

# The Standing of State-owned Enterprises under the ICSID Convention: A Chinese Perspective

Wang Qing, Xu Lai, Ling Fanghao, Huang Ruotian,  
Bai Qianqian, He Kaiye, Sun Jiaxuan\*

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**Abstract:** In recent years, Chinese State-owned enterprises (SOEs) involved in foreign investment have become the subject of increased foreign scrutiny. Within International Centre for Settlement of Investment Disputes (ICSID) arbitration, this scrutiny has manifested in challenges to the standing of SOE claimants questioning whether they are eligible “nationals”. To date, ICSID tribunals have developed two different methods of assessing these challenges, namely the Broches test and the application of attribution rules within the International Law Commission (ILC)’s Draft Articles on Responsibility of States for Internationally Wrongful Acts. This inconsistent arbitral practice, as well as drawbacks of the Broches test, suggests that a combination of both standards would be a more optimal approach. Regarding Chinese SOE investors, further reform of Chinese SOEs and explicit inclusion of SOEs within the “investor” definitions of bilateral investment treaties (BITs) are advised in order to maximize their overseas protection.

**Keywords:** State-owned Enterprises, ICSID Convention, Jurisdiction *Ratione Personae*

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## I. INTRODUCTION

On January 29, 2021, Ukraine imposed sanctions on the Chinese company Beijing

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\* Wang Qing, LLB Candidate, Class of 2023, Experimental Class for Outstanding Legal Talents in International Business and Economics (ECOLT), Law School, University of International Business and Economics (UIBE). Email: anniewang010@hotmail.com.

Xu Lai (Joint First Author and Corresponding Author), LLB Candidate, Class of 2023, ECOLT, Law School, UIBE. Email: xulai1106@163.com.

Ling Fanghao, LLB Candidate, Class of 2023, ECOLT, Law School, UIBE. Email: lingfanghaolaw@163.com.

Huang Ruotian, LLB Candidate, Class of 2024, ECOLT, Law School, UIBE. Email: lexahuang02@gmail.com.

Bai Qianqian, LLB Candidate, Class of 2023, Law School, UIBE. Email: Echo\_Baiqq@163.com.

He Kaiye, LLB Candidate, Class of 2023, ECOLT, Law School, UIBE. Email: hkyviolet@163.com.

Sun Jiaxuan, LLB Candidate, Class of 2023, ECOLT, Law School, UIBE. Email: catherinesun2001@gmail.com.

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Skyrizon Aviation Industry Investment Co., Ltd (Skyrizon) and its Chinese shareholders, blocking their assets inside Ukraine on grounds of national security.<sup>1</sup> While these shareholders soon initiated arbitration against Ukraine under the China-Ukraine BIT,<sup>2</sup> Skyrizon itself has not done so, perhaps due to the widespread speculation that “Skyrizon could face difficulties proving that it is a private company” in a potential arbitration hearing.<sup>3</sup>

Allegations against the private character of Skyrizon are concerning because they could challenge the basis of its capacity to bring investment claims against Ukraine. Indeed, numerous tribunals have already accepted the argument that an enterprise with ties too close to the government may be excluded from International Centre for Settlement of Investment Disputes (ICSID) protection. The most recent example is the 2017 *BUCG v. Yemen* award, in which Yemen challenged the Chinese State-owned enterprise (SOE) Beijing Urban Construction Group Co. Ltd. (BUCG)’s standing by arguing that it acted as an agent of the government and discharged governmental functions. Although the tribunal ultimately found that BUCG did not engage in either of these behaviors, it affirmed that if BUCG had done so, it would be barred from ICSID arbitration.<sup>4</sup>

The examples of Skyrizon and BUCG illustrate how Chinese companies investing overseas have become increasingly threatened by the scrutiny of host States and the uncertainty of investment protection. In this context, it has become particularly valuable to examine the standards that past ICSID tribunals

1 The Ukrainian Weekly, New Year, New Battles: Does China Plan to Give up on Motor Sich? <https://www.ukrweekly.com/uwwp/new-year-new-battles-does-china-plan-to-give-up-on-motor-sich> (Last Visited on May 11, 2022).

2 Skyrizon Aviation Power, Announcement of Beijing Skyrizon Aviation Industry Investment Co., Ltd. on the Progress of Initiating International Investment Arbitration against Ukraine, [https://mp.weixin.qq.com/s/R\\_ZYc6yvXOUjCLZaCN1amA](https://mp.weixin.qq.com/s/R_ZYc6yvXOUjCLZaCN1amA) (Last Visited on May 11, 2022).

3 Radio Free Europe, Chinese Investors File Arbitration Case against Ukraine over Motor Sich, Investment, <https://www.rferl.org/a/china-motor-sich-skyrizon-arbitration-ukraine/31007011.html> (Last Visited on May 11, 2022); Bermet Talant, Igor Kossov, Tug of War: Chinese Investors Go on the Offensive for Motor Sich, <https://www.kyivpost.com/ukraine-politics/chinese-investors-go-on-the-offensive-for-motor-sich.html> (Last Visited on May 11, 2022).

4 *Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen*, ICSID Case No. ARB/14/30, Decision on Jurisdiction, May 31, 2017, p. 29.

have used to determine whether SOEs should be granted protection. Thus, Part II of this article is dedicated to this subject. Given the shortcomings of existing standards, Part III presents an improved approach to deliberating the standing of SOEs. Part IV analyzes the implications of current standards for Chinese SOE investors and proposes policy recommendations.

## II. EXISTING PRACTICE OF ICSID TRIBUNALS ON THE ISSUE OF SOES' STANDING

Under the ICSID Convention, the standing of SOEs to assert claims against States has long been extensively debated. This issue arises from Article 25(1) of the ICSID Convention, which reads, in part:

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.

The jurisdiction of ICSID does not extend to disputes between two Contracting States. Rather, the system established by the ICSID Convention is solely designed to settle disputes between Contracting States and “nationals” of other Contracting States.

However, the definition of “national” remains ambiguous in the ICSID Convention. Although Article 25(2) clarifies that “national” includes both natural and juridical persons, no further explanation exists in the ICSID Convention, raising the question of whether it encompasses SOEs. An answer was found in the ICSID Convention’s negotiating history, which indicated that the term “national” was intended to include not only privately-owned companies but also wholly or partially government-owned companies.<sup>5</sup>

The question then becomes: Which kinds of SOEs can be considered as

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<sup>5</sup> Christoph H. Schreuer, *The ICSID Convention: A Commentary*, 2<sup>nd</sup> Edition, Cambridge University Press, 2009, p. 161.

eligible “nationals” under the ICSID Convention, as opposed to ineligible embodiments of States? As the tribunal in *Maffezini v. Spain* suggested, a domestic determination of this issue is not necessarily binding upon international arbitral tribunals. Whether an entity will be regarded as an organ of the State is a question that should be determined under applicable principles of international law.<sup>6</sup>

Accordingly, the following two sections illustrate the existing practice of ICSID tribunals addressing this question, which centers on the application of two different sets of standards: the Broches test and the ILC Articles.

### A. The Mainstream Standard: Broches Test

#### *1. The Broches Test Disqualifies SOEs that Act as Governmental Agents or Discharge Governmental Functions*

One of the most essential guidelines for interpreting Article 25(1) of the ICSID Convention is a test formulated in 1972 by Aron Broches, the first Secretary-General of ICSID and one of the principal drafters of the ICSID Convention. He framed this test as follows:

[A] mixed economy company or government-owned corporation should not be disqualified as a “national of another Contracting State” unless it is acting as an agent for the government or is discharging an essentially governmental function.<sup>7</sup>

This standard, later known as the “Broches test”, was applied and further developed as a result of the *CSOB v. Slovak Republic* tribunal. In this case, the Slovak Republic contested the tribunal’s jurisdiction, arguing that the claimant Československá Obchodní Banka, A.S. (CSOB) acted on behalf of its home State of the Czech Republic rather than as an independent commercial entity. The tribunal cited the Broches test and analyzed two questions respectively:

<sup>6</sup> Emilio Agustín Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Decision on Jurisdiction, January 25, 2000, p. 82.

<sup>7</sup> Aron Broches, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, *Collected Courses of the Hague Academy of International Law*, Vol. 136, 1972, pp. 354-355.

Whether CSOB was “acting as an agent for the government” and whether CSOB was “discharging an essentially governmental function”. These two stages later became known as the “agent test” and “function test”. In the “agent test”, the tribunal linked the term “agent” with the presence of State control. The tribunal held that the Czech Republic’s 65% stock ownership did not give it absolute control over CSOB, because this ownership or control alone could not disqualify a company from filing a claim as a “national”.<sup>8</sup> In the “function test”, the tribunal reasoned that whether CSOB exercised governmental functions must be judged based on the nature of its activities and not their purpose, concluding that CSOB’s functions were commercial.<sup>9</sup> Ultimately, CSOB was considered as a qualified “national”.

Numerous subsequent tribunals have adopted CSOB’s approach. For instance, the *Flughafen Zurich v. Venezuela* tribunal concluded that SOEs can legitimately invoke ICSID’s jurisdiction so long as the Broches test is met.<sup>10</sup> The same view was upheld in *CDC v. Seychelles*<sup>11</sup> and *Telenor v. Hungary*.<sup>12</sup>

## 2. The Broches Test Has Faced Criticism

The Broches test (especially interpreted by the CSOB tribunal) has encountered criticism that primarily focuses on the following two points.

Firstly, Paul Blyschak has argued that tribunals following the Broches test and CSOB have continuously neglected the purpose of SOEs’ activities. Contemporary concerns reveal that SOEs’ motivations may be potentially relevant to the determination of jurisdiction under ICSID, with the main consideration that SOEs may “adopt the appearance of a private enterprise in order to further otherwise political objectives.”<sup>13</sup> Moreover, disregarding the purpose of SOEs’

8 *Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, May 24, 1999, p. 18.

9 *Ibid.*, pp. 20 & 23.

10 *Flughafen Zürich A.G. and Gestión e Ingeniería IDC S.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/19, Award, November 18, 2014, p. 274.

11 *CDC Group plc v. Republic of Seychelles*, ICSID Case No. ARB/02/14, Award, December 17, 2003, pp. 6, 19 & 34.

12 *Telenor Mobile Communications A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, September 13, 2006, pp. 16 & 18.

13 Paul Blyschak, State-owned Enterprises and International Investment Treaties: When Are State-owned Entities and their Investments Protected? *Journal of International Law & International Relations*, Vol. 27, No. 1, 2011, p. 31.

activities might allow the ICSID Convention to protect ostensible commercial behavior even though this behavior's goal contradicts the interests of the host State.<sup>14</sup>

Secondly, the *CSOB* decision has been criticized for its lack of comprehensiveness and since it is outdated.<sup>15</sup> Decided in 1999 by an ICSID tribunal as one of the earliest decisions on jurisdiction in investment arbitration, *CSOB* cited no authority in support of its choice to exclude consideration of the motives behind SOEs' activities. Its analysis of the controversial issue of SOEs' standing produced only twelve paragraphs and referenced only a single source.<sup>16</sup> Furthermore, since the *CSOB* decision, the international investment field has experienced a large amount of arbitral awards and academic discussion that considerably enriched judicial practice, with SOEs growing rapidly in size, number, and influence across the world.<sup>17</sup> As a result, scholars have argued that in a contemporary context, analyzing the private character of investors may require a perspective that differs from the *CSOB* case decided more than twenty years ago.

### B. An Alternative Standard: ILC Articles

An alternative approach is followed by a minority of other tribunals that consider the greater context of an enterprise's activities, including their purpose, in determining its sovereign or non-sovereign nature. These tribunals draw inspiration from the rules of attribution codified by the International Law Commission (ILC)'s Draft Articles on Responsibility of States for Internationally Wrongful Acts (ILC Articles). As customary international law,<sup>18</sup> these rules provide standards for determining when a State is responsible for a national's acts.

Although usually utilized in the context of State responsibility, investment

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<sup>14</sup> *Ibid.*

<sup>15</sup> Mark Feldman, State-owned Enterprises as Claimants in International Investment Arbitration, *Foreign Investment Law Journal*, Vol. 31, No. 1, 2016, p. 24.

<sup>16</sup> *Supra* n. 13, p. 32.

<sup>17</sup> *Ibid.*, p. 2.

<sup>18</sup> *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction, November 14, 2005, p. 19; *Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey*, ICSID Case No. ARB/11/28, Award, March 10, 2014, p. 281.

tribunals have also applied the rules of attribution within the ILC Articles to ascertain whether an SOE claimant has arbitral standing. For instance, in *Tulip v. Turkey*, the tribunal remarked that:

The issue of attribution relates both to the Tribunal's jurisdiction and to the merits of this dispute. Attribution is relevant [...] for both the purposes of the BIT and Art. 25 of the ICSID Convention.<sup>19</sup>

Later, in *Masdar v. Spain*, the tribunal listed Articles 4, 5, and 8 of the ILC Articles as potential rules that could adjudicate whether a dispute was “between two States”. The tribunal went on to apply Articles 5 and 8 in its determination of standing by examining whether the claimant exercised governmental authority (Article 5) or was under the effective control of the State in its investment activities (Article 8).<sup>20</sup>

Another notable case was *Maffezini v. Spain*, in which the claimant Maffezini brought proceedings against Spain for the conduct of a State-owned entity. Although the SOE in this case did not stand as a claimant but rather was owned by the respondent, the tribunal expressly recognized that these two situations were analogous and possessed sufficient similarities allowing for the utilization of jurisprudence developed for one definition in the context of another.<sup>21</sup> Citing the ILC Articles, the tribunal stated that:

The Tribunal may look to the applicable rules of international law in deciding whether a particular entity is a State body. These standards have evolved and been applied in the context of the *law of State responsibility*. The test that has been developed looks to various *factors*, such as *ownership, control, the nature, purposes, and objectives* of the entity whose actions are under scrutiny, and to the *character*

<sup>19</sup> *Ibid.*, *Tulip Real Estate and Development Netherlands BV v. Republic of Turkey*, p. 276.

<sup>20</sup> *Masdar Solar & Wind Cooperatief U.A. v. The Kingdom of Spain*, ICSID Case No. ARB/14/1, Award, May 16, 2018, pp. 168-172.

<sup>21</sup> *Emilio Agustín Maffezini v. The Kingdom of Spain*, Decision of the Tribunal on Objections to Jurisdiction, January 25, 2000, p. 79.

of the actions taken.<sup>22</sup> (Emphasis Added)

Among other factors, the *Maffezini* tribunal listed “purposes and objectives” as an independent element of the State entity test under the ILC Articles. The tribunal in *Salini v. Morocco* followed a similar approach, noting that:

In order to determine the degree of control and participation of a State in a company, the Tribunal [...] considers that it must take into account the *international rules governing the liability of States*. The assessment of the degree of State control and participation in a company is based on two criteria: the first, *structural*, in other words, related to the *structure* of the company and, in particular, to its shareholders; the other, *functional*, related to the *objectives* of the company in question.<sup>23</sup> (Emphasis added)

This discussion demonstrates that while the Broches test and ILC Articles standards share some elements, other elements contrast greatly, including whether to consider an SOE’s purpose. Tribunals have not yet developed a precise and uniform method to choose between or combine the two approaches, which has led to uncertain and unpredictable arbitral practice.

### III. AN IMPROVED APPROACH TOWARD DETERMINING THE STANDING OF SOES UNDER THE ICSID CONVENTION

Considering the disunity and criticism of present jurisprudence, in this section, we propose a more comprehensive approach towards the determination of SOE standing. We argue that while applications of the Broches test should proceed in order to grant commercially acting SOEs ICSID protection, certain

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<sup>22</sup> *Ibid.*, p. 76.

<sup>23</sup> *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, Decision on Jurisdiction, ICSID Case No. ARB/00/4, July 16, 2001, p. 31.

ILC Articles should also be integrated into the Broches test to enhance precision.

### A. Application of the Broches Test Should Continue

Firstly, we recommend that ICSID tribunals should continue to apply the Broches test. This entails that they admit SOEs as eligible investors under the ICSID Convention so long as their behavior does not exceed the scope of normal commercial entities. We endorse this perspective because of the present economic reality in which a vast number of SOEs around the world act as commercial entities and contribute significantly to the global economy.

#### *1. Many SOEs Act as Commercial Entities*

As SOEs become increasingly globalized and begin to lead international investment, those investing abroad do not simply discharge governmental functions or act as agents of the government. On the contrary, many, if not most, SOEs act as independent commercial entities in terms of legal properties and activities. Frequently, SOEs arise from a State's nationalization of private enterprises or contribution of State capital to private enterprises to help them deal with their financial difficulties.<sup>24</sup> In these cases, although the State is one source of these enterprises' capital, it neither changes its original business structure nor interferes with their operation and management, but is solely a financial investor. The nature and activities of these SOEs are essentially the same as private companies.

Examples from investment jurisprudence illustrate the commercial nature of many SOEs. In *BUCG*, BUCG joined an open tender, bid as a general contractor, and competed with other contractors during selection, leading the tribunal to conclude that BUCG's actions were based on commercial interests.<sup>25</sup> In *CSOB*, the tribunal found that the SOE claimant CSOB's international banking transactions and foreign commercial operations were essentially commercial rather

<sup>24</sup> Zhang Anran, The Standing of Chinese State-owned Enterprises in Investor-state Arbitration: The First Two Cases, *Chinese Journal of International Law*, Vol. 17, No. 4, 2018, p. 1148.

<sup>25</sup> *Supra* n. 4, p. 40.

than governmental.<sup>26</sup> Both BUCG and CSOB's business activities were profit-seeking and complied with host States' commercial regulations in the same way as private investors. Consequently, under the Broches test, they were not excluded from international arbitration because of their State-owned background.

Data shows that similar to BUCG and CSOB, a significant number of SOEs across the globe operate as independent commercial entities. For instance, an Organization for Economic Co-operation and Development (OECD) study of SOEs in five countries observed that in Israel, 33 of 92 SOEs functioned with commercial motives;<sup>27</sup> in Norway, 19 of 46 SOEs were profit-oriented;<sup>28</sup> and in New Zealand, 16 SOEs operated commercially and shared the same market and regulatory conditions as private companies.<sup>29</sup>

In addition, as a growing number of SOEs have expanded their commercial activities around the globe, many SOE home States now observe competitive neutrality. This means that these States will not grant preferential treatment to SOEs regarding competition, public procurement, taxes, regulation, and other policies, in order to prevent host States from implementing protectionist responses.<sup>30</sup> Operating as commercial businesses without preferential treatment compared to private companies, these SOEs should have the same right as private enterprises to safeguard their financial interests by participating in investment arbitration. An assumption that all SOEs should be disqualified as investors would hence be inequitable. This is why the Broches test should be applied to distinguish commercially operated SOEs from governmentally operated ones and why they should receive investment protection.

## *2. SOEs Greatly Contribute to the World Economy*

According to the OECD, State ownership has a significant presence in the world

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<sup>26</sup> *Supra* n. 8, p. 20.

<sup>27</sup> Hans Christiansen, Balancing Commercial and Non-commercial Priorities of State-owned Enterprises, *OECD Corporate Governance Working Papers*, No. 6, 2013, p. 24.

<sup>28</sup> *Ibid.*, p. 41.

<sup>29</sup> *Ibid.*, p. 33.

<sup>30</sup> OECD, Ownership and Governance of State-owned Enterprises: A Compendium of National Practices, *OECD Corporate Governance Working Papers*, 2021, pp. 43-44.

economy.<sup>31</sup> The International Finance Corporation (IFC) noted that SOEs accounted for 20 percent of investment, 5 percent of employment, and up to 40 percent of domestic output in countries around the world. Moreover, SOEs provide critical services in key economic sectors, including utilities, finance, manufacturing, and natural resources.<sup>32</sup> In addition, the OECD reports that 204 out of the world's 2,000 largest publicly listed companies were identified as SOEs.<sup>33</sup> These originated from 37 different countries with China ranking first (70 SOEs), followed by India (30), Russia, and the United Arab Emirates (9 each).<sup>34</sup>

As SOEs have a crucial role in the global economy and international investment,<sup>35</sup> disqualifying all SOEs from participating in ICSID proceedings would leave a drastic proportion of the world's investors without an effective remedy against arbitrary sovereign acts. Depriving commercially operating SOEs of protections granted to other investors would also inhibit the facilitation of transnational investment, one of the key purposes of the ICSID Convention.<sup>36</sup>

## B. ILC Articles 5 and 8 Should Be Integrated into the Broches Test

However, the practical applications of the Broches test are imperfect. As previously mentioned, the Broches test as interpreted by the *CSOB* tribunal has been criticized for being incomprehensible and outdated, particularly because it did not clearly define the specific standards and rationale for the “agent test” and “function test” analyses. Moreover, the tendency of some tribunals to refer to the ILC Articles’ rules of attribution instead of the Broches test in determining

31 Przemyslaw Kowalski, Max Büge, Monika Sztajerowska and Matias Egeland, *State-owned Enterprises: Trade Effects and Policy Implications*, OECD *Trade Policy Papers*, No. 147, OECD Publishing, 2013, p. 5.

32 IFC, *Corporate Governance of State-owned Enterprises*, [https://www.ifc.org/wps/wcm/connect/0863aaf9-321a-4d10-b60b-155e5fcbdd5/SOE\\_Fact\\_Sheet\\_July2018.pdf?MOD=AJPERES&CVID=msfCu3u](https://www.ifc.org/wps/wcm/connect/0863aaf9-321a-4d10-b60b-155e5fcbdd5/SOE_Fact_Sheet_July2018.pdf?MOD=AJPERES&CVID=msfCu3u) (Last Visited on May 11, 2022); See *supra* n. 31, Kowalski, P. et al. (2013), pp. 6-7.

33 *Supra* n. 31, p. 20.

34 *Ibid.*

35 Curtis J. Milhaupt, *The State as Owner — China's Experience*, *Oxford Review of Economic Policy*, Vol. 36, No. 2, 2020, p. 4.

36 International Centre for Settlement of Investment Disputes, *ICSID Convention, Regulations and Rules*, Washington D.C., 2003, p. 11.

the standing of SOEs has created judicial uncertainty.

In reality, as the *BUCG* tribunal duly noted, the “agent test” and “function test” that Broches proposed are mirror images of the attribution rules codified in ILC Articles 8 and 5.<sup>37</sup> This suggests that the two sets of standards can be combined. This is precisely the approach that we recommend future tribunals to adopt, so that a clearer test allowing for a broader view of international law can be developed.

### *1. The “Agent Test” Should Be Synthesized with ILC Article 8*

First, we propose that the “agent test” should be synthesized with ILC Article 8 in order to more effectively determine whether an SOE exhibits the State control adequate for being recognized as a governmental agent. ILC Article 8 provides that:

The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct.

ILC Article 8 can assist tribunals with ascertaining the standard of State control. Under ILC Article 8, stake proportion cannot be a direct indication of State control. Instead, the presence of “instructions”, “direction”, or “control” is required. This approach is consistent with existing jurisprudence. In *CDC v. Seychelles*, the claimant was 100% owned by Britain;<sup>38</sup> in *Telenor v. Hungary*, the claimant was 75% owned by Norway.<sup>39</sup> Nevertheless, these high proportions of State ownership excluded neither claimant from ICSID arbitration.

More significantly, investment jurisprudence applying ILC Article 8 demonstrates that the existence of a compliance or approval mechanism in the home State that mandates SOEs’ pursuit of State initiatives may demonstrate

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<sup>37</sup> *Supra* n. 4, p. 34.

<sup>38</sup> *Supra* n. 11.

<sup>39</sup> *Supra* n. 12.

the presence of State control.<sup>40</sup> In *EDF v. Romania*, this control was manifested by State mandates, directives, or legislation specifically directing the disputed investment;<sup>41</sup> in *Bayindir v. Pakistan*, by important company decisions made by the home State's senior officials, and by the requirement of governmental approval for these decisions.<sup>42</sup> Furthermore, the tribunals in *Foremost Tehran v. Iran* and *EDF* held that SOE decisions are attributable to the State when the adopted measures "went beyond the legitimate exercise by the majority of the shareholders."<sup>43</sup> These standards developed under ILC Article 8 would provide future tribunals with a more precise method of defining an agent of the State.

## 2. The "Function Test" Should Be Supplemented by ILC Article 5

Second, we advise that when applying the "function test", tribunals should focus on the "particular instance" in deciding the nature of an SOE's activities. The concept of the "particular instance" arises from ILC Article 5, which reads:

The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity *in the particular instance*. (Emphasis added)

The *BUCG* tribunal stressed that when determining an SOE's function, tribunals should concentrate on the "particular instance."<sup>44</sup> This means that the evidence both parties rely on should be directly related to the investment in dispute, and other facts concerning the enterprise should be excluded from the

40 Mark McLaughlin, Defining a State-owned Enterprise in International Investment Agreements, *ICSID Review – Foreign Investment Law Journal*, Vol. 34, No. 3, 2019, p. 606.

41 *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award, October 8, 2009, pp. 201 & 211-213.

42 *Supra* n. 18, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, pp. 125 & 128.

43 *Foremost Tehran, Inc., Foremost Shir, Inc. and Others v. The Government of the Islamic Republic of Iran, The Ministry of Economic Affairs and Finance and Others*, IUSCT Case Nos. 37 and 231, pp. 70; See *supra* n. 41, *EDF (Services) Limited v. Romania*, p. 210.

44 *Supra* n. 4, p. 42.

evaluation of the “function test”. As discussed above, many SOE activities are of a business nature. Separating the commercial “particular instance” of an SOE’s specific investment from other “instances” would be more reasonable in protecting the legitimate rights of SOEs with commercial or partly commercial functions.

In this vein, the determinative fact of the “function test” becomes whether, in the disputed investment, the enterprise itself engaged in policy-making, development, legislative, or administrative action; or if its actions, strictly speaking and divorced from their greater context, were within the competency of a private commercial entity.<sup>45</sup>

By focusing on the “particular instance”, the purpose behind activities will not be considered. This approach is appropriate for two reasons. On one hand, as the tribunal in *ADC v. Hungary* noted, the principle of “piercing the corporate veil” only applies to situations where the real beneficiary of the business misused corporate formalities in order to disguise its true identity and thereby avoid liability.<sup>46</sup> However, when serving as claimants in investment arbitration, SOEs themselves are not attempting to escape liability but rather safeguard legal rights. Therefore, it is unnecessary for tribunals to “pierce the corporate veil” and find the motives behind SOEs’ activities. On the other hand, this method grants tribunals greater confidence and predictability because the motivations or purposes behind investment are often extremely difficult to decipher: they may be masked, and there are often multiple motivations underlying an action.<sup>47</sup>

In conclusion, tribunals that combine the “agent test” and “function test” of the Broches test with ILC Articles 8 and 5 can follow a more distinct and universal scheme when deciding similar cases with SOE claimants, which exhibits greater certainty and specificity in determining whether each aspect of the Broches test is met.

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<sup>45</sup> *Supra* n. 8, pp. 18-23.

<sup>46</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, Award, October 2, 2006, p. 335.

<sup>47</sup> *Supra* n. 13, pp. 1-27.

## IV. IMPLICATIONS OF ICSID JURISPRUDENCE FOR CHINESE SOE INVESTORS

The criteria of ICSID tribunals for adjudicating the standing of SOEs are particularly relevant for China, due to their prominence in the Chinese economy and foreign direct investment (FDI) flows. Recent cases such as *BUCG* exemplify the challenges that Chinese SOE investors face when seeking remedies for infringements of their rights. While considering these difficulties, this section evaluates the implications of SOE-standing-related investment jurisprudence for Chinese SOE investors. It first explains China's existing policies for these investors, indicating that policy change may be required to ensure that Chinese SOEs are granted arbitral standing. Then, it presents policy recommendations for enhancing the protection of Chinese SOE investment.

### A. China's Existing Policies towards SOE Investors

#### *1. China's Domestic Policies towards SOEs*

Public ownership is the predominant type of ownership in China. As a basic socialist economic system is part of the Chinese Constitution, SOEs are the core of China's national economy, especially in FDI. According to statistics from China's Ministry of Commerce, by the end of 2020, the number of Chinese investors involved in outward FDI reached 29,000, which included 1,491 SOE investors. SOEs accounted for 46.3% of China's non-financial FDI stock of US \$2,310.6 billion, distributing investment flows into over 16 sectors.<sup>48</sup>

This is a view that, from 1978 to the mid-1990s, Chinese SOEs were mainly directed by the State to serve the national objective of expanding the market economy while guaranteeing the State's control over strategic economic assets and vital infrastructure adhering to the socialism principle.<sup>49</sup> Some developed

<sup>48</sup> Ministry of Commerce of the PRC & National Bureau of Statistics & State Administration of Foreign Exchange, 2020 *Statistical Bulletin of China's Outward Foreign Direct Investment*, pp. 121-137.

<sup>49</sup> Sebastian Heilmann, *Red Swan: How Unorthodox Policy-making Facilitated China's Rise*, 1<sup>st</sup> Edition, The Chinese University of Hong Kong Press, 2018.

countries have argued that this relationship linked Chinese SOEs with “State capitalism” and the lack of “competitive neutrality”, which unfairly granted them competitive advantages in the global market. As a result, these countries refused to consider Chinese SOEs as eligible private investors.<sup>50</sup>

Nowadays, with its strong emphasis on international business and investment cooperation as well as its implementation of the Belt and Road Initiative (BRI), China has taken numerous measures to promote SOE reform by transforming them into commercial entities. *The Guiding Opinion on Deepening the Reform of SOEs* demonstrates China’s resolve to separate government mechanisms from SOEs, promote reform by implementing SOE classification, and introduce private capital into SOEs. Moreover, the *Three-Year Plan for the Reform of SOEs* has transformed over 97% of central SOEs into commercial enterprises. Furthermore, *Measures for the Supervision and Administration of Overseas Investment by Central SOEs* allows central SOE investors to devise their own development strategies and autonomously choose investment projects. Nevertheless, since many Chinese SOEs maintain close relationships with the government (for instance, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) has the power to advise on and supervise SOEs’ investment plans),<sup>51</sup> certain outsiders might have been confused about the commercial nature of these SOEs’ overseas investments.

## 2. China’s BIT Protection for SOE Investors

In the vast majority of Chinese bilateral investment treaties (BITs), the treaty text does not clarify whether protection is granted to Chinese SOEs. Our study of the 106 Chinese BITs currently in force found that only eight expressly include SOEs within their definition of “investor” for at least one party.<sup>52</sup> Two of

50 Ian Bremmer, *State Capitalism Comes of Age*, *Foreign Affairs*, Vol. 88, No. 3, 2009, p. 4.

51 Yu Qian, Graphic Record of the Press Conference on the Economic Operation of Central Enterprises in 2021, <http://www.sasac.gov.cn/n2588020/n2877938/n2879597/n2879599/c22813392/content.html> (Last Visited on May 11, 2022).

52 UNCTAD, International Investment Agreements Navigator, <https://investmentpolicy.unctad.org/international-investment-agreements/countries/42/china> (Last Visited on May 11, 2022). The eight Chinese BITs that expressly include SOEs within the definition of “investor” for at least one party are: China-Kuwait BIT (1985), Australia-China BIT (1988), China-Ghana BIT (1989), China-Qatar BIT (1999), China-Uzbekistan BIT (2011), Canada-China BIT (2012), China-Japan-Republic of Korea Trilateral Investment Agreement (2012), China-United Republic of Tanzania BIT (2013).

these eight BITs, the China-Ghana BIT (1989) and the China-Qatar BIT (1999), explicitly provide that SOEs are “investors” of the other contracting party, but do not include any similar clarity regarding the definition of Chinese investors. For example, the China-Ghana BIT provides that “State corporations and agencies and companies registered under the laws of Ghana which invest or trade abroad” are Ghanaian investors, while only including “economic entities established in accordance with the laws of the People’s Republic of China and domiciled in the territory of the People’s Republic of China” within the definition of Chinese investors.<sup>53</sup> In the absence of express stipulation, it is difficult for tribunals to conclude on the basis of most Chinese BITs whether SOEs should be granted standing, which increases the likelihood of deference to the Broches test.

## B. Recommendations for Policymakers

Considering China’s current policies for SOE investors, we suggest that policymakers should adopt the following two recommendations to assist Chinese SOEs seeking to obtain investment treaty protection: Promote reforms of Chinese SOEs to be aligned with arbitral standards and expressly include SOEs within the definitions of Chinese “investors” in BITs.

### *1. Promote Reforms of Chinese SOEs While Considering the Broches Test*

As mentioned above, the Broches test is the standard that tribunals most often adopt to determine whether an SOE can legitimately invoke ICSID jurisdiction.<sup>54</sup> Within the Broches test, the agent test focuses on the determination of State control. Investment tribunals have consistently found that State ownership alone cannot disqualify an SOE from filing a claim as a “national”<sup>55</sup> Instead, an SOE acts as a State agent when there is a compliance or approval mechanism in the home State that mandates the SOE’s pursuit of State initiatives.<sup>56</sup> As for the function test, although many tribunals have held that the

<sup>53</sup> China-Ghana BIT (1990), Article 1(b).

<sup>54</sup> *Supra* n. 10.

<sup>55</sup> *Supra* n. 8, p. 18.

<sup>56</sup> *Supra* n. 40.

nature of an SOE's activities is more determinative than its purpose,<sup>57</sup> it is likely impossible to clearly divide the assessment of these two factors, while the classification of whether a behavior is governmental or commercial is purposive in itself.<sup>58</sup>

However, in China's case, the exponential growth of its FDI flows, Chinese SOEs' close relationship with the government, as well as their expanding global impact have placed these SOEs at the center of legal controversy. For example, regarding the relationship between SOEs' investment decisions and the State's political interests, suspicions arise from the fact that the appointment and removal of some key positions of particular SOEs can be influenced by government (while most SOEs remains its own power to decide most personnel without reporting to the authority). Moreover, SASAC supervises and guides the development strategies of Chinese central SOEs, and it also reserves the right to approve SOEs' involvement in non-principal industries. All of these circumstances have raised doubts regarding whether Chinese SOEs are eligible for ICSID protection.

In order to secure international investment protection and avoid disputes arising from overseas investment, we advise that Chinese SOEs should deepen their reform, particularly by improving their governance mechanism so as to meet the standards of the Broches test. It is important to note that this advice does not change or diminish the nature and value of Chinese SOEs. Considering China's circumstances and social system, SOEs have an important role in China's high-speed economic growth.<sup>59</sup> In contrast to private corporations that focus solely on making profits, SOEs are much more active in business sectors that greatly impact the public interest and involve taking on more social responsibility. Throughout the past several decades, SOEs have served China's national strategic goals by promoting foreign exchange, leading independent

<sup>57</sup> *Supra* n. 8, p. 20; See *supra* n. 4, p. 35.

<sup>58</sup> Australian Law Reform Commission, Report No. 24: Foreign State Immunity (1984), <http://www.austlii.edu.au/au/other/alrc/publications/reports/24/> (Last Visited on May 11, 2022).

<sup>59</sup> Weng Jieming, State-owned Enterprises Are the Important Material and Political Foundation of Socialism with Chinese Characteristics, *Learning Times*, No. 1704, 2021.

innovation, stabilizing its domestic economy, and undertaking social responsibilities such as job provision and environmental protection. In order to guarantee that Chinese SOEs are of the people, by the people, and for the people, they should still act under SASAC's legal supervision from a macro perspective so they can act in favor of their shareholders and the public.

Based on these conditions, we recommend that China should adopt the following measures. Firstly, China can further support the theory of “competitive neutrality” and gain international recognition by achieving SOEs' tax, regulatory, supervision, debt, and subsidiary neutrality.<sup>60</sup> Indeed, this theory matches the Chinese government's goal to “maintain a fair market environment and limit government intervention” as mentioned in *The Guiding Opinion on Deepening the Reform of SOEs* and *Opinions on Establishing a Fair Competition Review System in the Market System*.

Secondly, we advise that Chinese SOEs should deepen their structural reform. To eliminate doubts towards their commercial identity, the ownership and management rights of SOEs can be gradually separated to achieve marketization when participating in the market economy. SOEs can also highlight the importance of external and internal directors as well as managerial practitioners in their management and decision-making processes.<sup>61</sup>

Thirdly, SOEs can be classified into two categories depending on their orientation: commercial businesses and public welfare providers. This distinction would help SOEs to prove their commercial status during investment arbitration.

Fourthly, China can refer to overseas experience when improving its SOE

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60 Gao Weihe, Yin Hua, Prompt the Launch of the Chinese Version of the “Competitive Neutrality” to Help the Reform of State-owned Enterprises, [https://www.thepaper.cn/newsDetail\\_forward\\_10250925](https://www.thepaper.cn/newsDetail_forward_10250925) (Last Visited on August 15, 2022); OECD, Competitive Neutrality and National Practices, pp. 58-76, <https://www.oecd.org/daf/ca/50250966.pdf> (Last Visited on September 14, 2022). Nicholas R. Lardy, Achieving Competitive Neutrality in China, The People's Bank of China and International Monetary Fund Seventh Joint Conference Volume — Opening up and Competitive Neutrality: The International Experience and Insights for China, p. 60.

61 The State Council of PRC, *Opinion of the State Council on Promoting the Pilot Reform of State-owned Capital Investment and Operation Companies*, Articles 1.2 and 2.4, [http://www.gov.cn/zhengce/content/2018-07/30/content\\_5310497.htm?from=singlemessage&isappinstalled=0](http://www.gov.cn/zhengce/content/2018-07/30/content_5310497.htm?from=singlemessage&isappinstalled=0) (Last Visited on September 14, 2022).

supervision mechanism. One prominent reference is Singapore's Temasek model, in which the central government relies on a special wholly-owned enterprise to supervise SOEs. When this approach is implemented, the government receives annual dividends and ensures that morally sound and wise people are appointed to SOE boards, while SOEs' business plans and investment decisions are fully independent of any governmental interference or influence.<sup>62</sup>

Lastly, since there is no uniform standard for identifying eligible SOE investors, we recommend that China should actively participate in its rule-making process as well as promote the formation of fair, reasonable, and adequate rules that globally protect Chinese SOE investors.

## *2. Expressly Include SOEs within the Definition of Chinese "Investors" in BITs*

As a low proportion of Chinese BITs expressly identify Chinese SOEs as protected investors, future Chinese SOEs who resort to ICSID arbitration will most likely be subject to the Broches test. Although no tribunal has ruled that an SOE lacked standing based on the Broches test, it is unclear whether this will occur in the future. Even if the results are favorable, every time that this test is mentioned, Chinese SOEs will still need to spend a considerable amount of time and effort to prove that they are eligible investors.<sup>63</sup> In particular, when considering China's BITs with Ghana and Qatar, tribunals might interpret the express inclusion of SOEs within the definition of Ghanaian and Qatari "investors" and not Chinese "investors" to mean that Chinese SOEs were not intended to receive protection.<sup>64</sup>

Therefore, in newly concluded or renegotiated BITs, China should expressly include SOEs within the definition of Chinese "investors". This terminology could negate the need for tribunals to resort to the Broches test, as some have suggested that when a BIT expressly includes SOEs within the

62 Temasek.com, Defining Temasek, <https://www.temasek.com.sg/en/about-us/history-of-temasek> (Last Visited on May 11, 2022).

63 Zhang Xiaojun, Function Exploration and Paradigm Construction of Bilateral Investment Agreements in the Construction of the Belt and Road, *International Economic Review*, No. 4, 2021, p. 125.

64 *Supra* n. 8, pp. 21-22.

definition of “investor”, a tribunal risks having its decision annulled due to an excess of jurisdiction if it excludes an SOE from standing based on the Broches test.<sup>65</sup> The annulment committee in *Malaysia Historical Salvors v. Malaysia* utilized similar reasoning, as it annulled the award because it had denied jurisdiction based on the *Salini* test even though the claimant satisfied the BIT’s definition of “investment”.<sup>66</sup> In addition, incorporating SOEs into the definition of “investor” is consistent with the practice that many countries have implemented, and other contracting parties are likely to accept it. Recent treaties and model BITs such as the United States-Mexico-Canada Agreement (USMCA), ASEAN Comprehensive Investment Agreement, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and 2012 US Model BIT all categorically provide that SOEs are protected investors.<sup>67</sup>

## V. CONCLUSION

As China’s economy and global protectionist sentiment have risen, Chinese SOEs have been subjected to increasingly intense international scrutiny. The predicaments that Skyrizon and BUCG have faced exemplify one facet of this heightened scrutiny: Doubts about the private nature of SOEs have forced ICSID tribunals to evaluate the question of whether an SOE claimant can be granted standing. Two main perspectives can be extracted from existing jurisprudence on this issue: the utilization of the Broches test and the application of the ILC Articles’ rules of attribution. The drawbacks and non-uniformity of current standards have led us to propose a novel approach that advocates for integrating ILC Articles 5 and 8 into the two tiers of the Broches test. When considering existing standards as well as China’s domestic policies and BIT protection for SOE investors, we additionally suggest that China should deepen

65 Mohtashami, Reza and Farouk El-Hosseny, State-owned Enterprises as Claimants before ICSID: Is the Broches Test on the Ebb? *BCDR International Arbitration Review*, Vol. 3, No. 2, 2016, p. 383.

66 *Malaysian Historical Salvors SDN BHD v. Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, April 16, 2009, p. 74.

67 USMCA Articles 1.5 & 14.1; ASEAN Comprehensive Investment Agreement Articles 4(d) & 4(e); CPTPP Articles 1.3 & 9.1; 2012 US Model Bilateral Investment Treaty, Article 1.

its reform of SOEs in view of the Broches test and expressly specify in BITs that Chinese SOEs can indeed be regarded as protected investors.