

ACHIEVING EQUALITY IN THE SETTLEMENT OF INVESTMENT DISPUTES: THE LOCAL REMEDIES RULE AS A PANACEA *

Abstract

This paper critically analyses the current regime of investment arbitration which is adopted internationally for the settlement of investment disputes between foreign investors and host States. By adopting a doctrinal approach, the author argues that it is high time national courts took an active part in the resolution of substantive aspects of investment disputes and this can be achieved by promoting the principle of exhaustion of local remedies under international law. This is because the objective of investment arbitration should be to work towards providing examples for national courts in host States, particularly developing countries, to follow in hopes that these countries can reform their own flawed regulatory institutions for settling such disputes.

Keywords: Investment Arbitration; National Courts; Local Remedies Rule

1. Introduction

Over the years, the regime for investment arbitration, which provides for principles that govern the resolution of disputes between States and foreign investors, has gained prominence in the field of international law. The popularity of Bilateral Investment Treaties ('BITs')¹ has grown over the years since developed and developing countries around the world have realized the importance of forging economic relationships between each other. However, foreign investors need to feel safe in host States and BITs guarantee certain standards of treatment in favour of foreign investors. BITs also provide for the resolution of investment disputes through investment treaty arbitration because foreign investors do not have faith in the national courts of various host countries. Hence, the major rationale for the existence of investment treaty arbitration is to give foreign investors some guarantees that the rule of law and due process will be respected in the neutral forum, instead of national courts when alleging that the government itself has breached its international obligations. This mechanism for settling investment disputes has held sway for decades. Hence, most investment disputes are not settled by national courts of host States. Ideally, investment treaty arbitration should work to provide examples for national courts in host States, particularly developing countries, to follow in hopes that these countries can reform their own flawed regulatory institutions.² However, this is not the case and the trend needs to change. The author argues that it is high time national courts took an active part in the resolution of substantive aspects of investment disputes and this can be achieved by promoting the principle of exhaustion of local remedies. This principle requires foreign investors to seek redress for any harm allegedly caused by a host state in the domestic courts of the host state before resorting to investment treaty arbitration.

This paper is structured as follows: section one (1) briefly traces the history of investment treaty arbitration regime, and part two (2) discusses the principal mechanisms for the settlement of investment disputes – i.e., investment treaty arbitration and national courts. Part three (3) analyses how the local remedies principles can help in enhancing the role of national courts in the settlement of investment disputes, and part four (4) concludes by finding that there is an unfair balance between the roles of investor-state arbitration and national courts in the settlement of investment disputes and suggests that the local remedies rule should be actively utilised in striking the right balance.

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¹ BITs have been defined as 'agreements establishing the terms and conditions for private investment by nationals and companies of one country in the jurisdiction of another.' – See Z Elkins et al, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000', (2006) 60(4), International Organization, 811.

²D Ma, 'BIT Unfair: An Illustration of the Backlash against International Arbitration in Latin America' (2012) 2 J. Disp. Resol, 1.

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2. Brief History of the Investment Treaty Arbitration Regime³

Disputes relating to foreign investment existed before the emergence of BITs.⁴ Corporations and individuals engaged in cross border commercial and personal activities, and international law provided some protections against harm for these legal persons.⁵ However, the legal standing to bring claims against states was not certain, particularly because individuals and corporations were not recognized actors in the international scene.⁶ Usually, the foreign investor would seek diplomatic protection from its home state and will expect its state to enforce the espoused claim against the host state using diplomatic, judicial or/and use of force.⁷ When cross border investment became an essential part of the global economy, the importance of protecting the property and investment of foreign investors became a concern for several states.⁸ Capital exporting states insisted that host states, particularly developing countries, need to guarantee a minimum level of treatment for foreign investors that come from their countries, which is not dependent on the host country's regulatory regime.⁹

The Hull Rule attempted to solve this problem. The emergence of this principle of international law that required compensation for expropriation can be traced to the dispute between Mexico and the United States between 1915 and 1940.¹⁰ This principle came under attack by several host states¹¹ for several reasons. For example, according to Elkins et al, '[a]part from the obvious problem of enforcement, this approach did not allow potential hosts to voluntarily signal their intent to contract in good faith.'¹² Particularly, some Latin American countries protested this regime by adopting the Calvo doctrine which required host states to simply afford foreign investors a treatment that is equivalent to that given to their domestic investors.¹³ Hence, the Calvo doctrine suggested that foreign investors should seek redress in the courts of the host states if the uniform treatment had been violated.¹⁴

It was difficult to reconcile these conflicting positions and threats of expropriations held sway. Home states could not use force in the protection of the foreign investments of its nationals because the United Nations Charter

³For a detailed analysis of the emergency of BITs, see A Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties', (1997) 38 Va. J. Int'l Law, 645; M Sornarajah, 'State Responsibility and Bilateral Investment Treaties', (1986) 20 J. World. Trade L, 79; A Akinsanya, 'International Protection of Direct Foreign Investments in the Third World', (1987) 36 Int'l & Comp. L.Q, 58; JW Salacuse, 'BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries', (1990) 24 Int'l Law, 655; MI Khalil, 'Treatment of Foreign Investment in Bilateral Investment Treaties', (1992) 7 ICSID Rev, 339.

⁴M Waibel, A Kaushal, K Chung & C Balchin, 'The Backlash Against Investment Arbitration: Perceptions and Reality' in M Waibel, A Kaushal, K Chung & C Balchin (eds), *The Backlash Against Investment Arbitration* (London: Kluwer Law International, 2010).

⁵J Robbins, 'The Emergence of Positive Obligations in Bilateral Investment Treaties', (2006) 13 University of Miami International and Comparative Law Review, 409.

⁶RD Bishop et al, *Foreign Investment Disputes: Cases, Materials and Commentary* (2d Ed, Kluwer Law International, 2014); J Ding, 'Enforcement in International Investment and Trade Law: History, Assessment, and Proposed Solutions' (2016) 47 Geo. J. Int'l L, 1137.

⁷J Gimblett & O T Johnson, Jr., 'From Gunboats to BITs: The Evolution of Modern International Investment Law,' in KP Sauvart (ed), *Yearbook on International Investment Law & Policy Vol. 2010-2011*, (Oxford University Press, 2011) p.649.

⁸C Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley: University of California Press, 1985), pp.137-64; Robbins, supra note 5.

⁹Lipson, *ibid*, 8-12; Robbins, *ibid*, p.410.

¹⁰Guzman, supra n 3. The then United States Secretary of State, Cordell Hull, sought compensation on behalf of the affected US citizens by making statements that required prompt, adequate and effective compensation for expropriation conducted by the Mexican government.

¹¹ For example, Iran nationalized British oil assets in 1951, Libya expropriated Liamco's concessions in 1955, and Egypt nationalized the Suez Canal in 1956. 'In 1962, the UN General Assembly adopted the Resolution on Permanent Sovereignty over Natural Resources that provided for merely appropriate compensation in the event of expropriation.' See Elkins et al, supra note 1, p.813.

¹²*Ibid*.

¹³Lipson, supra note 8 p.80; Robbins, *ibid*, 410. S Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation*, (Hart Publishing: 2009); DR Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy*, (Minneapolis, MN: University of Minnesota Press, 1955); BM Cremades, 'Resurgence of the Calvo Doctrine in Latin America', (2006) 7 Bus. L. Int'l 53; Wenhui Shan, 'From North-South Divide to Private- Public Debate: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law', (2006-2007) 27(3) Nw. J. Int'l. L. & Bus. 631.

¹⁴Lipson, supra note 8 pp.18, 74; Robbins, supra note 5, p.411.

prohibits the use of military force except in self-defence.¹⁵ Hence, various capital exporting states decided to enter into BITs as a way of ensuring that certain protections are available to their nationals.¹⁶ This was when BITs started gaining prominence. In addition, the belief that protecting the interests of foreign investors will lead to an increase in foreign direct investment ('FDI'), which will in turn, lead to the development of the host states¹⁷ also assisted in the popularity of BITs. Furthermore, some developing countries also believed that signing BITs with developed states will improve the relationship between both states, and that BITs can as a vital source of capital for economic development.¹⁸

In 1959, Germany was the first to conclude a BIT¹⁹ with Pakistan and Dominican Republic.²⁰ The spread of BITs has intensified dramatically over the past two decades.²¹ The form of BITs varies but the agreements generally contain provisions relating to the definition of investment, the establishment of the minimum standards of treatment required from the host state, including provisions that ensure fair and equitable treatment and prohibit expropriation, and the establishment of a dispute settlement mechanism to govern the settlement of investment disputes which may arise between the host state and a foreign investor.

3. Settlement of Investment Disputes: Investment Arbitration Tribunals and National Courts

Several measures are available for the settlement of investment disputes that arise between foreign investors and host states. For example, home states engaged in various diplomatic measures like negotiations, with the host states in circumstances where the host states have unfairly treated the foreign investment of the home state's nationals.²² However, with the emergence of BITs, there are two major mechanisms that are available for the resolution of investment disputes. The foreign investors can bring claims against the host states in the host state's national courts. They can bring claims against the host states in investment treaty arbitral tribunals. The option to be adopted by the foreign investors is usually provided for in the relevant BIT.

Investment Arbitration:

The earliest BITs did not have clauses that provided for international arbitration in the resolution of investment disputes.²³ However, almost all BITs provide private parties with the right to settle investment disputes against host

¹⁵See UN Charter art. 2 & 51; See K Vandeveld, 'A Brief History of International Investment Agreements' in K Sauvart & L Sachs (eds), *The Effects of Treaties in Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation and Investment Flows* (Oxford Scholarship Online: 2009).

¹⁶J Robbins, supra note 5 p.410.

¹⁷Elkins et al, supra n 1. Whether BITs achieve their goal of increasing the inflow of FDI to developing countries and thereby promoting economic development, and to what extent, remains a subject of controversy. However, this point is outside the scope of this paper.

¹⁸ Particularly when other means of obtaining finance, such as foreign aid and International Monetary Fund (IMF) and World Bank loans, largely dried up between 1980s and 1990s. See JW Salacuse, 'The Emerging Global Regime for Investment', (2010) 51 *Harv. Int'l L.J.* 427, 439; Elkins et al, *ibid*, p.811.

¹⁹ Because the country lost most of its foreign investment because of its defeat in the Second World War. See JW Salacuse & NP Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', (2005) 46 *Harv. Int'l L.J.* 67, 68.

²⁰ Other Western European countries quickly followed Germany's lead. France concluded its first BIT with Chad in 1960, Switzerland concluded its first BIT with Tunisia in 1961, the Netherlands with Tunisia in 1963, and so on. See generally, United Nations Conference on Trade and Development, *Bilateral Investment Treaties in the Mid-1990s* (1998).

²¹ As at 1988, about 309 BITs were in place but by 2013, over 2,800 of the nearly 3,200 international investment agreements in existence were BITs. See AJ Pappas, 'References on Bilateral Investment Treaties, (1989) 4 ICSID Rev. Foreign Invest. L. J, 189; United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, Global Value Chains: Investment and Trade for Development*, 2013.

²² L Trakman, 'Foreign Direct Investment: Hazard or Opportunity?' (2009) 41 *The Geo. Wash. Int'l L. Rev.* 24. This process has some disadvantages because it is discretionary.

²³ S Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation*. (Hart Publishing, 2009); JW Yackee, 'Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties', (2008) 33 *Brooklyn Journal of International Law*, 40; K Tienhaara, 'Once BITten, Twice Shy? The Uncertain Future of Shared Sovereignty in Investment Treaty Arbitration, (2011), <www.sciencedirect.com> accessed 27 April 2019.

The 1959 Abs-Shawcross Draft Convention on Investment Abroad was the earliest attempt at providing foreign investors with the option of international arbitration through BITs and other similar treaties like NAFTA. See ANewcombe & L Paradel, *Law and Practice of Investment Treaties: Standards of Treatment*, (Alphen Aan Den Rijn: Kluwer Law International, 2009).

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states through international arbitration in recent times.²⁴ In fact, it has been argued that the right to arbitrate is the most significant right provided by BITs.²⁵ The primary purpose of adopting this mechanism stems from the need for foreign investors to avoid domestic influence or any kind of bias in the settlement of investment disputes in national courts. Hence, due to deficiencies that exist in some national courts, including fear of corruption and incessant delays, investment arbitration guarantees a neutral forum for the settlement of disputes, and prevents host states from acting in an arbitrary manner towards foreign investors that have disputes against them.²⁶ It is also believed that this mechanism will, in turn, enhance the improvement of the rules of law within a developing host country.²⁷ In addition, investment arbitration is seen as a 'legitimate mechanisms for structuring and stabilizing international investment relations without institutionalizing a pro-investor bias or disregarding the host state's legitimate power to regulate'.²⁸

However, investment arbitration has faced intense criticisms over the years. Although some investment arbitral tribunals agree on many issues,²⁹ inconsistent decisions arise regularly from different arbitration tribunals. This development has greatly weakened the system for the settlement of investment disputes and caused crisis that affects investors and developing host states.³⁰ Ten Cate³¹ for example, discussed these conflicts using the cases that arose from the BIT between Argentina and the United States. The cases involved U.S investors like CMS Gas Transmission Company,³² LG&E Energy Corporation,³³ Enron Creditors Recovery Corporation,³⁴ Sempra Energy International,³⁵ and Continental Casualty Co.³⁶ These cases arose due to the policies adopted by Argentina in reaction to the 2011 economic and political crisis. In these cases, the claims of the different U.S. investors were hinged on the same acts and policies of the Argentinian government and the various tribunals assessed the BIT between the United States and Argentina. Yet inconsistent decisions and interpretations were largely reached by these tribunals in relation to sensitive issues.³⁷

Furthermore, several foreign investors structure their investments and corporate structure for the sole purpose of gaining the protection of a BIT.³⁸ In addition, although the regime for BITs (and other free trade agreements like

²⁴CM Ryan, 'Meeting Expectations: Assessing the Long-Term Legitimacy and Stability of International Investment Law', (2008) 29 U. Pa. J. Int'l L. 725, 733. See also D Schneiderman, 'Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes', (2010) 30 N.W. J. Int'l L. & Bus, 383.

²⁵Ryan, *ibid* p.733.

²⁶JW Salacuse, 'The Emerging Global Regime for Investment', (2010) 51 Harv.Int'l L. J, 427, 441-42, 444; Ma, *supra* note 2.

²⁷SD Franck, 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law', (2007) 19 Pac. McGeorge Global Bus.& Dev. L. J, 337.

²⁸CN Brower et al., 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?', (2009) 9 Chi. J. Int'l L, 471.

²⁹See G Kaufmann-Kohler, 'Is Consistency a Myth?', in E Gaillard & Y Banifatemi (eds), *Precedent in International Arbitration* (Huntington New York: Juris Publishing, 2008) p.137, 138-141.

³⁰SD Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions', (2005) 73 Fordham L. Rev, 1558-59; A Leeks, 'The Relationship Between Bilateral Investment Treaty Arbitration and the Wider Corpus of International Law: The ICSID Approach', (2007) 65 U.T. Fac. L. Rev, 1, 34.

³¹IM Ten Cate, 'The Costs of Consistency: Precedent in Investment Treaty Arbitration', (2013) 51 Columbia Journal of Transnational Law, 418.

³²*CMS Gas Transmission Co. v Argentine Republic*, ICSID Case No.ARB/01/8, Award May 12, 2005; *CMS Gas Transmission Co. v Argentine Republic*, ICSID Case No. ARB/01/8, Annulment Decision Sept. 25, 2007.

³³*LG&E Energy Corp. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability Oct. 3, 2006.

³⁴*Enron Corp. v Argentine Republic*, ICSID Case No.ARB/01/3, Award May 22, 2007; *Enron Corp. v Argentine Republic*, ICSID Case No. ARB/01/3, Annulment Decision July 30, 2010.

³⁵*Sempra Energy Int'l v Argentine Republic*, ICSID Case No.ARB/02/16, Award Sept. 28, 2007; *Sempra Energy Int'l v Argentine Republic*, ICSID Case No. ARB/02/16, Annulment Decision June 29, 2010.

³⁶*Cont'lCas. Co. v Argentine Republic*, ICSID Case No.ARB/03/9, Award Sept. 5, 2008; Annulment Decision Sept. 16, 2011.

³⁷ Detailed analysis of these cases can be found in Ten Cate, *supra* note 31, p 418, JE Alvarez & T Brink, 'Revisiting the Necessity Defense: Continental Casualty v Argentina', in KP Sauvart (ed), *supra* note 7 p.319; D Schneiderman, 'Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes', (2010) 30 Nw. J. Int'l L. & Bus, 383.

³⁸For example, see the case of *Philip Morris Asia Limited (Hong Kong) v The Commonwealth of Australia* UNCITRAL, PCA Case No. 2012-12, Award – December 2015 where the Arbitral Tribunal declined its jurisdiction in this case and held that the Claimant's investment was not properly admitted in Australia since the dispute had arisen before the Claimant obtained the protection of the BIT between Hong Kong and the Australia, and that, the commencement of the arbitration shortly after the Claimant's restructuring constituted an abuse of rights.

NAFTA) was intended to protect the interests of foreign investors against discrimination, and to treat foreign investors in a comparable way as the domestic investors, the regime gives an unfair advantage to foreign investors over domestic investors. For example, in the case of *Mondev International Limited v United States*,³⁹ assuming there were no technical/jurisdictional grounds for dismissing the claim against the United States based on NAFTA, the United States may have had to paid compensation to the claimant for its losses. However, if the original dispute, with an identical cause of action, had arisen between a domestic investor and the government, the debate would have ended when the U.S. Supreme Court denied certiorari.⁴⁰

National Courts:

Under the current regime, national courts are not the primary mechanism for the settlement of investment disputes. However, several commentators have argued that national courts should be allowed to resolve investment disputes that arise between a foreign investor and the host government. Recently, some countries, like Australia, have stated that they will not resolve investment disputes under the auspices of the ICSID or similar arbitral body, but through its domestic courts.⁴¹ The same line of action has been considered by Nicaragua, Indonesia, Philippines and Venezuela at various times in the past decade.⁴² The first step towards this approach was the promulgation of the ‘Calvo Doctrine’ which has been discussed above.⁴³

The reasons for choosing national courts over investment arbitration are numerous. For example, host states are also wary of investment arbitration because it impedes of the sovereignty of the host state, especially when there is an inconsistency between the BITs, customary international law, and the domestic laws of the host states. There is also need to give national courts the opportunity to apply public policy considerations, such as the protection of the environment, human rights, national security and so on, in adjudicating the disputes just like the courts do in relation to disputes that involve other local investors exclusively.⁴⁴ In general, the intention and expertise of the arbitrators, especially in relation to public interest issues and there is a fear that arbitrators will rank their private economic interests above the political and economic interests of the host states.⁴⁵ Host states are also wary of investment arbitration because it impedes of the sovereignty of the host state, especially when there is an inconsistency between the BITs, customary international law, and the domestic laws of the host states. In addition, it is believed that arbitral proceedings are more expensive than settling investment disputes in national courts. For example, Australian government stated that ‘investor-state arbitration exposes Australia to costly, fractious, and dysfunctional disputes with foreign investors, such as Philip Morris Australia, that have deep pockets.’⁴⁶ Furthermore, national courts adhere to a set of certain procedural principles,⁴⁷ and this is not the case in arbitration proceedings. These procedural principles may be less flexible in some countries, depending on whether the host state is a civil or common law country, but these principles generally exist. In relation to procedural matters, the national courts have an appeal processes which is preferable than the arbitral processes that does not give room for appeals.⁴⁸ The absence of precedents is also an issue. The presence of an appellate system and the use of precedents will encourage consistency and transparency in the decision-making processes, as well as enhance the legitimacy of the process as whole. There is a general belief that people will trust the legal mechanism more when it offers predictability.⁴⁹

³⁹*Mondev International Ltd v United States of America*, NAFTA Case No. ARB (AF)/99/2, Award Oct. 11, 2002.

⁴⁰Supra note 39. See D Krueger, ‘The Combat Zone: *Mondev International Limited v United States of America* and the Backlash against NAFTA Chapter 11’, (2003) 21 B.U. Int’l LJ, 399.

⁴¹LE Trakman, ‘Investor State Arbitration or Local Courts: Will Australia Set a New Trend?’ (2012) 46 J. World Trade 83; LE Trakman, ‘Foreign Direct Investment: An Australian Perspective’, (2010) 13 Int’l Trade & Bus L. Rev, 31, 48.

⁴²LE Trakman & K Sharma, ‘Jumping Back and Forth between Domestic Courts and ISDS’ in S Hindelang & M Krajewski, (eds), *Shifting Paradigms in International Investment Law*, (United Kingdom: Oxford University Press, 2016) p.317.

⁴³Under the ‘Brief History of Investment Treaty Arbitration’ page number 2.

⁴⁴ L Trakman, ‘The ICSID Under Siege’, (2012) 45 Cornell International Law Journal, 649.

⁴⁵PM Norton, ‘A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation’, (1991) 85 AM. J. Int’l L, 74.

⁴⁶ See L Trakman, supra note 43 p.650; LR Nottage, ‘Consumer Product Safety Regulation and Investor-State Arbitration Policy and Practice After *Philip Morris Asia v Australia*’, (2011) 22 Austl. Product Liability Rep, 154.

⁴⁷Trakman, *ibid*.

⁴⁸ *Ibid*.

⁴⁹DJ Sushama, ‘Appellate Structure and Need for Legal Certainty in Investment Arbitration’, available at <<http://kluwerarbitrationblog.com/2014/05/01/appellate-structure-and-need-for-legal-certainty-in-investment-arbitration/>> accessed 18 April 2019.

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According to Fry, an appellate regime will encourage a reason-based approach which will ‘add a large measure of consistency to the regime, regardless of whether different lines of precedent develop over time.’⁵⁰

However, relying solely on national courts for the settlement of investment disputes is not a flawless alternative. According to Trakman, notwithstanding the absence of strict application of judicial precedents in investment arbitration, this mechanism is still likely to be more coherent than a multiplicity of different state laws applied by national courts to foreign investment disputes.⁵¹ In addition, the fear of bias remains but in investment arbitration, the parties have autonomy in selecting arbitrators, while judges of the national courts are appointed by the host state, through various domestic processes.⁵² In reaction to the arguments that national courts are subject to specific rules of procedure, most investment arbitral institutions also have similar rules of procedure for the resolution of investment disputes, including the UNCITRAL⁵³ and ICSID rules.⁵⁴ Arbitrators appointed by the parties in the investment arbitration are usually experts in international investment law in a manner that judges of national courts are not.⁵⁵ Investment arbitration proceedings are also considered more flexible and quicker than national court proceedings, due to the appeal system in place in various national courts. The likelihood that the arbitral awards will be final is high, as opposed to judgments of national courts. The arbitral awards are also easily enforceable in multiple jurisdictions by the courts of signatory countries to the ICSID or New York Convention.⁵⁶

4. Striking A Balance Between Investment Arbitration And National Courts: The Role Of The Local Remedies Rule
It has become clear that both systems of dispute settlement are characterized by flaws. The pitfalls of the national court system and investment arbitration suggest that relying solely on either mechanism will not advance foreign investment. As discussed above, investment arbitration dominates the realm of dispute settlement in modern BITs, leaving national courts with no power in settling substantive issues that arise in investment disputes. Indeed, national courts play a role in the general process of resolving disputes between foreign investors and host states, particularly at the enforcement stage. For example, in non-ICSID arbitration domestic courts may have the power to set aside international arbitral awards.⁵⁷ But this role is not enough since most investment disputes are resolved through ICSID.⁵⁸

There is need to strike a balance between the investment arbitration and national courts regime so that both mechanisms can work together for the benefit of foreign investors and host states. This is not ideal. Investment arbitration should work to provide examples for national courts in developing countries to follow, in hopes that these countries can reform their own flawed regulatory institutions.⁵⁹ So far, this task is not being achieved by the present structure for settling investment disputes which limit the role of national courts to enforcement of arbitral awards and in some cases BITs impair the strength of rule of law within a developing country.⁶⁰ According to Franck, ‘foreign investors rationally refrain from championing good and generalized law reforms in the developing state, preferring instead to protect their interests by relying on the BIT rule of law enclave.’⁶¹

⁵⁰JD Fry, ‘Regularity Through Reason: A Foundation of Virtue for International Arbitration’, (2011) 4 *Contemp. Asia Arb. J.* 57, 82.

⁵¹LE Trakman, ‘Choosing Domestic Courts over Investor-State Arbitration: Australia’s Repudiation of the Status Quo’, (2012) 35(3) *UNSW Law Journal*, 979.

⁵²LE Trakman, ‘A Plural Account of the Transnational Law Merchant’ (2011) 2(3) *Transnational Legal Theory* 309, 335.

⁵³UNCITRAL does not administer arbitration or conciliation proceedings. Other institutions, most notably the Permanent Court of Arbitration (‘PCA’), administer investor–state disputes under the UNCITRAL Rules. See LE Trakman, *supra* note 50.

⁵⁴*Ibid.*

⁵⁵C Dugan et al, *Investor–State Arbitration* (New York: Oxford University Press, 2008); P Muchlinski et al (Eds) *The Oxford Handbook of International Investment Law* (New York: Oxford University Press, 2008).

⁵⁶LE Trakman, *supra* note 50.

⁵⁷*Czech Republic v CME*, Svea Court of Appeals, 15 May 2003, 42 ILM 919 2003.

⁵⁸For example, as at 2012, the largest proportion of investment disputes were brought under the ICSID Convention and the ICSID Additional Facility Rules (61.9 percent of all disputes), followed by UNCITRAL Arbitration Rules (27.6 percent). Other disputes were brought under SCC Rules (5.1 percent) and ICC Rules (1.6 percent), as well as under other rules (3.9 percent) See UNCTAD, 2013 - Recent Developments in Investor-State Dispute Settlement (ISDS), Updated for the Multilateral Dialogue on Investment, 28-29 May 2013.

⁵⁹Ma, *supra* note 2.

⁶⁰T Ginsburg, ‘International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance’, (2005) 25 *Int’l Rev. L & Econ.* 107, 119. ‘[T]he decision to bypass domestic courts may reduce courts’ incentives to improve performance by depriving key actors from a need to invest in institutional improvement.’ See also Ma, *Supra* note 2.

⁶¹Franck, *supra* note 27. Ma, *Supra* note 2.

The involvement of local courts in settling substantive issues in investment disputes can be encouraged. A ready solution is the strict application of the exhaustion of local remedies rule. The exhaustion of local remedies rule is a principle that requires foreign investors to seek redress for any harm allegedly caused by a host state in the national courts of the host state before resorting to investment arbitration. This principle is a recognition of the judicial sovereignty of the host state over legal issues that arise or are connected within its legal system.⁶² Hence, the principal purpose of the rule is to give the host state an opportunity to redress the illegality done in its jurisdiction.⁶³

The practice of incorporating the requirement for the exhaustion of local remedies rule was incorporated in IIAs has become rare,⁶⁴ as states conclude investment treaties under which they give advance consent to foreign investors to resort to international investment arbitration for the resolution of disputes. The prevalent practice is that foreign investors can initiate claims in investment arbitration without prior recourse to the host state's domestic courts. Under these treaties, there need not be an express waiver of the local remedies rule. The mere existence of an arbitration clause is often interpreted as a waiver of the local remedies rule, particularly in arbitrations brought under the ICSID Convention.⁶⁵ In recent years, states including Argentina and India, have reintroduced a mandatory requirement to pursue or exhaust local remedies for the settlement of investment disputes in their investment treaties.⁶⁶ In some other BITs, it is provided that local remedies must be utilized for a certain period before international arbitration may be initiated.⁶⁷ It is difficult to classify this treaty requirement as falling under the local remedies rule since the claimant is allowed to turn to international arbitration once the time has elapsed⁶⁸ and these provisions have not been honored in practice, mainly through its non-application.⁶⁹ In addition, foreign investors can avoid the application of the local remedies rule by relying on the most favored nation (MFN) clauses in the same BITs which allow the investors to rely on other BITs of the host State that did not contain that requirement.⁷⁰

The local remedies rule can help to create a balance between the roles of investment tribunals and national courts in the settlement of investment disputes. First, this principle will strengthen the legal system of host states and will help in the development of the law especially regarding public interest issues that arise in investment disputes since national courts are best placed to consider these public interest issues. They touch on the sovereignty of the host state, the proceedings in national court will be public, unlike arbitration which is private is inappropriate, and an appeal process which will encourage a further review of the issues will exist. This requirement to exhaust local remedies before resorting to international arbitration presupposes that investment arbitration tribunals will be available to review the decisions of the local courts, if and when the need arises. This process will discourage foreign investors from forum shopping and taking advantage of BITs by restructuring their businesses.

In addition, having to spend money in domestic litigation, as well as in investment arbitration will possibly discourage some foreign investors from resorting to arbitration without making efforts to settle the dispute. The

⁶² M Sornarajah, *The International Law on Foreign Investment*, (United Kingdom: Cambridge University Press, 2010), p.219-21.

⁶³ MN Shaw, *International Law* (United Kingdom: Cambridge University Press, 2003), p.730.

⁶⁴ Domestic judicial systems would reassume their roles as the primary fora for disputes involving claims by foreign investors, and investor state tribunals would provide an extra layer of protection against any deficiencies in domestic legal processes.

⁶⁵ In relation to ICSID, article 26 of the ICISD Convention provides that '[c]onsent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.' According to Amerasinghe, '[i]t is clear that by virtue of Article 26 of the ICSID Convention the rule of local remedies is waived where it otherwise would apply in circumstances where ICSID arbitration is the relevant means of dispute settlement...'. See CF Amerasinghe, *Local Remedies in International Law* 22 (2nd Ed, Oxford University Press, 2004), p.269.

⁶⁶ Ibid.

⁶⁷ For example, article 10 of the BIT between Argentina and Germany; the Egypt–United Kingdom BIT, Article 8(1); the France–Morocco BIT, Article 10. Norway's Model BIT of 2007 contains a particularly onerous provision. Under Article 15(3), ICSID arbitration becomes available if 'agreement cannot be reached between the parties to this dispute within 36 months from its submission to a local court for the purpose of pursuing local remedies, after having exhausted any administrative remedies...'

⁶⁸ C Schreuer, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration', (2005) 4 *The Law and Practice of International Courts and Tribunals*, 1.

⁶⁹ Ibid.

⁷⁰ For example, *National Grid PCL v Argentine Republic*, Decision on Jurisdiction, June 2006; *Maffezini v Spain*, Decision on Jurisdiction, January 2000, 5 ICSID Reports 396. See Schreuer supra note 67.

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possibility of an appellate review by the arbitral tribunals will also assist national courts in developing countries to learn from the expertise of arbitrators and it will help national courts to act fairly, bearing in mind that their judicial sovereignty is at stake when their decisions are constantly overturned by arbitral tribunals. The appellate process will also help to restore legitimacy in the process of settling investment disputes, and give foreign investors a chance, in the event of bias or other deficiency of national courts. Adopting strict local remedies rules will guarantee more consistency in the settlement of investment disputes, especially in national courts of developed countries that have a solid framework for the rule of law. Although BITs differ, resolving the same or closely related legal questions that arise from the same or closely related BITs will guarantee fairness and legitimacy in the process of settling disputes, and it will help parties to resolve disputes by adopting negotiation or other forms of alternative dispute resolution after having the opportunity to assess their legal positions before hand. Domestic courts will also be required to incorporate the provisions of the international investment law in their domestic laws or apply the provisions of the BITs, and international law when relevant to ensure a uniform application of similar BITs across different jurisdictions.

These ideas may be viewed by some commentators as undermining the judicial sovereignty of national courts, a process that will encourage delay in the settlement of disputes, and a process that will be provide unfair advantage to foreign investors over domestic investors. However, in relation to delay, a uniform, reasonable and realistic timeline for settling disputes in national courts and arbitral tribunals can be provided for in various BITs and procedural rules of the various arbitral institutions. This will mean that host states will need to make provisions for expedited resolution of such disputes. For example, strict timelines for filing of court process and delivering of judgment, and domestic appellate review. Foreign investors can also be given the opportunity of resorting to arbitral tribunal in the event that there is a clear, manifest, and unambiguous proof that justice will not be achieved in the national courts. Arbitral tribunals will also have to restrict their review process to specific issues of law and fact.

In relation to sovereignty, compromise needs to be struck between foreign investors and host states for the advancement of their goals. This principle will also not be totally unfair to domestic investors in the host state as it is simply a price which must be paid by them in encouraging foreign direct investment, and enhancing the relationship between home states and host states – which will in turn, assist in the business so the domestic investors. With time, this expedited process will help in a more reliable resolution of disputes. The domestic investors will also have these advantages when they go to other states for foreign investment. The various arbitral institutions, particularly ICSID⁷¹ can help in the implementation of this strategy. However, if ICSID is reluctant, relevant parties can denounce the ICSID Convention by following Articles 71, 72 and 73 of the ICSID Convention.⁷²The treaties can also be renegotiated by agreement of the parties⁷³ to provide for the application of the local remedies rule and to adopt the arbitral institution that is willing to apply the same rules. Terminating the BITs can also be a possibility but it must be done in accordance with the terms of the BIT and with the consent of the parties.⁷⁴

5. Conclusion

BITs have encouraged economic relationships between states over the years and one of the principal provisions in most BITs is the settlement of investment disputes that arise between foreign investors and host states. The most common mechanism provided for by recent BITs for the settling substantive legal and factual issues in investment disputes is investment arbitration tribunals. National courts, the other principal mechanism, are being limited to enforcing the arbitral awards that arise out of arbitration proceedings. Without a doubt, the national courts

⁷¹ICSID cases have held that claimants were entitled to institute international arbitration directly without first trying their luck in the local courts. See *Lanco v Argentina*, Decision on Jurisdiction, 8 December 1998, (ILM 457, 469/70 (2001)); *Generation Ukraine v Ukraine*, Award, 16 September 2003.

⁷² For example, The Republic of Bolivia and the Republic of Ecuador submitted notices of denunciation of the ICSID to the World Bank in May 2007 and July 2009 respectively. For a detailed analysis of the consequences and process of denunciation of the ICSID Convention, see C Schreuer, 'Denunciation of the ICSID Convention and Consent to Arbitration' in M Waibel et al (Eds), *The Backlash Against Investment Arbitration*, supra note 4.

⁷³ Article 39 Vienna Convention on the Law of Treaties available at <https://www.ilsa.org/jessup/jessup17/Batch%201/Vienna%20Convention%20on%20the%20Law%20of%20Treaties.pdf> accessed 21 April 2019. See K Nowrot, *Termination and Renegotiation of International Investment Agreements*, in S Hindelang & M Krajewski (Eds) supra note 42.

⁷⁴ Article 54 Vienna Convention on the Law of Treaties available at <https://www.ilsa.org/jessup/jessup17/Batch%201/Vienna%20Convention%20on%20the%20Law%20of%20Treaties.pdf> accessed 21 April 2019.

mechanism or investment arbitration cannot be used efficiently in the settling these disputes. This is not surprising as no mechanism is flawless and self-sufficient. Hence, there is need to strike a balance between the responsibilities of investment arbitration tribunals and national courts in settling substantive issues that arise from investment disputes. This step will help in the development of the national courts in the host states, amongst other advantages. The tool which will provide this balance is the local remedies rule which has been disregarded. For example, host states have tried to rely on this principle without success.⁷⁵ It is understandable that investors need to feel secure that the national courts will be competent to give a fair and unbiased consideration to all the legal and factual issues that arise in investment disputes. The time to assist national courts in achieving this goal line is here.

⁷⁵*Generation Ukraine v Ukraine*, Award, 16 September 2003, 10 ICSID Reports 240 at paras.13.1-13.6.; *IBM v Ecuador*, Decision on Jurisdiction, 22 December 2003, 13 ICSID Reports 105 at paras.77-84; *AES v Argentina*, Decision on Jurisdiction, 26 April 2005, 12 ICSID Reports 312 at para. 69.