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Deal or No Deal: The Fate of the EU-China Comprehensive Agreement on Investment and its Potential Impact on Future Investment Claims

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The EU-China Comprehensive Agreement on Investment (***CAI***), agreed in principle in December 2020, was announced with great fanfare. Forged after seven years of negotiations between the world's current largest trading block (the EU) and the country expected to have the world's largest economy by the end of this decade (China), the CAI was set to have a far-reaching impact on the global economy, including investment arbitration.

The recent tensions in the EU-China political relationship have, however, cast a shadow on the future of the CAI. At the moment, the ratification of the CAI is suspended in accordance with a decision rendered by the European Parliament in May 2021. It remains to be seen whether the deal can overcome current hurdles on the road to ratification.

Given such uncertainty, this article explores what either the passage or failure of the CAI entails for the world of investment arbitration by examining: (i) the status quo; (ii) the relevant provisions of the CAI; (iii) the CAI's prospects of success; and (iv) the outlook for future European-Chinese ISDS claims.

Where Do Things Stand?

Currently, there are 25 bilateral investment treaties (BITs) in force between China and all EU Member States, except Ireland. These BITs serve as a patchwork, offering some – but not consistent – investor protection. The older generation of BITs generally provide for investor?State arbitration only regarding certain claims, including for instance "a dispute involving the amount of compensation resulting from expropriation" (ie. Article 8(3) of the China-Denmark BIT). Conversely, the second-generation BITs expressly grant investors the right to bring arbitration claims for an enlarged suite of investment protections, including, most importantly, the violation of the fair and equitable treatment (FET) standard.

Despite the large-scale foreign direct investment that has flowed in both directions, these arbitration provisions have found little application to date. At the moment, there is only one known investment arbitration claim brought by an EU company against China, *Hela Schwarz v China*,

which remains pending. Similarly, Chinese investors have initiated only three arbitrations against EU Member States, none of which has proceeded to an award on the merits: *Ping An v Belgium* was brought by a Chinese insurance company in 2012, but dismissed on jurisdictional grounds in 2015; *Wuxi T Hertz Technologies and Jetion Solar v Greece* was brought by Chinese solar investors in 2019, but subsequently withdrawn; and most recently, a bank registered in Hong Kong brought a claim against Malta in *Alpene v Malta* in July 2021.

Chinese companies have, however, shown markedly increased interest in ISDS in recent years. One of the more high-profile examples is Huawei, which, in 2019, threatened claims against the Czech Republic regarding assertions by a Czech government agency that Huawei's technology posed a security threat. Moreover, in January 2021, Huawei submitted a Notice of Dispute to Sweden, asserting that the government's decision banning the company from participating in the country's 5G network violated the applicable BIT. Chinese investors' recent willingness to resort to ISDS can be seen even more clearly outside the EU, with recent headlines reporting claims against Ukraine and several African states.

What Does the CAI Say about Investment Protection?

From an EU investor perspective, the most progressive development in the CAI is the state parties' clear commitment to national treatment (Section II, Article 4), where each state party shall accord to investors of the other state party "*treatment no less favourable than the treatment it accords, in like situations, to its own investors and to their enterprises, with respect to establishment and operation in its territory*".

Nevertheless, other key investment protection mechanisms, such as an FET standard and an ISDS provision, are currently missing. Instead, the CAI contains essentially a placeholder – Section VI(2), Article 3 – that stipulates that parties will continue their negotiations on "*state of the art provisions*" in the fields of investment protection and ISDS, which they shall endeavour to complete within two years of the CAI being signed. Interestingly, this provision determines that in the negotiations of the dispute settlement mechanism, parties will take into account progress on "*structural reform of investment dispute settlement*" in the context of the UNCITRAL.

What the EU understands by "state of the art provisions" concerning investor protection and ISDS is relatively clear from the agreements it has recently signed with Canada, Mexico, Singapore and Vietnam, and the high-profile position it has undertaken in the ongoing UNCITRAL negotiations. First, in terms of substantive protections, this refers to a more precisely defined scope of FET, with clear deference to the state's right to regulate and explicit carve-outs for public health and environmental measures. Second, in terms of the ISDS process, it refers to establishing a permanent court, and, eventually, replacing the current system of party?appointed arbitral tribunals with a multilateral investment court (MIC).

China has also shown interest in reducing the scope of substantive protections. While almost all existing BITs between China and EU countries adopt a simple, unqualified formulation of the FET standard, China's more recent BITs often place limitations on FET. For instance, the Canada-China BIT (2012) confines the FET obligation to the minimum standard of treatment required by international law. Concerning ISDS procedures, China adopted a rather reserved attitude towards the EU's preference for an MIC in its submission to the UNCITRAL Working Group in July 2019.

China noted in its submission that "*[t]he right of parties to appoint arbitrators … is a widely accepted institutional arrangement … and should be retained in any reform process*."

What is the Prospect for the CAI?

After both parties had reached an agreement in principle in December 2020, the EC suggested that the next steps would be finalisation of the agreement, as well as submission for approval by the EU Council and the European Parliament. Nevertheless, as the tensions between the EU and China grew, the European Parliament eventually voted in May 2021 to freeze the ratification of the CAI until China lifts the sanctions imposed on certain MEPs and EU institutions.

The suspension does not necessarily mean that ratification is out of the question. In a press conference in July, the spokesperson of China's Ministry of Commerce indicated that China and the EU were still processing the legal review and technical preparations for the CAI. Analysts also stressed the mutual self-interest that both sides have to finalise the deal.

Should the CAI be ratified, the parties still need to agree on the outstanding provisions to grant protection to investors. Although the EU's stated objective is for the CAI to replace Member States' existing BITs with China, Section VI (2), Article 15(1) of the CAI expressly preserves previous agreements between EU and China for the time being.

Thus, any changes to the investment protection regime are essentially two steps away: first, the CAI itself will have to be ratified; and second, the exact contours of the ISDS provision will need to be negotiated and agreed upon between the EU and China. Until both of these steps are achieved, investors will remain protected to the extent provided for under the existing BITs.

Will there be More EU-Chinese Investment Claims?

With history as a guide, more EU-Chinese investment claims appear likely – regardless of the CAI's fate. The most important reasons are the waning of the Chinese authorities' historical reservations over ISDS and the increasing Chinese investments in Europe.

Successful ratification of the CAI and the agreement on final ISDS proceedings could further promote arbitration by providing investors with more consistent and broader protection. On the other hand, failure to ratify the CAI would reflect tensions between China and the EU, giving rise to additional potential claims. A particular area to monitor is the ongoing concerns expressed by certain EU Member States relating to security and the level of Chinese influence over crucial economic sectors.

At the same time, we should not necessarily expect a flood of new claims. While China may have embraced ISDS as a potential tool, it is plainly not seen as a tool of first resort, as highlighted in China's UNCITRAL Working Group submission, emphasising the importance of state-to-state dialogue and alternative dispute resolution mechanisms. Moreover, many Chinese investments are made by state-owned enterprises, and hence, potentially valid claims may remain unasserted due to broader considerations. Conversely, given the importance of China's market, some EU investors will think twice before commencing any arbitral proceedings against the State.

Conclusion

If adopted, the CAI may ultimately provide increased protection for European and Chinese investors. Moreover, given the economic and political weight of the parties, the ultimate form of ISDS provisions will have a significant impact on the future of investment arbitration and the fate of the MIC initiative. However, even without a clear final answer on the CAI, the evolving attitude of both the Chinese government and its investors towards ISDS, coupled with the changing international political and economic climate, suggests that we can expect to see more EU-Chinese investment claims in the years to come.

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