esf.be/new/wp-content/uploads/2011/10/ESF2011-07-Karel-De-Gucht-EU-China-Investment-Agreement-Final.pdf>. Accessed 2 February 2014.

<sup>105</sup> European Parliament Directorate-General for Internal Policies (Financial Services in EU Trade Agreements 2014, p. 8). [http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL\\_STU\(2014\)536300\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL_STU(2014)536300_EN.pdf). Accessed 3 December 2014.

<sup>106</sup> *Id.* p. 21.

<sup>107</sup> European Parliament Directorate-General for External Policies (Negotiations on the EU–Canada Comprehensive Economic and Trade Agreement concluded, Policy Paper 2014, p. 9). [http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO\\_IDA\(2014\)536410\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/536410/EXPO_IDA(2014)536410_EN.pdf). Accessed 14 November 2014.

<sup>108</sup> *Id.*

China has also accepted the negative list approach in its BIT with the US with negotiations for the negative list scheduled for early 2015.<sup>109</sup> European allowances will have to be made in light of China's level of development and the particular features of its economic model. Substantive rights on national treatment for foreign investors present in China, in particular, will prove difficult to uphold in what remains a broadly state-led economy. The potential for discord on BIT guarantees on substantive rights is in fact greatest when the treaty parties' domestic legal frameworks differ substantially in terms of the guarantees afforded to foreign investors. In this sense, negotiating the EU's first BIT with China is the negotiators' equivalent of learning at the deep end. That said, significantly improving the rights accorded to foreign investors where significant tensions exist is a valuable endeavour, and will provide balanced benefits to EU and Chinese investors in the other's market.

EU negotiators, by invoking WTO standards, indirectly refer to the obligation to allow greater flexibility by virtue of China's status as a developing state. Such flexibility can be leveraged in return for market-access provision and improved terms for European firms in the Chinese market. China, as a developing state, opposes making trade negotiation outcomes conditional upon labour or environmental standards, which can be used as cloaks for protectionism.<sup>110</sup> EU negotiators for the BIT will need to make allowances by negotiating special annexes in areas such as monopoly rights or national treatment, as it did during China's WTO ascension process.<sup>111</sup> Also, limitations on national treatment can be scheduled, allowing China sufficient time to meet its obligations under the BIT over time. Similar scheduled limitations would be consistent with GATS framework.<sup>112</sup> The EU can also utilize the BIT framework to continue to play an active role in assisting China in implementing effective reforms for the advancement of a more WTO-compliant regulatory regime, as it did during China's WTO ascension process.<sup>113</sup> This process can be complemented in parallel by the EUCTP and PCA frameworks, combining investment provisions with developmental assistance programmes. The BIT also does not ultimately prevent the unilateral withdrawal of Chinese or European concessions in the event of a dispute, alleviating mutual concerns and lending support to the arguments in favour of eventual implementation. Where tensions arise, at the very least the BIT can provide mechanisms to cater to PRC concerns regarding greater marketization and its industrialization and development goals, while addressing European concerns about technology disclosures. EU concerns about technology disclosures will have to be tempered by the obvious

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<sup>109</sup> US Department of the Treasury (US and China Breakthrough Announcement on the Bilateral Investment Treaty Negotiations 2013). <http://www.treasury.gov/connect/blog/Pages/U.S.-and-China-Breakthrough-Announcement-.aspx>. Accessed 2 March 2014; PRC State Council (Vice-Premier: Substantial progress on China-US trade issues 2014). [http://english.gov.cn/state\\_council/vice\\_premiers/2014/08/23/content\\_281474983038636.htm](http://english.gov.cn/state_council/vice_premiers/2014/08/23/content_281474983038636.htm). Accessed 7 November 2014.

<sup>110</sup> Lardy 2002, p. 156, cited in Yang 2009, p. 224.

<sup>111</sup> Eglin 1997, p. 500.

<sup>112</sup> WTO (Misunderstandings and scare stories: The GATS and investment 2015). [http://www.wto.org/english/tratop\\_e/serv\\_e/gats\\_factfiction5\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/gats_factfiction5_e.htm). Accessed 4 January 2015.

<sup>113</sup> Eglin 1997, p. 499.

benefits of Chinese investment, and recognition that Chinese investors are entitled to fair and equitable treatment in the event of making large-scale investments in Europe. The WTO framework stipulates that ‘the GATS allows Governments to impose on foreign service providers any conditions they wish, including those pertaining to local employment or technology transfer.’<sup>114</sup> Denying Chinese investors equitable treatment ultimately dilutes EU pleas for China to meet its WTO commitments on other issues such as IPR, fair market-access and state-subsidization.

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<sup>114</sup> WTO (Misunderstandings and scare stories): The GATS and investment 2015. [http://www.wto.org/english/tratop\\_e/serv\\_e/gats\\_factfiction5\\_3.htm](http://www.wto.org/english/tratop_e/serv_e/gats_factfiction5_3.htm). Accessed 4 January 15.