



International Arbitration

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International Tribunal Rules That Hong Kong Investor May Assert Claim Under Chinese Bilateral Investment Treaty

An international tribunal has issued the first arbitral award ever rendered under a Chinese bilateral investment treaty (BIT).

In *Tza Yap Shum v. Republic of Peru*, the tribunal convened under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID) recently issued its Decision on Jurisdiction and Competence.¹ The tribunal held that a Hong Kong resident could assert a claim against the Government of Peru under the BIT between China and Peru. The tribunal also broadly interpreted several provisions of this treaty, while adopting a more restrictive interpretation of the treaty's most-favoured-nation (MFN) clause.

Although this ruling is not binding as a matter of precedent, it will undoubtedly have a significant impact in any future cases brought under Chinese BITs. Moreover, given the increasing amount of "outbound" investment originating from Hong Kong and mainland China, the decision confirms the broad treaty protections available to such investors. In particular, the decision suggests that Hong Kong investors may assert claims not only under the 16 BITs to which Hong Kong is a party, but also the approximately 130 BITs that China has signed.²

In this briefing, we discuss some of the salient holdings in the decision.

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Standing of Hong Kong Residents

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By way of background, the claimant – Mr. Tza – brought his claim before ICSID under the Peru-China BIT. He argued that Peruvian tax authorities had, by virtue of a tax lien, destroyed the value of his investment in a Peruvian food products company. Peru lodged several jurisdictional objections to the claim.

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In particular, Peru argued that, by virtue of his residency in Hong Kong, Mr. Tza lacked standing to assert a claim under the Peru-China BIT. The treaty only protects "natural persons who have nationality of the People's Republic of China *in accordance with its laws* . . ."³ As a Special Administrative Region (SAR) of China, Hong Kong exercises a high degree of autonomy, with a distinctive set of laws and practices. Indeed, Hong Kong can enter into international treaties.

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The tribunal rejected this argument, observing that, under China's Nationality Act, Mr. Tza is a Chinese national.⁴ His residency does not change this fact, as the Nationality Act applies equally

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¹ *Tza Yap Shum v. Republic of Peru*, ICSID Case No. ARB/07/6, Decision on Jurisdiction and Competence, dated 19 June 2009 ("Decision"). Although the decision was rendered on 19 June 2009, it was not made public until August 2009.

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² According to one source, China had signed 126 BITs and two free trade agreements (FTAs) with investment chapters as of July 2008. Norah Gallagher & Wenhua Shan, *Chinese Investment Treaties: Policies and Practice*, App. I (2009). The number of such instruments has grown significantly since that time. However, several of China's BITs have not yet entered into force.

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³ Peru-China BIT, Art.1(2) (emphasis supplied).

⁴ Decision, ¶¶ 58, 61.

in Hong Kong.⁵ Nor could the tribunal find any evidence that the Peru-China treaty was intended to exclude Hong Kong residents from its scope.⁶

This decision thus suggests that Hong Kong residents who are Chinese nationals may – depending on the language of the BIT in question – bring claims under Chinese BITs with third countries. We note that, by contrast, Hong Kong residents who are not Chinese nationals would not be able to invoke Chinese BITs, just as Chinese nationals who are not residents of Hong Kong could not invoke Hong Kong BITs.⁷

The ruling does not address whether corporate entities established in Hong Kong may bring claims under Chinese BITs. However, we believe that entities incorporated under the laws of Hong Kong are properly regarded as being incorporated under Chinese law. This being so, there is good reason to expect that Hong Kong companies would indeed have standing to pursue claims under Chinese BITs.⁷

Indirect Claims

The tribunal also held that the Peru-China BIT protects individuals who invest *indirectly* in the host State's territory.⁸ Mr. Tza had invested through a shell company incorporated in the British Virgin Islands, which in turn owned 100% of the shares in the Peruvian subsidiary. Such "indirect" investment vehicles are quite common, and reflect tax and other objectives.

By permitting individuals to assert claims based on such arrangements, the tribunal confirmed the broad universe of investors that are protected under Chinese BITs.

Scope of Expropriation Claims

In addition, the tribunal broadly interpreted the scope of the treaty's protections in cases of expropriation.¹⁰

Like many of the Chinese BITs signed before the new millenium, the Peru-China BIT only permits the arbitration of disputes "involving the amount of compensation for expropriation."¹¹ However, the tribunal held that this language did not limit its jurisdiction to the mere quantification of damages. After

examining the wording of the provision, its surrounding context, the object and purpose of the treaty, and jurisprudence interpreting similar provisions, the tribunal found that its jurisdiction extended to related matters, including whether or not an expropriation had occurred in the first place.

Restrictive Reading of MFN Clause

By contrast, the tribunal adopted a restrictive interpretation of the MFN clause contained in the Peru-China BIT.¹² This provision calls for treatment that "shall not be less favourable than that accorded to investments and activities associated with such investments of investors of a third State."¹³ The claimant sought to use this MFN clause to take advantage of the more favourable protections afforded in another treaty – the Peru-Colombia BIT, which allows claimants to initiate arbitral proceedings under legal theories other than expropriation.

The tribunal rejected this approach. It relied, in part, on the particularly restrictive language contained in the Peru-China BIT, which only allows claimants to arbitrate expropriation claims. The tribunal reasoned that this specific language (permitting arbitration of only expropriation matters) should prevail over the more general language of the MFN clause. The tribunal also examined the divergent jurisprudence relating to MFN clauses, and cited in support the more restrictive approach taken by tribunals in cases such as *Plama v. Bulgaria*.¹⁴

This aspect of the decision could be problematic, as it limits Chinese investors pursuing arbitral claims under many earlier generation BITs to expropriation theories. It is often more difficult to prevail under an expropriation argument than, for instance, an argument that the host State failed to provide the investor with fair and equitable treatment.

Conclusion

On balance, the decision in *Tza Yap Shum* broadly interprets the protections available under the Peru-China BIT. This could be a valuable precedent for Chinese investors – including those in Hong Kong – who seek the protections afforded under any of China's approximately 130 BITs.

⁵ Decision, ¶¶ 54, 60.

⁶ Decision, ¶ 71.

⁷ With respect to individuals, Hong Kong BITs generally protect "physical persons who have the right of abode in its area." See, e.g., Thailand-Hong Kong BIT, Art. 1(4)(b)(i). "Area" is defined as including "Hong Kong Island, Kowloon and the New Territories." *Id.*, Art. 1(1)(b).

⁸ See, e.g., Gallagher & Shan, at 91-93. Hong Kong corporate entities are, in principle, covered by Chinese BITs unless expressly excluded, as in the 2006 Russia-China BIT (which has not entered into force). *Id.*

⁹ Decision, ¶¶ 94-111.

¹⁰ Decision, ¶¶ 187-188.

¹¹ Peru-China BIT, Art. 8(3).

¹² Decision, ¶¶ 193-216.

¹³ Peru-China BIT, Art. 3(2).

¹⁴ Decision, ¶¶ 217-220.

Now that the jurisdictional phase of the proceedings have concluded, the merits phase will commence. We recommend that outbound investors in Greater China closely monitor this case, including any final award.

A copy of the tribunal's jurisdictional decision can be found at <http://ita.law.uvic.ca>.

Winston & Strawn is well-positioned to assist its clients in structuring their investments to take advantage of treaty protections, and in evaluating and pursuing treaty-based claims. If you have any questions or would like to discuss these matters further, please contact Winston & Strawn's Hong Kong office or its International Arbitration Practice Group through the attorneys listed below:

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