

Sovereign Immunity, Expropriation, and Dispute Resolution Mechanisms in Middle Eastern Investment Disputes

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ABSTRACT: *The difficulty in Middle Eastern investment disputes lies not merely in ordinary breach of contract, but in the intersection of host-State sovereign conduct, the Sharia-based legal order, public policy defenses, and international arbitral enforcement mechanisms. When foreign investors encounter expropriation, nationalization, administrative arbitrariness, or sovereign immunity defenses, reliance solely on domestic litigation thinking often fails to secure effective remedies. This article constructs a practical framework around restrictive sovereign immunity, expropriation and indirect expropriation, the arbitrationization of administrative procedural defects, arbitral barriers, overlapping multilateral treaties, and denationalized remedies under investor-State dispute settlement (ISDS).*

KEYWORDS - *Expropriation, International arbitration, Middle East investment, Public policy, Sovereign immunity*

I. INTRODUCTION

Middle Eastern investment disputes are characterized by sovereign acts intersecting with Sharia-based legal orders and enforcement mechanisms. While restrictive immunity and expropriation are well-documented, a comprehensive practical framework addressing overlapping treaties and procedural barriers remains scarce. This article constructs a practical guide for navigating sovereign immunity, administrative arbitrariness, and arbitral obstacles. By integrating doctrinal analysis with typical case studies, it offers a full-lifecycle operational checklist, equipping investors with strategic remedies to mitigate sovereign risks under international investment law.

II. SOVEREIGN IMMUNITY AND ABUSE OF SOVEREIGN ACTS: FROM ABSOLUTE PROTECTION TO RESTRICTIVE IMMUNITY

Once a Middle Eastern investment dispute escalates from a commercial dispute into a sovereign act of the host State, the first obstacle is the defense of sovereign immunity. A host State may wrongfully repudiate a contract and confiscate assets while packaging its conduct as “non-justiciable sovereign acts” in order to resist claims by transnational investors. If investors continue to understand sovereign immunity as absolute and comprehensive protection, they will misjudge the remedial path.

International arbitral tribunals and major Western judicial systems generally adopt the theory of “restrictive immunity”: once the conduct of a State or State-owned enterprise is characterized as “commercial activity,” its overseas and affiliated assets may be subject to seizure and attachment. Chinese State-owned enterprises in particular must abandon the misconception that “State background per se entails immunity.” Restrictive immunity does not automatically exclude enforcement risk merely because the investor is State-owned; on the contrary, if the conduct is characterized as commercial, the sovereign protective umbrella may rapidly fail.

In response, a combination of “circumvention” and “limitation” may be adopted. First, investment may be structured through a bilateral investment treaty (BIT) between China and the host State, political risk insurance may be purchased from China Export & Credit Insurance Corporation (Sinosure), and international legal remedies may be pursued before the International Centre for Settlement of Investment Disputes (ICSID). Second, when entering into commercial contracts with a Middle Eastern host government or its enterprises, if the foreign party requests a “waiver of immunity clause,” the Chinese party may agree to waive jurisdictional immunity in order to accept neutral international arbitration; however, it must preserve execution immunity and strictly limit the scope of assets subject to compulsory enforcement to assets used for that specific commercial purpose, without touching core State assets. This “tiered waiver” strategy both responds to the foreign party’s demand for arbitral jurisdiction and avoids exposing core State assets to enforcement risk.

The tradition of judicial intervention in Middle Eastern legal systems further amplifies sovereign risk. Comparative legal literature notes that when commercial expectations are frustrated, Islamic law excuses contractual obligations while English law requires strict adherence, and the two differ.^[1] Moreover, judges may reduce the debtor’s contractual obligations in cases of extreme hardship, and the parties may not contract out of this in advance.^[2] This means that a host State may not only intervene directly through administrative orders, but may also legitimize unilateral termination or price adjustment through local courts on low-threshold grounds such as “changed circumstances” or “anticipated displeasure.” Therefore, sovereign immunity cannot be understood solely from the perspective of public international law; it must also be anticipated in conjunction with local traditions of judicial intervention.

III. EXPROPRIATION, NATIONALIZATION, AND ADMINISTRATIVE ARBITRARINESS: CHARACTERIZATION, COMPENSATION, AND PROCEDURAL REMEDIES

Expropriation and nationalization are among the most destructive political risks in transnational investment. Administrative arbitrariness and nationalization by a host State directly challenge the compensation principles of customary international law. If Chinese enterprises rely solely on general customary international law to protect their investments, it will often be insufficient to address the reality of the intertwining of local politics and law in the Middle East. A more effective path is to build a multi-layered defense through multilateral and bilateral treaty systems.

First, enterprises should proactively examine whether China and the relevant Middle Eastern host State have concluded a BIT containing high-standard investment protection provisions, so as to clarify compensation standards for expropriation in written treaty form. At the same time, they should seek to include a “stabilization clause” in the contract and introduce political risk insurance products to hedge against nationalization and expropriation risks. For major projects invested in the Middle East, it is necessary to purchase “expropriation and political violence insurance” from Sinasure or the Multilateral Investment Guarantee Agency (MIGA) to transfer the recovery risk arising from sovereign default. MIGA guarantees in particular carry strong international credit backing and can usually cover 90%–95% of the investment amount, transferring the economic losses of sovereign default to an international policy-based insurance mechanism.

Second, a distinction must be drawn between direct and indirect expropriation. In practice, not only does an explicit “nationalization” by a host government constitute expropriation; where the host State substantially deprives the project of its economic benefits through policy changes, prohibitions, or other means, indirect expropriation may also be established, and the Chinese enterprise is entitled to compensation at fair market value. Therefore, Chinese enterprises should strictly control localization compliance red lines, especially with respect to environmental, labor, and “localization” indicators such as Saudization and Emiratization, and establish a comprehensive local compliance system to avoid constituting material breach and thus giving the host State an excuse for “lawful revocation of licenses.”

Third, enterprises should be adept at capturing administrative procedural defects and converting them into claims for unlawful expropriation under international law. When confronted with surprise inspections, fines, or threats of license revocation by Middle Eastern government authorities, Chinese enterprises must immediately issue a written objection and apply for a hearing and defense. Specifically, they should carefully examine whether the administrative procedural steps of “notice” and “hearing” comply with legal requirements. If the Middle Eastern administrative authority fails to fulfill its reasonable notice obligation, this constitutes a violation of the “fair and equitable treatment” standard required by international law. Under the rule in *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, if prior reasonable notice is not given or no opportunity for hearing and defense is provided before revocation of a license, the international law standard of “fair and equitable treatment” is violated. The standard response procedure is: upon a surprise penalty, immediately issue a written objection and request a formal penalty decision and a hearing; if the other party refuses a hearing or the notice is defective, such as substituting a public announcement for direct service, preserve evidence of the procedural defect; in subsequent arbitration, argue that the material procedural defect has caused the act to depart from due process of law and substantially deprived property rights, thereby characterizing it as “unlawful expropriation” and seeking full compensation at fair market value.

Finally, to address sovereign contract-modification risk, enterprises should adopt an “economic equilibrium clause” instead of a traditional “frozen stabilization clause.” Its core arrangements include: first, a mandatory renegotiation clause, expressly providing that if changes in the host State’s laws or tax policies significantly

increase the Chinese enterprise's costs or substantially reduce its returns, both parties "shall be obliged" to renegotiate in order to restore the original economic equilibrium of the contract; second, a tiered automatic profit adjustment mechanism, under which when commodity prices or the project's overall rate of return exceed a predetermined percentage threshold, the host State's share is automatically increased. Through such institutionalized flexible concession arrangements, the enterprise may proactively defuse the potential risk of the host State unilaterally repudiating or amending the contract through administrative coercive measures in the future.

IV. DISPUTE RESOLUTION MECHANISMS: GOVERNING LAW, JURISDICTION, AND ARBITRAL BARRIERS

4.1 Rejection of Codified Law by Sharia Courts and Conflicts of Governing Law

When a dispute enters the initial stage of judicial proceedings, the contest over jurisdiction and the determination of governing law often decides the direction of the entire case. The unique conflicts of laws in the Middle East and the exclusionary operational logic of Sharia courts mean that Chinese enterprises cannot assume that everything is safe merely by reading Saudi modern regulations (Nizam). Empirical studies show that Middle Eastern Sharia courts display an institutional rejection of secular codified law.^[3]

Therefore, in designing dispute resolution clauses, the "statute-centric" mindset should be abandoned. First, enterprises should seek to agree on international commercial arbitration protected by the New York Convention. If resolution must be local, they should seek to designate jurisdiction to specialized committees that clearly apply secular regulations, such as committees specifically hearing foreign investment or commercial paper disputes, so as to avoid the systematic rejection of codified law by traditional Sharia courts. Second, they should expressly exclude local law and court jurisdiction and choose neutral international commercial arbitration institutions, such as arbitral institutions in London, the Dubai International Financial Centre (DIFC), Singapore, or Hong Kong, and expressly choose a highly developed and neutral commercial legal system such as English law through a governing law clause. If the counterparty insists on applying Islamic law principles, it must be ensured that the selected arbitral tribunal includes professional experts proficient in Islamic law as arbitrators or consultants. Finally, the governing law clause should be refined, avoiding the mechanical use of generic common law templates, and as far as possible agreeing on "host State law combined with generally accepted international commercial principles" as the governing law; in sensitive financial clauses such as financing, guarantees, and liquidated damages calculation, local senior Islamic law experts should be engaged for compliance review.

4.2 International Arbitration Barriers and Public Policy Defenses

Although international arbitration is the preferred path for transnational disputes, it still faces numerous procedural obstacles in the Middle East when confronted with host-State administrative privileges and overlapping treaty jurisdiction. When courts of the Gulf Cooperation Council (GCC) states recognize and

enforce foreign arbitral awards, there are two institutional “safety valves”—non-arbitrability and public policy—either of which may serve as a legal basis for refusing enforcement.^[4]

This structural obstacle manifests in two ways. First, when concluding agreements with Middle Eastern government departments, if special authorization from the highest administrative authority is not obtained, the international arbitration clause may be void ab initio. Second, even if a winning award is obtained, the losing local party may easily invoke “violation of domestic public policy” to refuse recognition and enforcement. The Saudi Civil Transactions Law adopted in June 2023 is a milestone in the modernization of the Saudi legal system and will significantly enhance Saudi Arabia’s attractiveness as an international arbitral seat. Previously, the absence of codified civil substantive law in the Saudi legal system—all civil transactions being governed by uncodified Islamic law principles—led to serious uncertainty and unpredictability, making foreign parties unwilling to choose Saudi law as the governing law or Saudi Arabia as the arbitral seat. The new Civil Transactions Law, through codified, clarified, and modernized rules, is expected to eliminate these concerns and make Saudi Arabia a “safe arbitral seat” in the Middle East. ^[5]It should be noted, however, that Saudi courts apply a very high threshold for setting aside awards for violation of Islamic law: an award may be set aside only when it contravenes an authoritative explicit scriptural text or consensus (ijma’); ordinary violations do not constitute a public policy exception.^[6]

In general international legal practice, the international arbitration system itself also carries the risk of Western legal hegemony. The rules, language (English), and adjudicatory power of international arbitration are highly monopolized by top Anglo-American law firms, leaving Chinese enterprises at a natural disadvantage as they operate in a non-native legal system and a non-domestic legal system. Countermeasures include: strict ex ante compliance review to ensure that, when signing arbitration clauses with Middle Eastern State organs or State-owned enterprises, all statutory internal approval documents or government waivers required for the other party’s consent to international arbitration are obtained; choosing regional international arbitration centers as alternatives, such as the Dubai International Arbitration Centre, or arbitral institutions in free zones that have adopted modern arbitration laws; expressly providing in the arbitration clause that the tribunal shall apply the UNIDROIT Principles of International Commercial Contracts or the UNCITRAL Arbitration Rules to enhance the international neutrality of the award; increasing the advance payment ratio and adopting a letter of credit or bank guarantee system linked to construction milestones to front-load the absorption of cash-flow risk during performance; forming a strong foreign-related legal team with Anglo-American law backgrounds and extensive international arbitration experience, and choosing Asian hub arbitral seats such as the Hong Kong International Arbitration Centre (HKIAC) or the Singapore International Arbitration Centre (SIAC). UAE arbitration users are increasingly “looking East,” choosing Asian arbitration institutions and seats, especially Singapore, with driving forces including the deepening of China-Arab economic cooperation under the Belt and Road Initiative, growing trade between the UAE and Asian countries, and Singapore’s institutional advantages and innovative rules as an arbitral seat.^[7]

In addition, the Abu Dhabi Global Market (ADGM) provides Chinese enterprises with an alternative “common-law-friendly” arbitral seat in the Middle East. ADGM is a financial free zone in Abu Dhabi that directly applies English common law, uses English as its working language, and has an internationalized bench; its court system closely approximates the arbitration-friendly judicial environment of London or Singapore.^[8]

4.3 Overlapping Multilateral Treaties and Denationalized Remedies under Investor-State Dispute Settlement (ISDS)

The investor-State dispute settlement (ISDS) mechanism, as an important tool for checking host-State sovereignty, is not without obstacles in practice. When Middle Eastern States implement policy changes, they may easily trigger “indirect expropriation” risks harmful to foreign investment. Early Chinese BITs limited arbitration to expropriation compensation and could not expand the scope of arbitration, so investors’ standing to arbitrate was limited. Therefore, at the investment structuring stage, the “denationalization” institutional advantage of ISDS should be fully utilized to elevate investment disputes to the level of international law. Eligible investors may, based on substantive protection provisions in BITs, such as fair and equitable treatment and umbrella clauses, directly initiate international arbitration against the host State as respondent, thereby escaping political interference and procedural barriers in the host State’s domestic judicial system.

In investment route planning, priority should be given to Middle Eastern countries that have concluded high-standard BITs with China as investment destinations, ensuring that the treaty basis for ISDS remedies exists at the outset of the project. Given that regional multilateral agreements such as the OIC Investment Agreement often contain relatively unique investor-State dispute settlement mechanisms or ad hoc arbitration avenues, Chinese enterprises may consider establishing a holding entity with substantive commercial operations in another member State of the Organisation of Islamic Cooperation, such as the UAE or Malaysia, and then making indirect investments in the target Middle Eastern country. In this way, when a dispute arises, the enterprise can not only invoke the protection of bilateral investment treaties but also activate the protective umbrella provided by regional multilateral treaties, achieving a “double insurance” cumulative effect.

V. Practical Implications of Typical Cases

First, the *Dallah* case: winning an arbitration does not equal final recovery. *Dallah Real Estate and Tourism Holding Company v. The Ministry of Religious Affairs, Government of Pakistan* shows a fundamental divergence between the courts at the seat of arbitration and the courts at the enforcement forum regarding whether a non-signatory is bound by an arbitration clause. The French court at the seat emphasized substantive control, while the English enforcement court adhered to mutual intent. The UK Supreme Court ultimately held that there was no objective evidence that all parties had a “subjective common intention” to bind the

Government of Pakistan to the agreement, and that the enforcement court should not blindly defer to the arbitral tribunal's own determination but must independently conduct a substantive review of the jurisdictional evidence. The lesson for Chinese enterprises is: in foreign-related contracts, the main commercial contract and the arbitration clause should separately specify the governing law, avoiding the application of an unforeseeable law of the seat; where an SPV signs, the behind-the-scenes controlling party must issue a guarantee containing an arbitration clause to lock in its status as a party; enforcement review risk means that winning an arbitration does not equal final recovery.

Second, the Sofregaz case: zero tolerance for Gharar and contractual certainty. In *Sofregaz v. Iranian Gas Storage Company*, the French party, affected by sanctions, proposed to "split and restructure" the contract, replacing it with a euro-denominated new contract and removing the bank guarantee. The Iranian owner believed that the French party was using "uncertainty" to delay the project, resolutely rejected the modification proposal, and unilaterally terminated the original contract on the ground of fundamental breach. The ICC arbitral tribunal held that the Iranian party's termination was lawful, and the Paris Court of Appeal dismissed the application to set aside. The underlying logic is Islamic law's zero tolerance for contractual uncertainty (Gharar).^[9] When drafting Middle Eastern engineering or long-term contracts, Chinese enterprises must pursue "extreme certainty" of the subject matter, price, and delivery standards, adopt the "milestone splitting method" to divide long-term contracts into multiple short-term sub-contracts that can be independently delivered and settled; any engineering variation during performance, even a minimal drawing adjustment or material substitution, must trigger a rigorous "variation order procedure" and obtain written confirmation from the Middle Eastern owner or its authorized engineer, so as to re-lock the "known nature of the subject matter."

Third, the Mamancochet case: fear of sanctions is not force majeure. The English High Court held that merely facing the risk of US secondary sanctions is not sufficient to excuse a party from performing the contract. The defendant insurer refused to pay on the ground that an Iran-related claim might trigger US sanctions, but the court strictly construed the sanctions clause and distinguished between "risk of being sanctioned" and "actual illegality." Chinese enterprises cannot unilaterally invoke force majeure or terminate a contract merely because they "fear being sanctioned." If a Chinese enterprise in the Middle East suspends work or refuses payment on the ground of "commercial risk" arising from foreign secondary sanctions, it will be found to have committed unlawful breach in international arbitration and fall into the abyss of huge claims at the private law level. Countermeasures include: cutting off the USD clearing nexus, using non-USD settlement for high-risk business; making "material risk of penalty" a condition for termination; and providing alternative currency payment clauses so that if the original currency is restricted, payment may be made in a non-restricted currency.

Fourth, Dubai Supreme Court Case No. 209/2021: the fatal loophole of arbitration clauses in interrelated contracts. In that case, the developer's construction contract with the first contractor contained no arbitration clause, while its service contract with the consultant contained an arbitration clause. The Dubai Court of First Instance upheld the consultant's jurisdictional objection, but the Court of Appeal and the Supreme Court, on the

grounds of “avoiding conflicting judgments” and “the interests of justice,” upheld the appellate judgment and dismissed the jurisdictional objection. The Dubai Supreme Court made clear that in the UAE, arbitration remains an “exceptional” dispute resolution method, arbitration agreements must be narrowly construed, and they cannot bind third parties that have not consented to arbitration. This case sounds a warning for Chinese large engineering, procurement, and construction (EPC) enterprises in handling overseas project subcontracting systems: if the main contract provides for international arbitration, but a contract with a local small subcontractor omits an arbitration clause or accepts local court jurisdiction, then once an overall project quality dispute arises, the Middle Eastern owner may use that local subcontractor as an “anchor” to drag the Chinese general contractor into lengthy Middle Eastern local court litigation, rendering the carefully designed international arbitration clause meaningless. Therefore, when handling overseas project subcontracting systems, EPC enterprises must ensure that all interrelated contracts unify the arbitration clause and governing law.

VI. Conclusion and Operational Checklist

Sovereign immunity, expropriation, and dispute resolution in Middle Eastern investment disputes are essentially an institutional game across legal systems, sovereigns, and procedures. Chinese enterprises should establish the following operational checklist from the perspective of the full project life cycle:

Investment structuring stage: prioritize countries that have concluded high-standard BITs with China; establish holding entities with substantive operations in the UAE, Malaysia, etc., to achieve dual protection under bilateral and regional multilateral treaties; establish SPVs through Hong Kong, Singapore, or DIFC/ADGM to block reverse piercing of debt.

Contract formation stage: unify arbitration clauses across all interrelated contracts; separately specify the governing law for the main contract and the arbitration clause; avoid Gharar and pursue extreme certainty of subject matter, price, and delivery standards; convert “non-refundable deposits” into advance payments with substantive consideration.

Performance and operation stage: establish a localization compliance evidence chain; ensure any variation follows a written variation order procedure; upon administrative raids, immediately issue written objections, request hearings, and preserve evidence of procedural defects; adopt economic equilibrium clauses instead of frozen stabilization clauses.

Dispute trigger stage: first determine whether the host State’s conduct is a commercial act or a sovereign act; if it is a commercial act, enforce against its overseas commercial assets; if it is a sovereign act, activate the dual-track mechanism of BIT arbitration plus political risk insurance claims.

Arbitration enforcement stage: verify whether the arbitration clause has obtained special authorization from the host State’s highest administrative authority; choose neutral or common-law-friendly arbitral seats such as

DIFC, ADGM, HKIAC, or SIAC; agree on UNIDROIT or UNCITRAL Rules; maintain performance records meeting common law evidentiary standards; guard against public policy and non-arbitrability defenses.

Footnotes

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