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Investor Rights Protection Standards under the China-Russia BIT

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Abstract: ***This article examines the level of investor protection foreseen by the China-Russia BIT. Article examines investor rights protection standards foreseen under the treaty, namely national treatment, most-favored-nation (MFN) treatment, fair and equitable treatment (FET), expropriation and compensation and investor-state dispute settlement (ISDS).***

Keywords: bilateral investment treaty, BIT, investment, China, Russia

Over the past two decades of the 21st century, China and Russia have increased the level of commodity turnover by over 13 times, from 8 billion in 2000 to $111 billion in 2020. [1] Since 2010, China has been securing the position as Russia's largest trading partner. In the past two decades, the countries have significantly diversified the structure of mutual trading. At the same time, the investment cooperation between two countries has not been equally successful. From 2003 to 2018, the investment inflow from China to Russia has doubled from $0.31 billion to $0.72 billion correspondingly. [2] Even though the Russian share in the Chinese total outbound investments remains quite small compared to other countries targeted by Chinese investors. In 2018, it reached 0.6 percent from the overall ($143 billion). [3]

Nevertheless, the investment cooperation between the states demonstrates a high potential due to the compatible nature of their economies.[4] An intensified economic cooperation corresponds to the states' local agendas. It is mentioned as one of the methods to reinforce the economic development of China-Russia borderline regions (Far East region in Russian and Heilongjiang province in China). [5] In 2019, along with the national development strategy Russia introduced the Far East Development Strategy which states the particular importance of the cross-border projects with the foreign countries close to the region, including China. [6] China has also reflected the importance of the cross-border economic cooperation between Heilongjiang province and Russia in its 14th Five-Year-Plan. [7] Cooperationwith Russia has been mentioned in Section 2 of Article XXXII of the Plan that is devoted to the promotion of the revitalization of the northeast.

One way to improve an investment flow is to ensure a better protection of investments. Russia and China established key principles of the investment promotion and protection under *the Agreement Between the Government of the People's Republic of China and the Government of the Russian Federation on the Promotion and Mutual Protection of Investment* (China-Russia BIT) concluded back in 2006. [8]

In regard to the relevance of BITs for development of investment cooperation, Ibrahim Shihata proposes that, overall, signing and development of the treaties is one of the ways to intensify investment cooperation.[9] Arjan Lejour and Maria Salfi find that "*ratified BITs increase on average bilateral FDI stocks by 35% compared to those of country pairs without a treaty*" (2015, 2).[10] Josef Brada, Zdenek Drabek, and Ichiro Iwasaki, however, disagree with this position stating that "*multilateral investment treaties, bilateral trade agreements and multilateral trade agreements have an effect on FDI that is so small as to be considered as negligible or zero*" (2021,58). [11] Nevertheless, scholars mention that negative results could be caused by inaccuracy of scholars' findings as well as general practice of countries to conclude basic investment treaties that fail to address specific matters under the investment protection regime. Therefore, the development of the China-Russia BIT may be considered the way to intensify investment cooperation between the states.

Considering the aforementioned, it is relevant to understand the gaps in the investor protection regime as foreseen by the current treaty between China and Russia.

The doctrine has no extensive analysis for the investor rights protection standards under the China-Russia BIT. One of the most extensive review of the standards under the treaty was proposed by Insur Farthutdinov, who points out that treaty foresees such standards as (i) national treatment, (ii) most-favored nation (MFN) treatment, (iii) fair and equitable treatment (FET), (iv) compensation in case of expropriation and (v) investor-state dispute settlement (ISDS). Nevertheless, analysis of the scholar lacks review of the practical implications of the standards as they are incorporated under the China-Russia BIT. [12] Overall, scholars tend to focus on the general review of the standards in international practice. Therefore, analysis of deficiencies of the investors' rights protection standards under the China-Russia BIT require the initial review of the scholars' interpretation with respect to the different types of regulation of the standards in international practice.

National treatment is described in doctrine as a contractual standard implying a hosting state's obligation to treat foreign investors in at least as well, or not less favorable manner than its own investors. [13] Under discussion of national treatment scholars point out that it is a contractual standard that generally varies in the BITs based on (i) the investment stage covered, (ii) exceptions and (iii) comparator test. [14]

Ignacio Gomez-Palacio and Peter Muchlinski distinguish two types of national treatment models based on the investment stages covered, namely a 'controlled entry' model limited to post-entry (post-establishment) stage and a

'full liberalization' model that extends national treatment to the pre-entry (pre-establishment) stage of investments. [15] Scholars also name these models as 'post-entry national treatment' and 'pre-entry national treatment'. [16] It is suggested that the post-entry model more beneficial for the states as it ensures unlimited states' control over the entry of investments and allows them to apply admission and screening procedures and refuse on entry of investments. [17] The pre-entry model is treated by scholars as more beneficial for investors as it ensures better access to markets, resources and opportunities allowing for investment decisions to be made on purely economic grounds. [18]

Exceptions under the national treatment are generally categorized into two types: general and country-specific exceptions. [19] Peter Muchlinski describes the first type of exceptions as based on public health, national security or morals, while Don Wallace and David B. Bailey define them as exceptions based on national security, culture and public order. [20] The second group of exceptions includes 'subject-specific exceptions' under certain fields based on reciprocity treatment requirements from an investor's state (taxation or intellectual property) or public procurement and 'industry-specific exceptions' which exclude or limit investors' participation in certain types of industries. [21] This type of exception is incorporated under the treaties as a certain list of industries and activities and, therefore, is also referred to by other scholars as 'negative list' exceptions. [22] According to Don Wallace and David B. Bailey, incorporation of the industry-specific exceptions along with general exceptions ensures the greatest possible transparency with respect to the application of the national treatment. [23]

UNCTAD experts mentioned that comparator clauses under the national treatment include reference to the 'same' ('identical') circumstances and 'like' ('similar') circumstances. [24] Experts state that incorporation under the national treatment clauses with reference to 'same' ('identical') circumstances in practice results in narrowed scope of the standard as the occurrence of an identical situation may be hard to prove. [25] With respect to the clauses referring to 'like' ('similar') circumstances, UNCTAD experts conclude that such references provide better protection to investors in case of a dispute. [26] UNCTAD experts also mention that a significant number of investment agreements provide no comparator clauses. Such national treatment clauses according to UNCTAD experts "*offer the widest scope for comparison as, in principle, any matter that is relevant to determining whether the foreign investor is being given national treatment can be considered*" (1999, 34). [27]

Another investor rights protection standard, MFN treatment, defined by the scholars as contractual standard ensuring not less favorable scope of rights for foreign investorscompared to investors of other nationalities. [28] UNCTAD experts define that major differences between the MFN treatment clauses lie in (i) the subject-matter, (ii) investment stage, and (iii) exceptions applicable. [29]

Pia Acconci and UNCTAD experts mention that subject-matter MFN treatment clauses under treaties may either refer to both 'investors' and their 'investments' or to one of them. [30] EdoardoStoppioni points out that in cases when MFN treatment clauses refer only to 'investments' some tribunals narrow the scope of MFN treatment as not applicable to dispute settlement mechanisms. [31] While UNCTAD experts confirm that reference of the MFN clauses solely to 'investors' could result in limitation of the standard application with respect to the beneficiaries of investment. [32]

As for the investment stages, similarly to national treatment, scholars distinguish 'post-establishment' and 'pre-establishment' models of MFN treatment. [33] UNCTAD experts point out that negative implications of the 'post-establishment' model include no protection of foreign investors under MFN treatment against potential discrimination during the incorporation of legal entities or in the process of establishment of other form of investment in the recipient state. [34]

Under discussion of exceptions to the MFN treatment, UNCTAD experts distinguish two types: 'systematic' and 'country-specific' exceptions. [35] The first type of exceptions, according to the scholars, exclude application of the MFT treatment to the free trade agreements, customs unions or economic integration organization agreements, while the second type exclude application to certain economic sectors or non-conforming measures. [36] Pia Acconci also distinguishes 'general exceptions' that concern public policy matters (public order, health and national security). [37] As it is mentioned by UNCTAD experts, the scope of exceptions generally depends on the model of the MFN treatment clause. [38] The BITs with the pre-establishment model of MFN treatment tend to incorporate country-specific exceptions. This approach could be evidenced in most of the US and Canada 's BITs which incorporate the lists of economic sectors excluded from the application of the MFN treatment standard in separate annexes to the treaties. Overall, treaties with such lists of the excluded industries and regulations found by scholars as ensuring more regulation transparency and consequently treated by scholars as more beneficial for investors.

FET standard is described by the scholars as a contractual standard implying the state's obligation to treat foreign investors fairly and equitably regardless of the treatment the state grants to its own investors and investors of third states. [39] Scholars mention that FET is a non-contingent standard, and it does not depend on the level of protection provided by the state to its own investors and investors of third states. [40] As noted by the OECD and UNCTAD experts together with numerous scholars, despite considerable history and arbitration practice, the content of the FET standard remains to be under discussion in international law. [41] Overall, UNCTAD experts categorize FET clauses into the four following types: (a) unqualified (general) FET without any reference to international law or any further criteria; (b) FET linked to international law; (c) FET linked to the customary minimum standard of treatment (MST); (d) FET with additional substantive content. [42]

Major discussion with respect to this standard in the doctrine is related to the correlation of the FET to the international customary minimum standard of treatment (MST). Later one

is defined by the scholars as a general concept intended to encompass international law doctrine of denial of justice and state responsibility for injuries to aliens. [43] Some scholars propose that initial incorporation of the FET clauses in the BITs could be explained by the historical political sensitivities with respect to the MST. [44] Based on this interpretation of the FET clauses origin, scholars define the FET standard as tantamount to the MST. [45] Rudolf Dolzer and Christoph Schreuer, however, disagree with this interpretation stating that "*it seems implausible that a treaty would refer to a well-known concept like the 'minimum standard of treatment in customary international law' by using the expression 'fair and equitable treatment*'" (2012, 124). [46] Stephen Vasciannie also stands on this position, arguing that contracting states were unlikely to accept the idea that MST is fully reflected in the FET without clear discussion considering that MST has itself been an issue of controversy between developed and developing states for a considerable period. [47] This reasoning is resulted in a different approach where the FET standard is defined as an autonomous standard that provides additional extended level of protection comparing to the MST . [48] Both interpretation approaches have been recognized in the tribunal practice and the choice of a tribunal depends on the FET clause wording . [49] Patrick Dumberry , Andrew Newcombe and LluísParadell point out that tribunals are more likely to interpret the FET as tantamount to the MST in cases where the BITs foresee the FET clauses referring to the MST or international law, while in other cases where the BITs incorporate unqualified FET clause the FET tribunals are more flexible in interpretation and tend to interpret the FET as an independent standard. [50] At the same time, UNCTAD experts claim that this correlation between the FET clause wording and the FET interpretation is not well established. [51]

As for the practical implications of these two approaches, UNCTAD experts and Patrick Dumberry mention that interpretation of FET as an MST equivalent generally results in a stricter approach of the arbitral tribunals with respect to the liability threshold, where mere illegality of the state actions at domestic level is insufficient to establish a breach of the standard. [52] Nevertheless, according to these scholars it is difficult to establish the exact difference in violation threshold between these two standards. Scholars also find little effect of certain interpretation approaches on the FET content.

Under the discussion of another standard, compensation in case of expropriation, one of the major discussions between scholars related to the indirect (creeping) expropriation and legality requirements of expropriation. Overall, scholars agree that indirect expropriation is a series of government measures or a single act depriving investors from the access to the property or its benefits despite remaining title to the property. [53] Federico Ortino raises the question of the magnitude of deprivation that should be settled by the measures to constitute an indirect expropriation. [54] The scholar points out that indefinite wording of expropriation clauses in the BITs causes controversial arbitral practice, when some tribunals require host state measures that totally deprive investor's access to investments, while other tribunals recognize indirect expropriation and implement less demanding requirement of substantial deprivation. [55] At the same time, scholar mentions that it is difficult to determine any specific threshold for substantial deprivation as it is determined on the case-by-case basis. [56]

As for legality requirement of expropriation, the 2012 UNCTAD study outlines four key requirements of lawful expropriation, including (i) public purpose, (ii) non-discriminatory manner, (iii) execution in accordance with the due process of law and (iv) payment of compensation. [57] Public purpose, according to UNCTAD experts and MuthucumaraswamySornarajah, entails that a host state can implement expropriation only in pursuance of a legitimate welfare objective. [58] August Reinisch refers to public purpose and non-discriminatory manner requirements of the expropriation as standard elements foreseen by the customary international law. [59] The specific content of the requirement that expropriation should be done in non-discriminatory manner remains unclear. The third requirement of due process, according to UNCTAD experts, entails that exportation shall conform with the procedures established in domestic laws and regulations and fundamental internationally recognized rules and entails investor's right to an independent review of the case. [60] Requirement of compensation payment is found in the doctrine as the most controversial. As stated by August Reinisch and Nikièma Suzy, a major share of the modern BITs implements a so-called 'Hull formula' that requires compensation to be prompt, adequate and effective. [61] August Reinisch defines the promptness as payment within a reasonable period accompanied by payment of the interest for the period of delay. [62] As mentioned by UNCTAD experts, some treaties foresee a specific period for payment of the compensation. [63] Andrey Danelyan points out that the provisions may differently regulate the moment from which the period commences, namely some BITs foresee that period should be calculated from the date when compensation amount is established, while others stipulate that it shall be counted from the date of actual expropriation. [64] As for the effectiveness of compensation, according to August Reinisch and UNCTAD experts, this requirement basically means that the compensation shall be paid in freely convertible or freely usable currency. [65]

Investor-state dispute settlement (ISDS) regulation in the BITs cover three major points: the scope of the disputes, resolution forums and coordination between them. [66] According to UNCTAD experts, some BITs refer to 'all disputes' or 'any dispute'. [67]August Reinisch, Yetty KomalasariDewi, Arie Afriansyah, AkhmadBayhaqi and Howard Mann refer to such clauses as ensuring better protection of investors as they may also cover disputes based on the state's breach of investment contract with investor, customary international law and possibly even domestic legislation. [68] At the same time, as mentioned by UNCTAD experts, most of the BITs narrow the scope of the disputes covered by the resolution mechanism by reference to the treaty-based disputes or disputes arising out of specific treaty clauses or even by excluding disputes related to the certain industries from the application of the resolution mechanism of the treaty. [69] According to UNCTAD experts, treaties may also include additional conditions for investor's right to refer to dispute resolution

methods provided under the treaty, as well as limit the time for submission of disputes for resolution. [70]

August Reinisch confirms that ISDS clauses typically provide a graduated procedure according to which the parties proceed from voluntary negotiations to binding domestic remedies or arbitration. [71] UNCTAD experts mention that the principal differences between provisions constitute their attitude towards the nature of the negotiation process and the claimant's choice between the domestic remedies and arbitration. [72] Some BITs, according to UNCTAD, foresee a so-called waiting period which shall elapse before the parties can proceed to formal resolution in court or arbitration, while other BITs incorporate the requirement that disputing parties shall commit a genuine attempt to resolve the dispute through negotiations. [73] Nevertheless, as pointed out by UNCTAD, such clauses generally do not provide what constitutes negotiations. [74] As mentioned by Claudia Ludwig, arbitrations tend to interpret such provisions as only requiring an investor to bring the claims giving both parties a chance to discuss the matter, nevertheless the vague wording could be the basis for the states to argue the acceptance of the case by arbitration and consecutively cause extension of the arbitration procedures. [75]

As for types of forums, UNCTAD experts point out that the vast majority of the BITs provide investor access to domestic courts and international arbitration. [76] According to UNCTAD study, the two most frequently provided options of arbitration under the BITs are arbitration under the International Centre for Settlement of Investment Disputes (ICSID) and United Nations Commission on International Trade Law (UNCITRAL) rules. [77] Gabrielle Kaufmann-Kohler and Michele Potestà argue that customary international law requires foreign investors to exhaust all domestic remedies before their claim becomes admissible at the international arbitration. [78] As specified by UNCTAD analysis, most of the modern BITs, however, waive this requirement and permit investor direct recourse to arbitration forums. [79] Moreover, as pointed out by scholars, tribunals tend to regard the waiver under the treaty unless it explicitly provides otherwise. [80] Under this perspective, as mentioned by UNCTAD, some BITs have developed two key approaches in order to avoid the double proceedings and claims, and ultimately contradictory decisions by incorporation of the “fork-in-the-road” and “no-U-turn” clauses. [81] Gabrielle Kaufmann-Kohler and Michele Potestà explain that under the “fork-in-the-road” clauses investors are obliged to choose between the domestic courts and arbitration before proceeding with the dispute, while under another “no-U-turn” clauses investorsretain the right to opt for settlement of dispute in arbitration before the dispute is resolved under the domestic court proceedings. [82]

Moving on to the specifics of the investor rights protection standards under the China-Russia BIT, as was mentioned before this treaty foresees all aforementioned standards.

National treatment is prescribed by Article 3(2) of the treaty and extends only to the post-entry stage of investments, which results in minimum certainty of investors in success of pursuing statemarkets. At the same time, the treaty does not foresee the likeness test, therefore providing tribunals the room for application of less demanding ‘similar circumstances’ formula. The China-Russia BIT also incorporates general exceptions to application of national treatment that refers to domestic laws and regulations of the contracting parties, which provide investors with less clarity over the differential regulation that they could be subject to.

MFN treatment standard is incorporated under Article 3(3) and 3(4) of the China-Russia BIT and refers only to investments, therefore leaving risks of tribunals interpretation of the MFN treatment under the treaty as not applicable to dispute settlement mechanisms. Similar to national treatment and MFN treatment, the China-Russia BIT covers only post-establishment phase of investment that entails no protection for investors against differentiation in treatment compared to other foreign investors on the stage of entry to the market. Moreover, the treaty provides only general exceptions that reserve application of MFN treatment with respect to more beneficial treatment provided under economic integration agreements and taxation treaties. Current China-Russia BIT also incorporates unqualified FET standard under Article 3. As was mentioned before, this model of the FET clause leaves the tribunals with unlimited authority to interpret the standard, which may result in unfavorable interpretation of the FET as a tantamount to MST and application of the higher violation threshold.

As for expropriation and compensation standard, it is foreseen under Article 4 of the China-Russia BIT and covers both direct and indirect expropriation. The treaty, however, uses general reference to indirect expropriation and does not provide the factors that shall be considered in determining the indirect expropriation, which leaves room for arbitration interpretation.

Expropriation legality requirements under the treaty include all four generally applied elements: public interest, due process, non-discriminatory manner and payment of compensation. China-Russia BIT defines the due process requirement as an obligation of the states to execute expropriation in conformance with regulations foreseen by the domestic legislation of contracting parties. Nevertheless, at date, the Russian legislation provides no specific regulation of expropriation procedure. Introduced in 1993, the *Constitution of the Russian Federation* (Russian Constitution) in Article 35 establishes that the state should pay full compensation prior to expropriation. [83] Russian Civil Code, Russian Foreign Investment Law and the RSFSR Investment Law (remains in effect insofar as they do not contravene the provisions of the Russian Foreign Investment Law), follow requirements introduced by the Russian Constitution, but do not establish specific universal requirements to the procedure. [84] Numerous attempts of the State Duma in Russia to pass a new law providing regulation of expropriation have never succeeded. Russian scholars continue to appeal for the introduction of the national law that would establish regulations of the expropriation process, as presently expropriation is executed based on “ad hoc” decision of state officials, which leads to uncertainty with respect to the due process requirement provided by the treaty. [85] Nevertheless, at date, it is hard

to assume when the Russian legislation will incorporate such regulations.

The compensation under the China-Russia BIT follows the Hull formula of prompt, adequate and effective compensation. The China-Russia BIT clarifies each of the requirements requiring that compensation should be paid without delay according to the market value of investments on the date immediately before the expropriation is taken or the impending expropriation becomes public knowledge, whichever is earlier, and in any freely convertible currency. The treaty also secures prompt requirement by payment of the interest from the day when expropriation is taken. On the national level, the aforementioned Article 35 of the Russian Constitution also establishes that the state should pay full compensation prior to expropriation. Therefore, based on comparison with the international practice of compensation payment regulation, it could be concluded that overall, the China-Russia BIT follows one of the best practices in this respect.

ISDS regulated under the current China-Russia BIT in Article 9 refers to any dispute related to an investment and ensures investors' right to seek for domestic remedies or arbitration even when the alleged infringement by the state is not arising out of the treaty. At the same time, as a prerequisite for investors to file disputes to the domestic court or arbitration center, the treaty foresees a 6-month negotiation process and indicates that this period shall be calculated from the moment when investor has given a request to the state for such negotiations. Therefore, the treaty minimizes the risk of arbitral interpretation of the negotiation period as not expired. Nevertheless, the ISDS clause does not provide much description with respect to the substance of the request remaining the risk of arbitration to consider a request as insufficient, in cases where there are no following substantial negotiations.

Investors under the treaty are provided with options of such forums as domestic courts, ad hoc arbitration under UNCITRAL rules and ICSID arbitration and does not foresee a requirement for investors to exhaust domestic remedies providing investors with the right to resort to international arbitration before obtaining a final decision in domestic courts. At the same time, China-Russia BIT foresees a “fork-in-the-road” condition, which deprives investorsof the ability to file disputes to the arbitration if they proceed with settlement in domestic courts. Considering general uncertainty of investors with respect to impartiality of domestic courts in case of disputes with the states, such limitation generally pushes investors to give up on more cost-effective options to settle the dispute within the state.

Based on the aforementioned, it could be concluded that there is potential for the development of an investor protection regime under all of the investor rights protection standards foreseen by the China-Russia BIT. As for the major deficiencies, national treatment and MFN treatment cover only post-entry stage, which results in more uncertainty from the point of view of investors with respect to the admission of investments and guarantees of equal entry compared to other foreign investors. Moreover, general exceptions foreseen for these standards increase uncertainty of investors with respect to the application of these standards on the post entry stage. Unqualified (general) FET clause under the treaty leaving the risks for investors to have burden of proof of violation of the standard by the state according to increased violation threshold, which remain to be uncharted under the tribunal practice. Treaty also remains an uncovered question of required level of investor deprivation under the indirect expropriation, which may result in adverse interpretation by tribunals. As for the ISDS regulation, a major negative factor from investors perspective has a “fork-in-the-road” condition, which limits the right of investors to try to use more cost-effective domestic settlement procedures.

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