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The Structural Implications of Belt-and-Road Arbitration: China's Legal Gamble across Eurasia

Horia Ciurtin · Monday, March 19th, 2018

The Belt-and-Road Initiative ("**BRI**") is a grand vision about connectivity, infrastructure, trade and unimpeded foreign direct investment ("**FDI**") flows. It is a path to China's largest export market – the European Union – which does not only propose to 'transit' Eurasia (and coastal East Africa), but to radically transform it. And, thus, mere construction and outpours of capital do not suffice for such an ambitious project. The scale and depth of the BRI require a substantial 'investment' in establishing a common normative nexus. For connectivity to actually exist as a functional feature of the project, it must also – on the long-term – take the shape of legal harmonization.

However, in this initial phase of the BRI, more modest objectives need to be achieved. And China has taken small – but firm steps – in this direction. Thus, while previously considered a problematic jurisdiction for arbitrating commercial disputes (and a difficult Respondent in investment litigation), China's status has significantly improved in the last few years. As it envisions itself to rather be the source of investors and contractors along the Belt-and-Road (and not a destination for FDI), Beijing is seeking legal mechanisms to ensure the protection of Chinese companies' interests abroad.

For this reason, China is well set on the course of strengthening CIETAC and also offering it – for the first time – a clear set of rules that will deal with investor-state disputes. However, if ADR as a whole is considered, it must be noted that China still favors mediation (usually state-to-state driven) as a manner of solving disputes, seeing arbitration as a measure of last resort. Nonetheless, it got involved in ensuring that this legal *ultima ratio* is circumscribed within a discernable pattern which is not so different from similar measures proposed by Western states. It might be a form of globalization with Chinese characteristics – as Beijing likes to portray it – but it does not diverge too much from the beaten track regarding international arbitration.

Returning to the BRI's intrinsic (and *necessary*) relationship with arbitration, it must be ascertained that it is the only viable way to ensure a stable and predictable framework for solving disputes over such a large area, with dozens of different jurisdictions, legal cultures and diverging geoeconomic interests. Most of the states that will become part of the BRI are not consolidated democracies, lacking independent judiciaries and national courts that uphold the rule of law. And that might be a problem for Chinese investors which will – inevitably – face the risk of (creeping) expropriation or breaches of the FPS and FET standards. And thus, although arbitration might not be the preferred solution for China, it is the best answer to such systemic risks.

On the other hand, for companies along the Belt-and-Road that trade, construct and invest in the opposite direction, targeting the Chinese mainland as a destination for their goods and FDI, arbitration *against* China (and within China) still remains problematic. Especially on the enforcement side. The judiciary is sometimes less than collaborative and – although it might permit enforcement on a regular basis – it strongly takes into consideration matters of public policy and personal ties to the Party members involved. Most large Chinese private entities are linked with the Party *nomenklatura* one way or another, representing a matter that BRI investors need to carefully take into account.

In this sense, China might seek to improve some procedural aspects of arbitration within its territory, but it will stick to its 'systemic' approach of favoring state-owned entities and Party-linked companies, even by making enforcement against them extremely difficult. On the short term, it is unlikely that significant improvements will take place where there are high stakes involved. Especially if they are in any way linked to the political scene. However, what can be expected is a more predictable framework and improved procedures in the statutes. How they will work in practice, it is difficult to tell.

Thus, even the recent enactment of the CIETAC 'investment arbitration rules' seems to be – at this stage – more an exercise in wishful thinking and PR for the BRI. Its practical effects upon existing BITs from the third generation that offer ICSID rules or UNCITRAL rules as possibilities. But such new rules might – nonetheless – impact the manner in which the Belt-and-Road contracts and treaties will be further modelled. If 'legal traditions' and 'customs' are taken into consideration when developing the arbitration framework, that will give a high margin of appreciation to the arbitrators that will be called to rule upon those disputes. Of course, if China has sufficient leverage on one country, it can renegotiate the existing BIT and introduce a mandatory reference to its new rules, but it is unlikely that many states will switch ICSID or UNCITRAL rules for CIETAC. Or choose an arbitral seat anywhere in Chinese mainland territory.

And that is why the Belt-and-Road is dependent upon a 'string' of regional arbitral venues that fulfil all the impartiality and quality requirements for every party involved. More precisely, in East and Southeast Asia, Hong Kong proves to be an excellent choice for the seat's jurisdiction when arbitrating with Chinese entities. Its legal system comes from a long Anglo-Saxon tradition of upholding the rule of law and an independent judiciary. The quality of the arbitral institutions is extremely high (see the HKIAC, ICC-HK), as well as of local arbitrators. The enforcement is quite swift (compared to mainland China) and it is within the bounds of what a Western-based investor would expect. In addition, for this region, the Singapore International Arbitration Centre is also a good choice, benefitting from the same qualities as Hong Kong and – even more – a total disconnection with Chinese authorities.

On the other hand, in Central Asia, the Middle East, the Balkans or Eastern Europe, the offer is quite scarce. The projected arbitral venue in Astana is still just in blueprint phase, while Moscow and Teheran do not have a consistent track record in large commercial arbitration (and no experience in investment disputes). That could, perhaps, leave Istanbul on-route and – for the BRI end-point – one could consider the Vienna International Arbitral Centre. Otherwise, almost all other parties will consider using Hong Kong, Singapore or a traditional Western-based institution.

For these reasons, China must seriously invest in developing a network of sister-institutions along the entire BRI, each having a regional focus. Unitary rules could be adopted, drafted along the UNCITRAL ones, but with additional provisions that allow the BRI specifics to emerge. CIETAC

ones might work just fine for Chinese companies that wish to settle a dispute against foreign entities or sovereigns, but they could prove insufficient and inadequate for a litigation going the other way round. And that is where such regional centers – 'decoupled' from China's state apparatus – need to emerge. As a measure to build confidence and to symbolically reveal all other parties that Beijing is accepting to be bound by clear and transparent rules, well beyond its jurisdiction.

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