The Chinese threat we forgot about: Huawei and ISDS

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During the era of coronavirus emergency, the words China and threat tend to suggest the origin of our common affliction. The world to emerge from coronavirus however will face both new challenges and the echo of old ones. An old problem is what to do about Chinese involvement in 5G infrastructure development. In light of the recent ban for Huawei equipment by the UK this post addresses the question of whether the Chinese multinational Huawei would have an investment claim against the German government were they to prohibit its participation in 5G deployment.

What would be the consequences of following the US approach?

Germany in early 2020 took a similar approach to the UK in allowing Huawei to continue to be involved in mobile technology development. Up till the summer of 2020, the position in the UK was that Huawei would be banned from supplying equipment to the sensitive parts of the network (known as the core). In addition, it would only be allowed to supply up to 35% of the kit in a network's periphery and it will be excluded from areas near military bases and nuclear sites. This core is where voice and other data is routed to ensure it gets to where it needs to be. Angela Merkel's Christian Democratic Union backed a strategy paper in February 2020 that could potentially curtail Huawei's involvement in Germany's 5G rollout by barring untrustworthy companies deemed to be subject to state influence from the process. These recommendations however stop short of banning Huawei technology outright. This position has now shifted in the UK, with the government of Boris Johnson moving closer to an outright ban. The US has already prohibited companies from using Huawei networking equipment in 2012 and the company was added to the US Department of Commerce's Bureau of Industry and Security Entity List in May 2019, following an executive order from President Donald Trump (and legislation) effectively banning Huawei from US communications networks (even though the coming into effect of the ban was successively postponed).

What would Huawei's options be in investor state dispute settlement (ISDS) if Germany adopted the US approach and tried to shut the company completely out of technology development in its jurisdiction? The China Germany bilateral investment treaty (BIT) of 2003 offers a contemporary take on ISDS. The treaty provides that if a dispute cannot be settled within six months of the date when it has been raised by one of the parties, it shall, at the request of the investor be submitted for arbitration. The venue shall be ICSID and the arbitration will take place under UNCITRAL rules unless the parties agree otherwise. The treaty (as other contemporary treaties) provides that investments shall benefit from national and most favoured nation (MFN) treatment. A Protocol to the treaty provides information on the interpretation of exceptions from protections on the basis of public policy and security interests.

Bans and investment tribunals

The first hurdle to overcome by any investor wishing to access ISDS is establishing the jurisdiction of the tribunal. This is commonly achieved by showing that the investor (or the investment) came under the protection of a BIT, establishing prima facie that a violation of the terms of the treaty has taken place, and that this violation is the result of a state act. Huawei certainly meets the definition of investor and investment under the German-China BIT. Huawei's investments in research and development in Germany grew from an initial 31 million euros in 2013 up to 112 million euros in 2017, amounting in in this period alone to more than 450 million euros. According to

a study conducted by a consulting firm, the German Institute for Economic Research (DIW), the Chinese telecommunications group is a major and growing investor in the German telecommunications market. In 2018, Huawei's German operations generated 2.3 billion euro's worth of business employing directly and indirectly 28.000 people. Therefore, this is an investment with a longstanding and deep involvement in the German economy.

As to the offending measure, an investment dispute requires a legally significant connection between the measure and a specific investment. Note however that it is not necessary that the state measure in question is directed specifically at a particular investment, only that it has an effect on it; and general measures that affect an investment can form the basis of a claim. In this part, our discussion is speculative as Germany has not yet moved to ban Huawei. Were it to go down the American route and instigate a legislative measure banning the company from continued involvement in R&D, investment and product deployment in the German telecommunications market, this would constitute a state act impacting on an investment with the potential to violate treaty commitments. This, in association with the status of Huawei as a protected investor would allow for a successful outcome to any determination of jurisdiction by an investment tribunal.

One country's security risk is another's discrimination

What are the rights protected? The Germany-China BIT is offering national and MFN treatment reciprocally to investors. If a Chinese investor like Huawei was singled out for bans (and prohibited from pursuing activities in which they were profitably engaged in the past) they would have a strong argument in favour of establishing treaty-violating discrimination. What will determine the outcome of an ISDS action by Huawei against a state such as Germany will not be the presence of discrimination per se (that much would be easily demonstrable), but the reasons for that discrimination. Namely, the key question is whether a national security and/or public policy exception could be applied in this case to justify targeted and discriminatory treatment. It is worthwhile to remember that the Protocol to the relevant BIT states that measures that have to be taken for reasons of public security and order shall not be deemed "treatment less favourable". Would a Huawei ban based on an assessment of the company as a 'security risk' due to links with the Chinese government come under the umbrella of public security and order, precluding it from being designated as less favourable treatment? This question is one of fact for a potential tribunal and cannot be definitively answered without access to the complete factual basis of a claim. However, the empirical bases for threat assessments stemming from geopolitical rivalry and vague ideological distaste in the past have been weak foundations for defending discriminatory acts in similar cases. A tribunal would need to balance the very real investment of Huawei in Germany against a perception of threat by German authorities and decide whether overt discrimination is in this case capable of being excused.

Multimillion claims in damages to be expected

How about damages were Huawei to establish unlawful discrimination? As our scenario envisages a ban on certain (or even all) involvement of Huawei in its core business activity, namely the development and deployment of telecommunications technology, any calculation of damages on a fair market value measure lead to significant amounts. The tribunal will review the financial impact on the operations of the Chinese multinational and assess the loss of profit involved plus any regulatory compliance costs. Even in the case where the government has taken the step to preclude investment in certain aspects of a network, there may be significant sunk costs, adjustment expenses and loss of profits involved that would feed into a calculation of damages in compensation. Looking at Germany, business activity exceeding 2 billion euros in value would be capable of generating multimillion claims in damages even before one looks at legal costs and the expenses of the tribunal itself.

It's all about the price tag

If Huawei is successful in using ISDS to counter bans build on national security concerns, does this prove that investment arbitration is a threat to national well-being? The answer depends on whether one is in favour of unfettered policy discretion. Curtailment of such discretion is not an unusual objective for investment treaties, the novelty comes from the target of potential actions (in this case a developed western state). When parties are unpredictable or considered a political risk, external constraints on their policy-making help stabilize the investment environment, providing an additional layer of protection for businesses. ISDS does not make democracy irrelevant. What it does instead is place a price tag on the exercise of sovereign discretion. Are western governments prepared to face the costs of their decisions?

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