

Resolving Investor State Dispute Settlement's Legitimacy Crisis: The Case for Reinstating the Requirement to Exhaust Local Remedies

Sebastian Timothy Whitefoord Curtis*

ABSTRACT

This article dissects a variety of structural issues that contribute to the 'legitimacy crisis' currently faced by Investor State Dispute Settlement (ISDS) and in particular, treaty-based Investor-State Arbitration (ISA). Primarily, it addresses issues of jurisdictional overlap with domestic courts, and the inability of ISA to engender 'good governance' norms and the rule of law in respondent states. By examining these structural issues and their relationship with the difficult, and at times inflammatory relationship between the international investment protection regime and domestic governments and judiciaries, it contends that further internationalization, or 'systemic reform' in lieu of the proposals made by the European Union is not adequate for resolving the legitimacy crisis. Rather, it proposes that a more radical, reintegration of domestic courts is necessary through the reinstatement of a traditional requirement of customary international law, the requirement to exhaust local remedies before commencing arbitral proceedings.

* LLM (LSE) '22, LLB '21 at the University of Bristol. The author would like to thank Dr Joshua Paine for his guidance and supervision of the author's undergraduate thesis, without which this work would not have been possible.'

INTRODUCTION

In 2015, during the height of negotiations over the controversial Transatlantic Trade and Investment Partnership, Celia Malmström, the EU Commissioner on Trade, decried a ‘fundamental and widespread lack of trust by the public in the fairness and impartiality of the old ISDS model’.¹ This statement reflected mounting criticism from both academic commentators and the general public directed towards what would become a major stumbling block in the ultimately failed negotiations.² At the heart of the controversy was Investor-State Arbitration (ISA), a mechanism of international investment protection enshrined in the ‘vast majority’ of international investment treaties around the world.³ This mechanism is often described as creating a ‘unique legal and political position for international investors’, in that it provides private foreign investors with a direct and exclusive right of standing to sue States for compensatory damages before an international tribunal.⁴ As a direct right, unlike in other comparable international fora, ISA does not require the exhaustion of local remedies prior to instigating arbitration.⁵ Furthermore, these tribunals are not public courts but consist of private, ad-hoc arbitrators whose judgements are nevertheless binding on states,⁶ via the New York Convention.⁷ The dramatic increase in critical literature over the last 10 years, alongside increased public awareness and activism, and the formation of public-interest groups

¹ Cecilia Malmström, ‘Proposing an Investment Court System’ (*European Commission Blog*, 16 September 2015) <https://wayback.archive-it.org/12090/20191128122737/https://ec.europa.eu/commission/commissioners/2014-2019/malmstrom/blog/proposing-investment-court-system_en> accessed 20 April 2021.

² Thomas Dietz, Marius Dotzauer and Edward S. Cohen ‘The Legitimacy Crisis of Investor-State Arbitration and the New EU Investment Court System’ (2019) 26 *Review of International Political Economy* 749, 750.

³ Yannick Radi, *Rules and Practices of International Investment Law and Arbitration* (1st edn, Cambridge University Press 2020) 26.

⁴ Jonathan Bonnitcha, Lauge N Skovgaard Poulsen and Michael Waibel, *The Political Economy of the Investment Treaty Regime* (1st edn, Oxford University Press 2017) 21.

⁵ Convention on the Settlement of International Disputes Between States and Nationals of Other States (adopted 18 March 1965, entered into force 14 October 1966) art 26.

⁶ Dietz, Dotzauer and Cohen (n 2) 751.

⁷ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted 3 My 1956, entered into force 7 June 1959) 330 UNTS 3 (New York Convention) art 3.

dedicated to dismantling Investor-State Dispute Settlement (ISDS) in its current form,⁸ has been characterised by several authors as an ongoing 'legitimacy crisis'.⁹

Amid mounting scrutiny, several different reformist movements have emerged, each spearheaded by a variety of different actors and targeting different contested elements of the investment protection regime. UNCITRAL Working Group III, established in 2017, has served as a multilateral forum to facilitate this process, equipped with a 'broad mandate' to identify concerns and recommend potential solutions to the UNCITRAL Commission whilst utilising the 'widest possible breadth of available expertise from all stakeholders', and have invited submissions from a variety of different sources including governments, universities and arbitration associations.¹⁰ Other states, however, have progressed their own reform agenda through direct action. The European Union for example, has been key proponents of 'systemic reform' through the establishment of a standing multilateral investment court to entirely replace ISA,¹¹ and have included provisions related to its future creation in recent bilateral investment treaties (BITs) with Canada, Vietnam, Singapore and Mexico.¹² On the other hand, 'paradigm shifters' like India, South Africa and Brazil; united by their scepticism of any system that allows investors to make international claims directly against States, have often acted unilaterally.¹³ One example of this kind of action is South Africa's controversial decision to unilaterally terminate several BITs in 2015, and 'pull out' of the established

⁸ Stop ISDS (Website) <<https://stopids.org.uk/>> accessed 27 April 2021.

⁹ Dietz, Dotzauer and Cohen (n 2) 752.

¹⁰ UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session' (19 December 2017) 34th Session (2017) UN Doc A/CN.9/930/Rev.1 3.

¹¹ Issam Hallak, 'Multilateral Investment Court' (*European Parliamentary Research Service*, January 2020) 8 <[https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/646147/EPRS_BRI\(2020\)646147_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/646147/EPRS_BRI(2020)646147_EN.pdf)> accessed 15 March 2022.

¹² Anthea Roberts, 'Incremental, Systemic, and Paradigmatic Reform of Investor-State Arbitration' (2018) 112(3) *American Journal of International Law* 410, 410.

¹³ *ibid.*

ISDS system,¹⁴ replacing it with the Protection of Investment Act,¹⁵ explicitly applicable to ‘all investors’ foreign and domestic alike, alongside establishing a system of State-to-State arbitration.¹⁶

Historically, the development of treaty-based ISA as a means of protecting the interests of foreign investors is rooted in overcoming the perceived failures of the primary system of investment protection that preceded it: diplomatic protection. Diplomatic protection, as a political and discretionary process, was ultimately considered ineffective in ensuring that foreign investors benefited from an ‘international minimum standard’ of protection regardless of any deficiencies in the legal system of the host state.¹⁷ In particular, it was conceived that a key ‘innovation’ of treaty-based ISA over the former diplomatic protection system would be that it would allow investors to bypass a traditional requirement of customary international law by removing the requirement to exhaust local remedies.¹⁸ This was first expressly confirmed in Art 26 of the International Centre for Settlement of Investment Disputes (ICSID) Convention, the most influential set of procedural rules for ISA.¹⁹

Indeed, the decision to remove the local remedies requirement, ‘dominated’ the contested drafting history of Article 26,²⁰ with delegates from Latin America expressing particular concern that the rule would undermine domestic courts and create procedural privileges for foreign investors.²¹ The

¹⁴ Mmiselo Freedom Qumba, ‘South Africa’s Move Away from International Investor-State Dispute: A Breakthrough or Bad Omen for Investment in the Developing World?’ (2019) 52(1) *De Jure Law Journal* 358.

¹⁵ Protection of Investment Act 2015 (South Africa), s 1.

¹⁶ *ibid* s 13(5).

¹⁷ Alireza Falsafi, ‘The International Minimum Standard of Treatment of Foreign Investors’ Property: A Contingent Standard’ (2007) 30 *Suffolk Transnational Law Review* 318, 321.

¹⁸ Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (2nd edn, Oxford University Press 2017) 114.

¹⁹ ICSID Convention (n 5) art 26.

²⁰ Christoph Schreuer, *The ICSID Convention: A Commentary: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (2nd edn, Cambridge University Press 2009) 403.

²¹ International Centre for Settlement of Investment Disputes, *The History of the ICSID Convention Volume II Part 2* (ICSID Publication 1968) 67.

decision reflects both the predominant motivations and the tacit assumptions that motivated the development of the international investment protection regime in the mid-20th century. First, it was assumed the regime would predominantly be used by investors from capital-exporting, developed nations in the West to protect their investments in developing nations, where there were seldom independent judiciaries or strong domestic institutions.²² Secondly, it reflected the fundamental motivation behind the establishment of the international investment regime: to protect foreign investments and incentivise investors to enter into emerging and potentially unstable markets.²³ Both of these assumptions, however, have been challenged in the modern context. Canada and Germany have both been subject to successful investment arbitration claims, despite having what are typically regarded as strong domestic institutions and independent judiciaries. Furthermore, ISDS, is now generally regarded as having responsibilities beyond the mere promotion of flows of foreign investment. This includes encouraging sustainable development and the promulgation of the rule of law, as indicated by the UNCITRAL endorsed UN Sustainable Development Goals,²⁴ and by increasing reference to these goals in modern BITs, such as the 2017 Rwanda-UAE IIA.²⁵

This article argues that in the context of mounting pressure in favour of reform, the decision to remove the requirement to exhaust all local remedies before referring the dispute to arbitration ought to be reconsidered. Instead, it ought to be reinstated in the international investment protection regime as a prerequisite for access to international arbitral proceedings. Furthermore, in the case of further systemic reform in lieu of the proposals of the European Union, it should be instated as a prerequisite for access to any multilateral investment

²² Peter-Tobias Stoll, 'International Investment Law and the Rule of Law' in Till Patrik Holterhus (ed), *The Law Behind Rule of Law Transfers* (1st edn, Nomos Verlagsgesellschaft 2019) 273.

²³ Gabrielle Kaufmann-Kohler and Michele Potestà, 'Why Investment Arbitration and Not Domestic Courts? The Origins of the Modern Investment Dispute Resolution System, Criticism, and Future Outlook' in Gabrielle Kaufmann-Kohler and Michele Potestà (eds), *Investor-State Dispute Settlement and National Courts* (1st edn, Springer International Publishing 2020) 13.

²⁴ UNGA Res 68/204 (27 July 2015) UN DOC A/RES/68/204.

²⁵ Rwanda – United Arab Emirates Bilateral Investment Treaty (signed 1 November 2017) Preamble.

court or institution. This position directly addresses several key sources of tension from which the current legitimacy crisis is derived. More precisely, this reform would help restore balance between international and domestic dispute mechanisms, whilst providing the mechanisms necessary for ISA to positively impact the domestic rule of law and achieve the UN Sustainable Development Goals.

Part I of this article collates a selection of jurisdictional issues currently raised by the ISA in the absence of a duty to exhaust local remedies. It will engage in a critical analysis of relevant arbitral jurisprudence in this area, ultimately arguing that no adequate solution has been found, giving rise to uncertainty, dissatisfaction, and unfairness. Further, it will argue that other prospective ‘incremental’ solutions within the current system are mostly ineffective. Instead, a duty to exhaust local remedies represents the most promising solution for restoring balance between international and domestic dispute resolution mechanisms.

Part II examines how ISA can serve as a mechanism to positively affect domestic institutions and the domestic rule of law through the promulgation of good-governance norms in host states. First, it addresses why issues relating to the domestic rule of law are of particular importance in relation to ISDS’s ongoing legitimacy crisis. Second, it examines countervailing narratives that suggest ISA in its current form does already improve outcomes at a domestic level, with a particular focus on the work of Schill and Ehandi. Third, it addresses the disparity between these narratives and on-the-ground empirical research. Finally, it applies Puig and Schaffer’s institutional methodology to contend that a duty to exhaust local remedies can provide the missing ‘complementarity mechanisms’ necessary for ISA to positively impact the domestic rule of law. This is achieved by aligning international and national dispute mechanisms, and this solution will be particularly valuable should the proposed multilateral investment court eventually be established.²⁶

²⁶ Sergio Puig and Gregory C. Shaffer, ‘Imperfect Alternatives: Institutional Choice and the Reform of Investment Law’ (2018) 112 *American Journal of International Law* 361, 365.

Whilst the potential difficulties raised by reinstating a duty to exhaust local remedies are addressed throughout, Part III of this article addresses three commonly cited criticisms. First, it contests the notion that domestic courts are inherently unsuitable fora for investment disputes and lack the required expertise. Second, it will consider whether a duty to exhaust local remedies would impose unduly onerous costs and delay on investors. Finally, it will consider whether the eventual establishment of a multilateral investment court would render the duty to exhaust local remedies incompatible or unnecessary.

I. JURISDICTIONAL CONFLICT AND ISA

1) The Nature of Jurisdictional Issues raised by ISA

In public international law, where claims regularly appear in both national and international fora, the jurisdictional overlap between the two has long been guarded by the 'exhaustion of local remedies' rule.²⁷ A prototypical example of this requirement is Article 35(1) of the ECHR, which requires the exhaustion of local remedies before a case can be argued before the European Court of Human Rights.²⁸ Similarly, prior to the development of treaty-based ISA and the original drafter's decision to exclude the requirement in the ICSID Convention, exhaustion was a pre-requisite for exercising the right to diplomatic protection, with States 'not able to present an international claim... before the injured person has... exhausted all local remedies'.²⁹

A key part of the rationale behind this lies in the desire to prevent parallel proceedings. This occurs where two different kinds of fora are simultaneously called upon to resolve a dispute concerning the same subject matter, raising the risk of conflicting judgements, or claimants 'trying their luck' across multiple different fora to maximise their chance of success.³⁰ To this end, the Institut de

²⁷ McLachlan, Shore and Weiniger (n 18) 98.

²⁸ Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention on Human Rights, as amended) (ECHR) art 35(1).

²⁹ International Law Commission 'Draft Articles on Diplomatic Protection, Official Records of the General Assembly' 61st session Supp No 10 UN Doc A/61/10 (2006).

³⁰ Jane Kelsey, David Schneiderman and Gus Van Harten and others, 'Phase 2 of the UNCITRAL ISDS Review: Why "Other Matters" Really Matter' (2019) Osgoode Legal

Droit International have argued that the avoidance of duplicative litigation ought to be considered a general principle of law, as ‘parallel litigation... may lead to injustice, delay, increased expense, and inconsistent decisions.’³¹ Secondly, the traditional separation of international and national fora, as preserved by the local remedies rule in diplomatic protection cases was motivated by respect for the legal authority of domestic courts in the interest of international comity.³² Specifically, jurisdictional overlap raises the concern that an international forum might unnecessarily encroach on the domestic court’s traditional function as the primary means of dispute resolution within that jurisdiction, particularly if the parties can pursue the claim directly at the international level, bypassing relevant domestic remedies. This norm has found expression in various forms throughout the jurisprudence of the major international dispute settlement bodies, most explicitly by the International Court of Justice (ICJ) in *Interhandel*, who justified comity on the basis that ‘the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic system’ in the first instance.³³ Thus, the local remedies rule was seen as a means of providing an opportunity for internalised learning through self-correction, and in the case of diplomatic protection struck a delicate balance. In the first instance, the domestic courts would have the opportunity to examine the dispute and apply domestic law and any other relevant source of legal norm within its jurisdiction, providing the opportunity to correct the underlying issue and set a lasting precedent. However, should the domestic system fail to correct the potential violation, the aggrieved investor would then be able to attempt to seek recourse at the international level.

Studies Research Paper, 7 <<https://www.ssrn.com/abstract=3329332>> accessed 18 November 2020.

³¹ L Collins and Georges Droz, ‘The Principles for Determining when the Use of the Doctrine of forum non conveniens and anti-injunctions is appropriate’ (Institut de Droit International, 2004) 70(2), 4.

³² James R. Crawford, Thomas D. Grant, ‘Local Remedies, Exhaustion OF, *Max Planck Encyclopedias of International Law* (Oxford University Press 2007) 7.

³³ *Interhandel Case* (Switzerland v United States of America) (Preliminary Objections) [1959] ICJ Rep 6, para 27.

In addition to the suspension of the local remedies' requirement, several features of investment disputes have a propensity to generate unique instances of judicial overlap. First, investors very often enter into investment contracts directly with states, which impose contractual obligations, alongside those imposed by the pre-existing bilateral investment treaties between the host state and investor's home state.³⁴ These contracts often contain a dispute resolution clause indicating the exclusive forum for the resolution of issues that may arise under that contract (most often a domestic institution).³⁵ Secondly, the subject matter of ISA cases frequently concerns government policies that directly impact the domestic population, such as changes to environmental law and labour law. *Veolia v Egypt*, which concerned an increase in the national minimum wage, is a particularly controversial example of this phenomenon.³⁶ Given the wide-ranging implications such reform has on local populations, as noted by Stoll, 'the rule of law can be seen to call for the adjudication of such cases through domestic courts' thus making careful management of judicial overlap particularly important.³⁷ Dissatisfaction with this issue in particular is clearly seen in the activity of the 'paradigm shifter' states. For example, South Africa's decision to 'pull out' of ISA was reasoned on the basis that ISA 'undermined the constitutionality of the state and its space to determine domestic policy'.³⁸ In its place, the South African legislature enacted the Protection of Investment Act, which contemplates that investor should instead use local remedies,³⁹ with state-to-state arbitration as a final resort.⁴⁰

2) Distinguishing between breaches of Treaty and Contract

³⁴ Gus Van Harten, *Sovereign Choices and Sovereign Constraints: Judicial Restraint Based on Relative Suitability* (Oxford University Press 2013) 123.

³⁵ Gabrielle Kaufmann-Kohler and Michele Potestà, 'The Interplay Between Investor-State Arbitration and Domestic Courts in the Existing IIA Framework' in Gabrielle Kaufmann-Kohler and Michele Potestà (eds), *Investor-State Dispute Settlement and National Courts* (Springer International Publishing 2020) 32.

³⁶ *Veolia Propreté v Arab Republic of Egypt*, ICSID Case No. ARB/12/15 (25 May 2018).

³⁷ Stoll (n 22), 284.

³⁸ Qumba (n 13) 56.

³⁹ Protection of Investment Act 2015 (South Africa) s 13.

⁴⁰ *ibid* s 13(5).

The vast majority of BITs provide a standing offer to arbitrate on the part of the host state. As a result, arbitration can be initiated whenever the investor decides to submit a request for arbitration. This consent is generally framed widely to include ‘all disputes... concerning investments’, or ‘any legal dispute... concerning an investment’, granting the tribunal ad hoc jurisdiction over disputes that go beyond the interpretation and application of the BIT itself, such as over disputes that arise from a contract in connection with the investment.⁴¹ Although some BITs have sought to limit this consent to ‘disputes arising within the scope of this agreement’, this is certainly not the norm in the vast majority.⁴² Once a claim is submitted, the starting point for a tribunal is thus first to determine what the appropriate cause of action’ is, before considering whether the tribunal has the power to hear and determine this kind of claim, and what sources of law it must apply.⁴³

The primary issue regarding cause of action’ and the most frequently problematic context in which it is raised during investment disputes, is whether a claim ought to be construed as treaty-based or contract-based. This is because foreign investors generally enter investment contracts directly with the host state, and these agreements usually contain an exclusive jurisdiction clause in favour of the domestic courts. Thus, whether the dispute is considered contractual or treaty-based is often determinative for jurisdiction selection. If the investor wishes to avoid their contractual obligation to litigate the dispute domestically and gain immediate access to international arbitration, they should then have to demonstrate that their cause of action is based on treaty rights as opposed to contractual rights.⁴⁴

On this issue, the starting point for tribunals has been to recognise that treaty rights exist on the distinct plane of international law, and no provision of national law may constitute a defence to such a claim.⁴⁵ Thus, the mere fact that the investor is able to seek recourse on the basis of their contractual rights in a

⁴¹ Andrea Marco Steingruber, *Consent in International Arbitration* (1st edn, Oxford University Press 2012) 299.

⁴² El Salvador - Netherlands Bilateral Trade Agreement (entered into force 1 March 2001) art 9.

⁴³ McLachlan, Shore and Weiniger (n 18) 151.

⁴⁴ *ibid* 152.

⁴⁵ *ibid* 111.

domestic court, has no impact on the admissibility of a claim predicated on treaty-rights to an international investment tribunal. This distinction holds regardless of whether both the treaty-based and contractual claims involve the same economic harm or alleged state wrongdoing.⁴⁶

The true impact of this position is made clear by the annulment committee in *Vivendi (No 1)*, and the case's influential reasoning has been 'widely adopted and followed in subsequent awards',⁴⁷ with commentator's referring to it as 'the most important case on the relationship between claims based on treaty and claims based on contract'.⁴⁸ This case concerned the proper jurisdiction of an investment tribunal, where the investor had directly entered into an investor-state contract that contained an exclusive jurisdiction clause in favour of domestic courts.⁴⁹ Whilst the claim had been made out by the investor on the basis of the fair and equitable treatment standard contained in Argentine-French BIT, it bore a strong factual overlap with the contractual relationship between the parties.⁵⁰

The original tribunal held that although the exclusive jurisdiction clause did not deny tribunal jurisdiction, 'the nature of the facts supporting most of the claims presented... make it impossible for the tribunal to distinguish... violations of the BIT from breaches of the Concession contract without first interpreting and applying the detailed provisions of that agreement'.⁵¹ As the parties had expressly assigned that task to the domestic courts via the exclusive jurisdiction clause in the investor-state contract, 'the Argentine Republic cannot be held

⁴⁶ Kaufmann-Kohler and Potestà (n 35) 34.

⁴⁷ McLachlan, Shore and Weiniger (n 18)118.

⁴⁸ Christoph Schreuer, 'Investment Treaty Arbitration and Jurisdiction over Contract Claims—the Vivendi I Case Considered' in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005) 282.

⁴⁹ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment (3 July 2002) para 11.

⁵⁰ Harten (n 34) 138.

⁵¹ *Vivendi* (n 49) para 72.

liable unless and until Claimants have... asserted their rights in proceedings before the contentious administrative courts of Tucuman'.⁵²

This decision, however, was subsequently reversed by the annulment committee. In their reasoning, the committee emphasises that even where the same state action is concerned, contractual and treaty-based claims have a different 'essential basis', and as a result, the 'state cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of the conduct as internationally unlawful under a treaty'.⁵³ Nevertheless, the committee readily admits that 'the content and application of internal law will often be relevant to the question of international responsibility', but that this should be interpreted as the 'incorporation' of domestic legal standards into the international standard, rather than those rights constituting the essential basis of the claim.⁵⁴ Thus, what *Vivendi* makes clear, is that the only test an investor's claim must meet to be within the jurisdiction of an arbitral tribunal is a *prima facie* test of eligibility.⁵⁵ In the words of the committee, if 'the conduct alleged by the Claimants, if established, could have breached the BIT', that is enough to establish jurisdiction.⁵⁶

With this in mind, it is difficult to disagree with Van Harten's conclusion that following the reasoning of the annulment committee in *Vivendi*, 'so long as the investor presented its claims in terms of the treaty, then the claim could proceed even if the factual issues and challenged state conduct related mainly to the contract'.⁵⁷ This proposition is further supported by the fact that investors are responsible for the submission of the initial request for arbitration.⁵⁸ Thus, they have the unique opportunity for 'framing their legal arguments in terms of the treaty', and avoiding their contractual obligations in the exclusive jurisdiction

⁵² *ibid* para 78.

⁵³ *ibid* para 103.

⁵⁴ *ibid* para 97.

⁵⁵ Stanimir Alexandrov, 'Breach of Treaty Claims and Breach of Contract Claims: Is It Still Unknown Territory?' in Katia Yannaca-Small (ed), *Arbitration Under International Investment Agreements: A Guide to the Key Issues* (Oxford University Press 2010) 342.

⁵⁶ *Vivendi* (n 49) para 112.

⁵⁷ Harten (n 34) 138.

⁵⁸ Radi (n 3) 286.

clause.⁵⁹ To this end, Schreuer notes that whilst 'practice on this point is not uniform.... In *Vivendi*, the Tribunal found... that it had to base its jurisdictional finding on the claim as formulated by the claimants', but that 'in a different part of the decision, the ad-hoc committee appeared to lean towards a more objective standard'.⁶⁰ Schreuer goes on to suggest that the proper approach lies 'somewhere between the two extremes', using the case of *Joy Mining v Egypt*, as authority to support this position.⁶¹

Whilst Schreuer's middle-ground approach would be preferable, it does not appear to be the approach adopted by the majority of tribunals following *Vivendi*. Indeed, tribunals often cite an express methodology of approaching 'the dispute as formulated by the claimants'.⁶² The predominance of this approach is supported by Van Harten's empirical research. Identifying 36 cases following *Vivendi* where arbitral tribunals faced the 'specific issue of whether to decline jurisdiction or stay proceedings where the investor's claim appeared to relate to a contract with a dispute settlement clause', he finds that in 30 cases tribunals found in favour of allowing the claim to proceed.⁶³ Nevertheless, this research is admittedly limited in that it only concerned judgements published before 2013, so more recent empirical research is necessary to confirm his findings.

On the other hand, Alexandrov doubts the possibility of dressing up contractual claims as treaty-based; arguing that 'the investor cannot "dress up" any claim as a treaty claim if the facts, as stated, cannot even if established, constitute conduct in breach of the treaty'.⁶⁴ However, this response can only resolve the marginal cases where the nature of the host state's activity is such that it is not possible for the activity to have breached a treaty standard. This does not include the vast majority of claims related to an investor-state contract, where claimants will almost always be able to argue that in neglecting its contractual obligations the state has acted in a way that could have breached a

⁵⁹ Harten (n 34) 139.

⁶⁰ Schreuer (n 48) 316.

⁶¹ *ibid* 322.

⁶² *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award (3 August 2004) para 180.

⁶³ Harten (n 34) 136.

⁶⁴ Alexandrov (n 55) 340.

treaty standard, and at the jurisdictional stage of proceedings tribunals would be unable to explore the merits of this claim.

The impacts of this decision are multiple and varied. First, as suggested by Van Harten, it raises issues of discrimination and may ‘disadvantage domestic investors, and less-deep pocketed foreign investors’ who are unable to instigate treaty proceedings for contractual disputes, and thus may receive a lower level of contractual protection.⁶⁵ Such a concern is echoed in the opinion of the dissenting arbitrator in *Eureko v Poland*, who observes that this may ‘create a privileged class of foreign parties to a commercial contract who may easily transform their contractual disputes with state-owned companies into BIT disputes’.⁶⁶ Secondly, the decision renders exclusive jurisdiction clauses in investor-state contracts for the most part ineffective. By preventing parties from accessing their mutually agreed venue to hear the contractual dispute, it seemingly runs against principles of party autonomy, on which arbitration, as a consensual means of alternative dispute settlement, is based.

As will be expanded upon later, the reinstatement of the duty to exhaust local remedies in ISA would not resolve the conceptual problem of separating the two kinds of claim. However, the duty would nevertheless discharge much of the latent tension that arises from this problem. The duty simply requires that the investors have exhausted all the possible avenues to have their ‘substantial grievance’ remedied domestically ‘under whatever rubric is available there’.⁶⁷ Thus, problems derived from foreign investors framing contractual disputes as treaty-based to gain immediate access to arbitration are resolved, as jurisdiction is no longer assigned on the sole basis of the possible cause of action.

3) Umbrella Clauses

A closely related problem stems from the use of ‘umbrella clauses’ in BITs. Here, the State guarantees through the treaty any specific undertakings it makes with investors of the other contracting State via contract or otherwise.⁶⁸ These

⁶⁵ Harten (n 34) 147.

⁶⁶ *Eureko B.V. v Poland*, Dissenting Opinion of Partial Award, IIC 98 (2005), 19 August 2005, Ad Hoc Tribunal (UNCTRAL) para 11.

⁶⁷ Crawford and Grant (n 32) 7.

⁶⁸ McLachlan, Shore and Weiniger (n 18) 170.

clauses are used to provide additional protection for investors and 'put contractual commitments under the BIT's protective umbrella' by granting the tribunal jurisdiction over them.⁶⁹ However, different tribunals have taken divergent approaches to determining the exact effect of an umbrella clause on contractual obligations. In particular, judgments have diverged over whether an umbrella clause confers the tribunal jurisdiction over all claims for breach of contract and whether the clause transforms those contractual obligations into treaty obligations.

Whilst detailed investigation into each of these approaches is beyond the scope of this article, umbrella clauses are relevant in so far as they represent a 'powerful tool' for elevating contractual disputes that might otherwise be dealt with domestically.⁷⁰ This was explicitly recognised by the tribunal committee in *SGS v Pakistan*, who recognised that under the claimant's interpretation of the clause, 'the scope of [the umbrella clause]... appears susceptible of almost indefinite expansion' and, rejected this on the basis that there was no evidence that either state had intended this effect,⁷¹ holding that an umbrella clause did not elevate all contractual claims to treaty claims.⁷² This decision, however, has been criticised in later tribunal jurisprudence and not followed, and in *SGS v Philippines* was described as failing to respect the 'ordinary language meaning' of the clause.⁷³

Tribunal jurisprudence has thus varied significantly in its approach to the proper interpretation of umbrella clauses. At its most expansive, as in *Noble Ventures v Romania*, umbrella clauses have been interpreted as 'transforming

⁶⁹ Christoph Schreuer, 'Travelling the BIT Route' (2004) 7 *The Journal of World Investment & Trade* 250.

⁷⁰ Alperen Afşin Gözlügöl, 'The Effects of Umbrella Clauses: Their Relevance in Interpretation and in Practice' (2020) 21 *The Journal of World Investment & Trade* 558, 580.

⁷¹ *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction (6 August 2003) para 173.

⁷² McLachlan, Shore and Weiniger (n 18) 131.

⁷³ *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (29 January 2004) para 119.

municipal law obligations into obligations directly cognizable in international law'.⁷⁴ Thus, current arbitral jurisprudence on umbrella clauses, is damaging in two regards. First, the current uncertainty surrounding the effective interpretation of umbrella clauses creates tension between domestic and international fora, where arbitral tribunals are more frequently called upon to issue injunctions to stay simultaneous domestic proceedings (where in the absence of clarity as to the appropriate venue, the investor pursues both avenues). Second, by potentially allowing for the 'transformation' of domestic legal obligations, umbrella clauses could enable arbitration to function as a direct substitute to domestic courts. Arbitral tribunals would be empowered to consider questions of domestic law without input from domestic courts, with potentially grave consequences on the domestic rule of law, a point which will be expanded upon in the second section of this article.

A domestic remedies requirement would not conceptually resolve the issue of proper interpretation of umbrella clauses; however, it would significantly alleviate the tension that arises from it. This is because it would function as a dynamic rule of procedure, and would need to be met for the claim to be admissible but does not otherwise alter the relevant jurisdictional scope of either international or domestic fora. Thus, investors should seek out domestic remedies to whatever extent is possible, and if unsatisfied with the result, seek out arbitration as an additional layer of protection. The arbitral panel, if then required to consider domestic law due to an umbrella clause, can do so in the benefit of the domestic courts prior interpretation of the relevant domestic legislation.⁷⁵

4) Rules of Election

A key mechanism through which States have sought to manage the jurisdictional overlap between national and international fora is through rules of election contained in BITs. In essence, these rules provide formal requirements for the selection of a particular dispute settlement option. The most common

⁷⁴ *Noble Ventures Inc v Romania*, ICSID Case No. ARB/01/11, Award (12 October 2005) para 53.

⁷⁵ Matthew C Porterfield, 'Exhaustion of Local Remedies in Investor-State Dispute Settlement: An Idea Whose Time Has Come?' (2015) 41 *Yale Journal of International Law Online* 7.

rules of election are 'fork-in-the-road' clauses and 'waiver/no U-turn' provisions.⁷⁶

Fork-in-the-road clauses seek to ensure that an investor's choice of a particular dispute settlement option is final by precluding resort to another option. For example, the 2006 Switzerland-Colombia BIT prescribes that 'once the investor has referred the dispute... the choice of procedure shall be final'.⁷⁷ However, there have long been concerns that the efficacy of this kind of clause turns heavily on how a 'dispute' is defined. In much the same way that investment tribunals formalistically distinguished between the 'essential basis' of treaty-based and contractual claims when assessing the impact of an exclusive jurisdiction clause, it has been generally held that, 'if the claims asserted in the host state courts are contractual and not treaty-based, the existence of a fork-in-the-road clause will not affect the subsequent invocation of a treaty-based claim before an investment-tribunal'.⁷⁸

Some commentators such as Schreuer have argued that this position is logical, given that if 'any utilization of domestic courts be seen as a choice under the fork-in-the-road-provision', this would put the investor in an 'intolerable position' whereby the cost of access to ISA would be to prevent the use of domestic courts in even the most basic sub-claims through the domestic courts.⁷⁹ This position does have merit. For example, in *Genin v Estonia*, the Republic of Estonia challenged ICSID jurisdiction on the basis that the claimant had previously submitted a domestic appeal to overturn the revocation of a banking license and thus activated the fork-in-the-road.⁸⁰ The challenge correctly failed, as a fork-in-the-road clause should not bar all access to all forms of ISA on the basis of an appeal that only forms a small part of the overall treaty-claim. Nevertheless, by strictly maintaining the separation between causes of action, practically no effective scope of operation is given to the fork-in-the-

⁷⁶ Kaufmann-Kohler and Potestà (n 35) 39.

⁷⁷ Switzerland-Colombia Bilateral Trade Agreement (6 October 2006) art 11 para 4.

⁷⁸ McLachlan, Shore and Weiniger (n 18) 132.

⁷⁹ Schreuer, 'Travelling the BIT Route' (n 69) 249.

⁸⁰ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2, Award (25 June 2001).

road clause.⁸¹ This runs counter to a basic principle of treaty interpretation and the Vienna Convention: that treaties should be interpreted as far as possible to give an effective meaning to their provisions.⁸²

Seeking a pragmatic middle-ground thus seems the most promising approach to resolving this issue. To this end, the judgment of the sole arbitrator in *Pantechniki v Albania* is worth examining.⁸³ Adopting a ‘more pragmatic test’, the arbitrator specifically focused on ‘whether the claim brought before the investor-state tribunal has an autonomous existence’ from the claim previously made before the domestic courts.⁸⁴ The later tribunals of *Toto Costruzioni Generali v Lebanon*,⁸⁵ and *Total v Argentina*,⁸⁶ did however revert back to the formalistic approach, focusing again on the different ‘essential basis’ of each claim. Nevertheless, in *H&H Enterprises Investments v. Egypt* the test established in *Pantechniki* was adopted again,⁸⁷ suggesting that *Pantechniki*, ‘cannot be regarded as an isolated incident’, but should be seen as a sign of gradual development in this area.⁸⁸

Modern BITs have also begun to contain a comprehensive range of different rules of election, worded specifically to avoid the limits imposed by tribunal’s formalistic application of the proper cause of action’. Within the 2018 EU-Singapore Investment Protection Agreement for example, Article 3.7 sets out a minimum 9 month wait period alongside a declaration to withdraw any pending claim submitted to another dispute settlement mechanism that concerns ‘the same *treatment* as alleged to breach (a treaty provision)’ and to

⁸¹ McLachlan, Shore and Weiniger (n 18) 123.

⁸² *ibid.*

⁸³ *Pantechniki S.A. Contractors & Engineers v. Republic of Albania*, ICSID Case No. ARB/07/21, Award (30 June 2009) para 54.

⁸⁴ Markus A Petsche, ‘The Fork in the Road Revisited: An Attempt to Overcome the Clash between Formalistic and Pragmatic Approaches’ (2019) 18 Washington University Global Studies Law Review 391, 394.

⁸⁵ *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Award (7 June 2012).

⁸⁶ *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Annulment (1 February 2016).

⁸⁷ *H&H Enterprises Investments, Inc. v Arab Republic of Egypt*, ICSID Case No. ARB 09/15, Tribunal’s Decision on Respondent’s Objections to Jurisdiction (5 June 2012).

⁸⁸ Petsche (n 84) 395.

waive the right to submit a claim in the future.⁸⁹ Additionally, it adopts a broad definition of 'claimant' as all people with a 'direct or indirect ownership interest'.⁹⁰ This is to prevent the clause being held ineffectual due to the claimants lacking identity of party, where multiple different parties contribute to a single investment but individually seek out dispute-settlement, such as in *Lauder v Czech Republic*.⁹¹

Nevertheless, these approaches are insufficient. First, whilst the development in *Pantechniki* is certainly a step forward, the fact that later tribunals have continued to apply the formalistic approach suggests that this is still an area of uncertainty. Treaty-based reform is also a protracted process and is not a 'realistic short-term solution' where 'existing BITs probably still have considerable life-expectancy'.⁹² Most importantly, even if an effective formulation was found, rules of election can have serious negative side effects. As noted by Kaufmann Kohler, even if a pragmatic middle-ground approach to their application could be found to fork-in-the-road clauses, they may simply 'prompt investors to immediately access the international forum, for fear of otherwise losing that option if domestic proceedings are started'.⁹³ This is problematic for reasons that are considered in more detail in the second part of this article, as it represents part of an overall shift towards international mechanisms of dispute settlement being used as substitutes for domestic institutions. This can have a serious impact on the domestic rule of law by denying states the opportunity for internal correction.

5) Resolving Issues of Jurisdiction with a Duty to Exhaust Local Remedies

As noted by McLachlan, a key part of the rationale behind the local remedies rule in other contexts, has historically been to help better reinforce the 'separation between the spheres of national and international law'.⁹⁴ Having examined the unique nature of the jurisdictional issues raised by ISA and the

⁸⁹ EU-Singapore Investment Protection Agreement (15th October 2018) art 3.7.

⁹⁰ *ibid.*

⁹¹ *Ronald S. Lauder v The Czech Republic*, UNCITRAL, Final Award (3 September 2001).

⁹² Schreuer, 'Travelling the BIT Route' (n 69) 250.

⁹³ Kaufmann-Kohler and Potestà (n 35) 25.

⁹⁴ McLachlan, Shore and Weiniger (n 18) 100.

deficiencies in both arbitral jurisprudence and rules of election at resolving these issues, a general duty to exhaust local remedies should be re-established.

By requiring investors to exhaust local remedies as a prerequisite for access to arbitration, ‘the effect of this rule is to preclude the possibility of parallel proceedings between national and international courts’, as the simultaneous review of state action in both fora becomes impossible.⁹⁵ Thus, an important motivation behind the current need for rules of election is resolved. Secondly, as the local remedies rule functions as a procedural rule governing the admissibility of a claim to an international tribunal, it does not need to engage in resolving the nebulous conceptual distinction between treaty-based and contractual claims. Instead, much of the underlying tension is resolved where the formalistic distinction between types of claim is no longer the basis for assigning jurisdiction. Instead, investors should seek to have their ‘substantial grievance’ resolved before a domestic court, ‘under whatever rubric is available there’.⁹⁶ This may be only national law, or (where States have explicitly made it possible), invoking treaty provisions directly before the national court. This issue of direct invocation of treaty rights before a domestic court will be further expanded on in the second section of this article. Access to an international tribunal is then held in reserve if they are unsatisfied with the domestic result or wish to make a claim on basis that they are unable to pursue domestically. In this way the role of the domestic judicial systems as ‘the primary fora for disputes involving claims by foreign investors’ is maintained, with investment arbitral tribunals held in reserve as an ‘extra layer of protection against any deficiencies in the domestic legal process’.⁹⁷

Thus, the domestic remedies rule would help to abate the worrying trend of arbitral tribunals functioning essentially as a ‘substitute’ to the domestic legal system is abated. This is a particularly important issue when we consider the impact of ISDS on the domestic rule of law in the second section of this article. Specifically, it will examine the way in which this prevents the effective development of the rule of law domestically, and how the exhaustion of domestic remedies requirement can help to resolve this.

⁹⁵ *ibid.*

⁹⁶ Crawford and Grant (n 32). 7.

⁹⁷ Porterfield (n 75) 7.

II. THE IMPACT OF ISDS ON THE DOMESTIC RULE OF LAW

The second key justification for reinstating the local remedies requirement relates directly to the role ISA can play in the 'promotion of the rule of law, through the promulgation of legal norms'.⁹⁸ ISA in its current form exists primarily as a substitute to domestic institutions and is thus unable to perform this function effectively. Secondly, reinstating a duty to exhaust local remedies would better enable ISA to positively impact the domestic rule of law. Specifically, it would provide the State where the violation occurred 'an opportunity to redress it by its own means, within the framework of its own domestic system',⁹⁹ and allow ISA to act as a powerful 'complementary mechanism' within the framework set out by Puig and Shaffer.¹⁰⁰ In this way, the local remedies rule can provide the mechanisms for increased interaction and discourse between domestic and international institutions that are currently lacking, and resolve the discrepancy between on-the-ground empirical research and pre-existing 'good governance' narratives.

1) The Importance of the Domestic Rule of Law in ISDS's Legitimacy Crisis

Before directly considering the mechanisms by which reinstating the local remedies requirement would better enable ISA to positively impact the domestic rule of law, it is worth considering why the claim that ISA can positively impact the domestic rule of law is particularly important in relation to ISDS's ongoing legitimacy crisis. As observed by Sattorova, the notion that ISDS promotes good governance and the rule of law in developing states has provided 'much-needed normative content' and 'additional justification' for evolving treaty norms.¹⁰¹ Indeed, as noted by Schultz and Du Pont, in order to legitimise its

⁹⁸ Emanuel Castellarin, 'Investment arbitration and the international rule of law. Rule of Law at the Beginning of the Twenty-First Century' (2018).

⁹⁹ *Interhandel Case* (n 33) para 27

¹⁰⁰ Puig and Shaffer (n 26) 362

¹⁰¹ Mavluda Sattorova, *The Impact of Investment Treaty Law on Host States: Enabling Good Governance?* (Hart Publishing 2018) 7.

continued existence, ISA ‘must fulfil some useful societal function’.¹⁰² This justification has become increasingly important amidst the growing body of empirical research that has challenged the traditional justification that entering into the regime of international investment law necessarily promotes a substantial increase in foreign direct investment.¹⁰³ Furthermore, even if a substantial increase in FDI could be guaranteed, recent research in development economics has challenged the underlying ‘assumption that FDI is necessarily beneficial for host countries’, with Bonnichita arguing that ‘the empirical literature on foreign investment suggests that this assumption should be abandoned.’¹⁰⁴ While detailed consideration of this empirical research is beyond the scope of this article, Sattorova is correct in suggesting that the development of a ‘good-governance narrative’ has thus become increasingly important in justifying the international investment protection regime.¹⁰⁵

The second reason why this claim has become particularly important is as a result of growing concerns that the extensive protection offered by investment treaties is granted ‘at the expense of local investors who are competitively disadvantaged’ and is thus discriminatory.¹⁰⁶ This concern was raised by the European Parliament during the failed TTIP negotiations, who argues that any proposed regime should be designed such that ‘foreign investors... benefit from no greater rights than domestic investors’.¹⁰⁷ A good example of this kind of discrepancy in levels of protection offered can be seen in US property law. In

¹⁰² Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study’ (2014) 25 *European Journal of International Law* 1147, 1148.

¹⁰³ Jason W. Yackee, ‘Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence’ (2011) 51 *Virginia Journal of International Law* 397, 399.

¹⁰⁴ Jonathan Bonnichita, ‘Foreign Investment, Development and Governance: What International Investment Law Can Learn from the Empirical Literature on Investment’ (2016) 7 *Journal of International Dispute Settlement* 31, 54.

¹⁰⁵ Sattorova (n 101).

¹⁰⁶ Leon E. Trackman, ‘Choosing domestic courts over investor–state arbitration: Australia’s repudiation of the Status Quo’ 35 *University of New South Wales Law Journal* 3, 979, 994.

¹⁰⁷ European Parliament Resolution of 8 July 2015 containing the European Parliament’s recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP) 2014/2228 (INI) 15.

this context it has been argued that the NAFTA treaty-right against indirect expropriation might offer a higher level of protection than Fifth Amendment protection against measures that do not constitute a 'regulatory taking'.¹⁰⁸ This concern led to the adoption of specific provisions within Trade Promotion Act 2002, with the explicit aim of ensuring that 'foreign investors... are not accorded greater substantive rights... than United States investors'.¹⁰⁹

As a result of *Vivendi* and subsequent arbitral jurisprudence that has emphasised the formal separability of claims based on investment treaties and national law, foreign investors should have little difficulty in presenting their claims as treaty-based, and thus invoking the higher level of protection offered at the international level. Thus, as raised by the dissenting arbitrator in *Eureko v Poland*, there is the distinct possibility of a 'privileged class of foreign investors' gaining a competitive advantage on national investors through access to treaty protection at first instance.¹¹⁰ This discriminatory market advantage is likely to be exacerbated in developing countries, where the traditional rationale for ISA's necessity has been to ensure foreign investors receive an 'international minimum standard' of protection, where the extent of the discrepancy in standards of protection offered by domestic institutions and investment treaties is too great.

Nevertheless, the strength of this attack on the legitimacy of ISA is significantly diminished if it can be demonstrated that by improving the quality of domestic institutions and the domestic rule of law, ISDS protects not only foreign investors but domestic investors also. Referred to as the 'halo' effect by the World Bank,¹¹¹ this narrative suggests that domestic investors indirectly benefit from the investment protection regime, as once tribunals have signalled what the standard of protection of investments should be, it 'provides a

¹⁰⁸ Matthew C. Porterfield, 'State Practice and the (Purported) Obligation Under Customary International Law to Provide Compensation for Regulatory Expropriations', (2011) 37 North Carolina Journal of International Law and Commercial Regulation 159, 166.

¹⁰⁹ Trade Promotion Act 2002 s 2102(3) (United States).

¹¹⁰ *Eureko* (n 66).

¹¹¹ World Bank, *World Development Report* (Oxford University Press 2005) 179.

benchmark for domestic judicial procedures as well'.¹¹² Thus, Sattorova notes that 'most recent narratives are premised on the idea of investment treaties altering outcomes not just for foreign investors but for host state communities also', justifying any apparent discrimination.¹¹³

2) 'Good Governance' Narratives of ISA

In part as a result of these challenges, a substantial body of literature has amassed in support of the notion that investment treaties, through the promulgation of the good governance norms enshrined in their substantive standards, can and do positively impact the domestic rule of law. A variety of different mechanisms have been proposed to support this narrative. First, it has been suggested that treaty-based standards might 'spill over into domestic law'.¹¹⁴ Building on this, Schill presents a particularly convincing narrative, suggesting that investment-treaty law operates as a form of comparative public law that can respond to systemic imbalances in host states' treatment of foreign investors.¹¹⁵ As investment treaty norms are predominantly 'rule-oriented', they correlate strongly with what is required by the rule of law.¹¹⁶ The standard against expropriation for example, 'guarantees respect for property rights as an aspect of the rule of law'.¹¹⁷ ISA thus improves the domestic rule of law by setting in place and enforcing compliance with these norms or 'embodiments of

¹¹² Thomas W Walde, 'The 'Umbrella Clause' in Investment Arbitration. A Comment on Original Intentions and Recent Cases' (2005) 6 *Journal of World Investment and Trade* 183, 188.

¹¹³ Sattorova (n 101).

¹¹⁴ Peter Muchlinski, Federico Ortino and Christoph Schreuer, 'Preface' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008).

¹¹⁵ Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 15.

¹¹⁶ Kenneth Vandeveld, *Bilateral Investment Treaties: History, Policy, and Interpretation* (1st edn, Oxford University Press 2010) 119.

¹¹⁷ Stephan W Schill. 'International Investment Law and the Rule of Law' in Jeffrey Lowell, J. Christopher Thomas and Jan van Zyl Smit (eds), *Rule of Law Symposium 2014: The Importance of the Rule of Law in Promoting Development* (Singapore Academy of Law, 2015) 90.

the rule of law'.¹¹⁸ In particular, ISA creates both an 'incentive' (the avoidance of having to pay monetary awards, and increased foreign investment), and a 'yardstick' (the substantive standards of protection enshrined in the BIT), on which states are able to model their behaviour in the long term.¹¹⁹

Similarly, Echandi provides several additional mechanisms specifically addressing nations that have weak judicial systems. First, he argues that as ISA is 'rule-oriented' rather than 'power-oriented' it lies in stark contrast to the populist politics that dominates developing states that lack the rule of law.¹²⁰ In these states, ISA prevents 'politics from playing a role in an investment dispute' by providing a strong disincentive against 'short-term policy reversals' and arbitrary behaviour.¹²¹ Thus, 'IIA's impose discipline over national authorities', until 'the host country gradually develops better administrative practices'.¹²² Secondly, Echandi argues that 'governments are seldom monolithic creatures', and that the source of many disputes is 'bureaucratic inertia' and 'turf-politics' between the government trade departments who negotiate treaties, and the other departments whose decisions breach them.¹²³ To this end, IIA's can generate 'pressures in the direction of fostering greater policy coordination amongst disparate government departments', fostering 'better governance practices' and strengthening the rule of law.¹²⁴ An example of this kind of effect might be the provisions providing for investor ombudsmen in the Kazakhstan's reformed Entrepreneurial Code, who can consider investor's 'appeals on issues arising during the course of investment activities'.¹²⁵

¹¹⁸ Stephan W Schill, *The Multilateralization of International Investment Law* (Cambridge University Press, 2009) 370.

¹¹⁹ Schill (n 115) 371.

¹²⁰ Roberto Echandi, 'What Do Developing Countries Expect from the International Investment Regime?' in Jose E. Alvarez and Karl P. Sauvant (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (Oxford University Press 2011) 12.

¹²¹ *ibid* 12.

¹²² *ibid* 13.

¹²³ *ibid* 16.

¹²⁴ *ibid* 16.

¹²⁵ Entrepreneur Code of the Republic of Kazakhstan (2015) art 314.

Empirical evidence, however, has posed a strong challenge to these claims. Of particular note is the unique work of Mavluda Sattorova, who carried out 54 country-specific, qualitative interviews with government officials, judges and lawmakers involved in investment treaty drafting and dispute settlement in five developing countries.¹²⁶ Despite, its limited sample size, this research is unique in that it gives direct insight as to the thoughts of government officials, members of the judiciary and politicians in developing nations who, if the ‘good governance’ narrative is to be believed, should show signs of institutional learning and awareness of the investment treaty regime. However, in summary, the results of her empirical research demonstrated a ‘systemic lack of awareness about the true implications of investment treaty law amongst government officials... even after states experienced a number of investor-state disputes’.¹²⁷ Additionally, she found that ‘when learning did occur, it has been confined to a limited group of individuals in key agencies, and the lessons have not been translated into concrete measures to address the root causes of investment disputes’.¹²⁸

Additionally, Sattorova finds that where States have encountered arbitration in a respondent capacity, their ‘response may not necessarily conform to what is predicted by the good governance narratives’.¹²⁹ For example, although Kazakhstan’s addition of provisions for ombudsmen might be considered a positive development following ISA, interviews with Kazakhstani officials reveal the government has ambitions to transform the countries’ investment landscape through the establishment of the Astana International Financial Centre.¹³⁰ This centre will operate as a ‘special jurisdiction’ and ‘shall not be a part of the judicial system of the Republic of Kazakhstan’, with foreign experts appointed as judges to adjudicate on issues raised by foreign investors.¹³¹ Thus, it cannot be assumed that states will necessarily respond to investors claims in a way that results in the promotion of good governance for all, or

¹²⁶ Sattorova (n 101) 61.

¹²⁷ *ibid* 101.

¹²⁸ *ibid* 110.

¹²⁹ *ibid* 101.

¹³⁰ *ibid* 86.

¹³¹ The Constitutional Law of the Republic of Kazakhstan ‘On Astana International Financial Centre’ (2017)

improves the domestic rule of law. It is often easier to avoid disputes by simply further isolating foreign investors from the domestic legal system rather than engage in systemic reform. This process of isolation is ultimately only likely to 'hamper the emergence of a national cadre of experts to diffuse and embed the norms of good governance' as investment disputes drift further away from the jurisdiction of domestic institutions.¹³²

Sattorova's empirical research thus reveals a fundamental difficulty with narratives that suggest that ISA in its current form has a strong positive impact on the domestic rule of law. Whilst Schill and Echandi may succeed in demonstrating that the norms contained in investment treaties reflect rule of law values, it is tacitly assumed that the necessary mechanisms are in place to ensure these norms are recognised, internalised and enforced by domestic institutions.¹³³ It is precisely at this point that a duty to exhaust local remedies has the most potential to integrate ISA into the domestic court process and provide the additional mechanisms necessary for investment treaty norms to positively impact the domestic rule of law.

3) Clarifying Standards and Improving Decision Making

First, the domestic remedies requirement would give domestic institutions the opportunity to resolve the dispute directly by requiring the investor to meaningfully seek out a remedy through the domestic courts where they may otherwise have resorted directly to arbitration. For states with less developed judicial systems, 'funneling' disputes with foreign investors through the domestic courts would help promote the rule of law by increasing local expertise in areas of law where arbitration is typically sought out and clarifying relevant domestic legal standards.¹³⁴ A good example of this kind of situation is where local authorities grant permits and licences for resource extraction. This avoids a situation like in *Bilcon v Canada*, where ISA was sought after a federal joint-review panel decided against approving a project to build a quarry and marine terminal.¹³⁵ Although this was the decision of a relatively low-level

¹³² Sattorova (n 101) 57.

¹³³ *ibid* 60.

¹³⁴ Porterfield (n 75) 5.

¹³⁵ *Bilcon of Delaware et al v. Government of Canada*, PCA Case No. 2009-04 (17 March 2015) para 24.

environmental panel, the investors did not seek out judicial review in either the courts of Nova Scotia or Canada's federal court system.¹³⁶ This was despite the fact that the dispute revolved around the panel's application of 'the core values of the affected communities' as a criterion in rejecting the application, with the investors alleging that was a 'departure' from what was required by Canadian Law.¹³⁷ This case clearly concerned a question of the proper application of a domestic legal standard and had review been sought the dispute would likely have been internally resolved, setting a binding precedent and clarifying the 'core values' standard to the benefit of future investors, foreign and domestic alike. Instead, the tribunal, lacking jurisdiction to directly consider whether the criterion was within Canadian law, nevertheless indirectly considered Canadian law by finding the decision 'arbitrary' on the basis that it 'departed from the mandate defined by the applicable law' and thus breached the minimum standard of treatment enshrined in the North Atlantic Free Trade Agreement (NAFTA).¹³⁸ The effect of this decision, as emphasised in the dissenting arbitrator's opinion, was to effectively make 'failure to comply with Canadian law... the basis for a NAFTA claim' and thus allow the claimant to 'bypass the domestic remedy provided'.¹³⁹ Thus in essence, the tribunal had become as a substitute to domestic courts. In addition to being a 'significant intrusion into domestic jurisdiction',¹⁴⁰ this decision does comparatively little to clarify the relevant domestic standard as it does not directly consider the legality of the application of the standard itself and occurs outside of the domestic system and is thus limited only to the immediate case.

Secondly, as argued by Porterfield, this mechanism could also work to benefit the decision making of arbitral tribunals (should arbitration eventually be resorted to), who can 'benefit from the (domestic) court's characterisation of the relevant domestic law', and from the 'evidence of relevant state practice'

¹³⁶ *ibid.*

¹³⁷ *Attorney General of Canada v Bilcon of Delaware Inc* [2018] 2018 FC 436 [11] (Federal Court of Canada).

¹³⁸ *Bilcon* (n 135) para 591.

¹³⁹ *Bilcon of Delaware et al v. Government of Canada*, PCA Case No. 2009-04, Dissenting Opinion of Professor Donald McRae (10 March 2015) para 48.

¹⁴⁰ *Bilcon* (n 139) para 48.

provided by initial pursuit of a dispute through the domestic courts.¹⁴¹ This is particularly valuable given the fact that tribunals are often required to consider issues of domestic law. For example, tribunals are often required to determine whether the investor's property or contractual rights qualify as an investment under domestic law. Furthermore, as in *Vivendi*, domestic legal standards can be 'incorporated' into the international standard, requiring tribunals to indirectly consider questions of domestic law. Although tribunals do routinely receive expert advice from local law experts in making these determinations, this would arguably be a more reliable way of ensuring that expertise is received as it is not left to the parties' or tribunal's discretion. Furthermore, the increased input of the domestic courts would increase the perceived legitimacy of arbitral decisions where those decisions concern domestic law.

On the other hand, it has been contended that a duty to exhaust local remedies would lead to disagreements between tribunals and domestic courts, exacerbating the dispute. Schreuer for example has suggested that 'once the host State's highest court has made a decision, it may be more difficult for a government to accept... a contrary international judicial decision'.¹⁴² Indeed, in contrast to diplomatic protection, a historical justification for investment arbitration regime has been to attempt to de-politicise disputes.¹⁴³ To this end, fear of increased politicisation was purportedly an important justification for the European Commission's decision not to include a duty to exhaust local remedies in its proposal for a multilateral investment court, according to an interview conducted by Puig and Shaffer.¹⁴⁴

However, there are several reasons to reject this analysis as the most likely outcome of imposing a duty to exhaust local remedies. First, in the application of certain standards of investment protection, such as claims of denial of justice,

¹⁴¹ Porterfield (n 75) 8.

¹⁴² Christoph Schreuer 'Interaction of international tribunals and domestic courts in investment law' in Bril Nijhoff (eds) *Contemporary issues in international arbitration and mediation: the Fordham Papers, vol 4* (Leiden 2010) 73.

¹⁴³ Kaufmann-Kohler and Potestà (n 35) 18.

¹⁴⁴ Sergio Puig and Donald Shaffer, Interview with Official of the European Commission (Brussels, 16 May 2018) (on file with authors) in Sergio Puig and Donald Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law' (2018) 112 *American Journal of International Law* 361, 407.

investment tribunals already require parties to resort to domestic remedies as a substantive requirement. For example, to proceed in a claim of denial of justice ‘the national system must have been tested’, and this has yet to cause unnecessary politicisation.¹⁴⁵ The extent to which the system must have been ‘tested’ has been interpreted differently by different arbitral tribunals, but in the influential case of *Loewen v United States*, it was held that ‘judicial finality’ must have been reached,¹⁴⁶ with the state not deemed to have spoken until all appeals are exhausted.

Second, the uncertainty that currently surrounds issues of jurisdiction, as discussed in the first part of this article, is already a considerable source of tension between domestic and international fora. For example, in *SGS v Pakistan*, after SGS initiated ICSID proceedings under the Swiss-Pakistan BIT, Pakistan applied to the Supreme Court of Pakistan for a ruling in favour of domestic contractual arbitration as specified in the exclusive jurisdiction clause in the investor-state contract.¹⁴⁷ After Pakistan’s Supreme Court found in favour of domestic arbitration proceedings, the ICSID tribunal was required to issue an injunction recommending the staying of all domestic proceedings until the tribunal had made a determination on jurisdiction, explicitly demonstrating its authority over the Supreme Court.¹⁴⁸ This source of tension would be considerably eased by a duty to exhaust local remedies for the reasons discussed earlier. Namely that simultaneous access to ISA alongside domestic mechanisms would become impossible, and thus there would be no need to issue injunctions to stay simultaneous parallel proceedings. Thirdly, if ISA is to genuinely influence the domestic rule of law as the good governance narratives promise, a degree of tension and friction with domestic institutions is likely necessary. Attempting to insulate domestic institutions from the consequences of failure to meet international standards ultimately does little to imbue those standards in the long term.

¹⁴⁵ Jan Paulsson, *Denial of Justice in International Law* (1st edn, Cambridge University Press, 2005) 108.

¹⁴⁶ *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3 (26 June 2003) para 143.

¹⁴⁷ *SGS v Pakistan* (n 71).

¹⁴⁸ *ibid.*

4) The Domestic Remedies Requirement as a Complementarity Mechanism

The third mechanism by which a duty to exhaust local remedies could improve the domestic rule of law is more ambitious. It does not form part of the traditional requirement to exhaust local remedies and it is suggested that this should be optional for States to implement but nevertheless represents a powerful mechanism that should be considered in current reform efforts. This would be to allow domestic institutions to directly invoke and apply the international standards of protection contained within investment treaties in conjunction with the duty to exhaust local remedies. This kind of dynamic 'complementary' mechanism, as envisaged by Puig and Shaffer would allow domestic courts to consider and rectify not only alleged violations of domestic law but of the standards enshrined in investment treaties.¹⁴⁹ This would affect domestic institutions in a variety of different ways. First, this process of direct application, overseen by arbitration tribunals, has the potential to dramatically increase both the awareness and internalisation of international standards of protection in domestic authorities.¹⁵⁰ Whilst Sattorova's empirical research revealed that four out of five high ranking members of Uzbekistan's judiciary 'were surprised to learn that a foreign investor's dispute with a government body might lead to investor-state arbitration... and that international law, despite being constitutionally recognised as one of the primary sources of legal norms, is rarely—if at all—considered as relevant', directly invocable treaty-rights would address this lack of awareness directly.¹⁵¹ Secondly, in the long-term, as treaty rights are repeatedly invoked in the domestic context, the prospect of the rule-oriented norms contained in investment treaties spilling over into domestic law becomes far more tangible. This conclusion is also supported by evidence from other fields of law where similar complementary mechanisms have been utilised. For example, Sohn and Baxter emphasize that in the field of State Responsibility for Injuries to Aliens, requiring domestic courts to oversee compliance with international law 'forces the maximum number of cases involving aliens into domestic courts... with consequent

¹⁴⁹ Puig and Shaffer (n 26) 403.

¹⁵⁰ *ibid.*

¹⁵¹ Sattorova (n 101) 203.

beneficial effects for the legal protection of aliens' due to 'a wider incorporation of international standards into municipal law'.¹⁵²

Additionally, this mechanism has the potential to greatly increase the degree of direct interaction between national and international dispute mechanisms.¹⁵³ Whereas interaction is currently limited, allowing domestic institutions to determine treaty-based claims with investment tribunals providing an appellate function, the possibility for direct dialogue is engaged. This dialogue would have the effect of clarifying relevant international standards, whilst also encouraging their promulgation into the domestic legal systems. There is also scope for this to potentially be combined with a system resembling the preliminary reference procedure used by the CJEU, where domestic courts would be able to refer questions to the international level regarding the proper interpretation or application of a treaty provision to prevent divergence.¹⁵⁴

Nevertheless, the use of directly invocable treaty rights as a 'complementary mechanism', amplifies concerns regarding a lack of necessary expertise in local judiciaries. While these concerns are addressed specifically in Part 3, this mechanism represents an option close to the upper threshold of how a duty to exhaust local remedies might be designed in conjunction with other mechanisms to maximise its impact on the domestic rule of law. As a result, it is separable from the local remedies rule and should be optional for States, perhaps as part of an '*à la carte* Multilateral Institute for Dispute Settlement on Investment' as envisaged as Schill and Vidigal, which would allow States to maintain their 'entrenched preferences for certain modes of dispute settlement' under a multilateral institutional framework.¹⁵⁵ From the outset, it might be imagined that direct invocation be primarily implemented in countries with highly developed judicial systems that have previous experience directly

¹⁵² Louis B. Sohn and Richard R. Baxter, 'Draft Convention on the International Responsibility of States for Injuries to Aliens' in F. V. Garcia-Amador, Louis Sohn & Richard Baxter (eds), *Recent Codification of the Law of State Responsibility for Injuries to Aliens* 262 (United Nations, 1974) 45.

¹⁵³ Puig and Shaffer (n 26) 406.

¹⁵⁴ *ibid* 404.

¹⁵⁵ Stephan W. Schill and Geraldo Vidigal, 'Designing Investment Dispute Settlement *à La Carte*: Insights from Comparative Institutional Design Analysis' (2020) 18 *The Law & Practice of International Courts and Tribunals* 314, 317.

invoking international legal norms before domestic courts, such as the member states to the ECHR. From this point, a stable international jurisprudence can begin to be developed before direct invocation is expanded further to willing States who seek to benefit from the positive effects it would have on the domestic rule of law.

III. SPECIFIC CRITICISMS OF THE LOCAL REMEDIES REQUIREMENT

Having examined the key benefits of implementing a duty to exhaust local remedies, three particularly pertinent criticisms of the local remedies requirement will be considered. First, that as a result of institutional bias and lack of expertise, national courts are unsuitable for considering investor's claims. Second, that a duty to exhaust local remedies would limit access to justice by leading to unduly onerous costs and time delays for investors. Thirdly, that current systemic reform efforts, like the creation of a multilateral investment court as tabled by the EU, are incompatible with a local remedies requirement or render it unnecessary for resolving ISDS's legitimacy crisis.

1) The Suitability of National Courts

The notion that national courts are unsuitable fora for determining investor-state disputes, has been a key part of the historical justification for ISA.¹⁵⁶ To this end, Schreuer argues that 'one of the main purposes of investment arbitration is to avoid the use of domestic courts', as they lack the independence necessary to consider claims impartially, and whose involvement is only likely to 'exacerbate the dispute' and 'affect the host state's investment climate.'¹⁵⁷ Furthermore, if domestic courts were empowered to consider treaty-based claims, as part of the 'complementary mechanism' discussed above, domestic courts in less developed jurisdictions would lack the necessary expertise to apply international law.¹⁵⁸ Furthermore, Bradley suggests that the 'opaque nature' of the treaty-making process combined with the 'vagueness' of

¹⁵⁶ International Centre for Settlement of Investment Disputes (n 21) 67.

¹⁵⁷ Schreuer (n 142) 73.

¹⁵⁸ Schill and Vidigal (n 155) 89.

treaty provisions would also pose issues for domestic courts seeking to enforce treaty obligations.¹⁵⁹

There are, however, a variety of reasons to suggest this claim is overstated, and that the risks surrounding the use of national courts can be mitigated. First, a significant caveat to this argument is that investors are still able to access international arbitration if they find the decision of the domestic court to be unsatisfactory, they simply must exhaust local remedies before doing so. Second, domestic systems in developing countries are often 'assumed, but not established to be inadequate.'¹⁶⁰ Unlike in other systems that allow international claims on behalf of private actors, there is currently no need to show that domestic institutions are inadequate before commencing arbitration proceedings (outside of a few limited grounds of treaty protection, such as denial of justice).¹⁶¹ Additionally, empirical evidence spanning 1,126 recent arbitrations reported up until January 2020 has shown that respondent states in ISA are 'overwhelmingly middle-income states' with 45% of claims against upper-middle-income states, 26% against high-income states, and only 5% against low-income states.¹⁶² Whilst state income is not a perfect correlation with the quality of judicial institutions, there is substantial economic research that suggests that the quality of judicial institutions, particularly in relation to civil disputes, is correlated with economic performance.¹⁶³ Thus, to assume that domestic courts are highly likely to be inadequate does not necessarily align with statistical evidence. Instead, the evidence suggests that for the majority of cases, the

¹⁵⁹ Curtis A. Bradley, 'The Treaty Power and American Federalism' (2019) 97 Michigan Law Review 390, 442.

¹⁶⁰ Lise Johnson, Lisa Sachs, Brooke Güven and Jesse Coleman, 'Clearing the Path: Withdrawal of Consent and Termination as Next Steps for Reforming International Investment Law' (Columbia Center on Sustainable Investment, April 2008) 10 <<https://ccsi.columbia.edu/content/clearing-path-withdrawal-consent-and-termination-next-steps-reforming-international>> accessed 10 March 2021.

¹⁶¹ Gus Van Harten, 'Fortifying Inequality' in Gus Van Harten, *The Trouble with Foreign Investor Protection* (Oxford University Press 2020) 10.

¹⁶² Daniel Behn, Malcolm Langford and Laura Létourneau-Tremblay, 'Empirical Perspectives on Investment Arbitration: What Do We Know? Does It Matter?' (2020) 21 *The Journal of World Investment & Trade* 188, 192.

¹⁶³ Marilene Lorizio and Antonia Rosa Gurrieri, 'Efficiency of Justice and Economic Systems' (2014) 17 *Procedia Economics and Finance* 104, 106.

domestic courts are located in states that generally are equipped with functional, if not perfect domestic institutions.

Nevertheless, there are of course still going to be disputes in nations with domestic judicial institutions who highly unlikely to provide a reasonable remedy to affected investors. These include countries with high levels of judicial corruption, or where judiciaries have been captured by state governments. In these cases, recourse to ISA is obviously still going to be necessary. In these cases, however, it must be noted that the duty to exhaust local remedies has always been accompanied by a futility exception whereby only 'reasonably available' domestic remedies need to be pursued.¹⁶⁴ Thus if it is manifestly clear that an investor will not receive an adequate remedy domestically, the local remedies requirement would not require them to exhaust local remedies before initiating arbitration. Thus, investors are not going to be required to pursue obviously futile local remedies. However, the investors would be required to demonstrate that domestic remedies are not reasonably available before the tribunal. Thus, even with the exhaustion of domestic remedies requirement in place, investors in high-risk jurisdictions will still have access to ISA. It is simply investors in countries with stronger institutions who will no longer be able to benefit from entirely avoiding the domestic system. Of course, the question of whether domestic remedies are 'reasonably available' is up to tribunal interpretation and there are going to be marginal cases. Nevertheless, it can be expected that this will improve as tribunal jurisprudence elucidates in more detail exactly what is required. Furthermore, this shift in responsibility towards investors making a positive case for their eligibility is ultimately preferable to the status quo, where investors can simply benefit from the assumption that domestic institutions are inadequate.

Third, as put forward in the overall thesis of this article, even in situations where the domestic courts are not perfect, this is ultimately a short-term concern that will be gradually resolved as the local remedies rule provides the mechanisms necessary for ISA to improve the domestic rule of law. Over time, as international legal norms are absorbed domestically, we can thus expect the number of disputes that cannot be resolved domestically to decrease. Finally, and specifically concerning the risks that could arise from domestic courts

¹⁶⁴ International Law Commission (n 29).

directly considering treaty-based claims as an ‘complementarity mechanism’, this risk could be significantly mitigated by adopting elements from similar mechanisms as they currently already exist in different international legal regimes. The ECHR for example, which also requires the exhaustion of local remedies and allows for treaty-rights to be invoked before national courts in certain circumstances, recognises a ‘margin of appreciation’, under which local institutions are granted ‘a degree of discretion in applying ECHR standards in light of local contexts’.¹⁶⁵ A similar principle could be applied to reduce the risk of tension between international and domestic institutions should investment treaty standards be invoked directly by domestic courts.

2) Costs and Delays

A second commonly raised challenge is that a domestic remedies requirement would place unduly onerous costs and delays on investors. As exhausting domestic proceedings may require investors to take a claim through multiple appellate courts, it may take a large amount of time and increase costs significantly. These additional costs may threaten access to justice, and as noted by Schreuer, the ‘the primary victims’ of increased cost and delays ‘would be small and medium-sized investors’ who may be unable to fund both sets of proceedings and thus may be denied access to justice.¹⁶⁶ This could further exacerbate the ‘minoritarian bias’ in ISA, whereby the largest investors are better positioned to take advantage of dispute settlement mechanisms than others.¹⁶⁷ Additionally, increased costs associated with access to arbitration may also ultimately ‘result in a decision not to invest’.¹⁶⁸

Making an accurate estimate of the real impact that a duty to exhaust local remedies would have on the cost and length of proceedings is difficult, as very few modern BITs contain a duty to exhaust local remedies. However, the most recent empirical evidence places the average length of investment arbitration

¹⁶⁵ Puig and Shaffer (n 26) 403.

¹⁶⁶ Christoph Schreuer, ‘Do We Need Investment Arbitration?’ (2014) 11 *Transnational Dispute Management* 1, 10.

¹⁶⁷ Puig and Shaffer (n 26) 407.

¹⁶⁸ Kaufmann-Kohler and Potestà (n 35) 73.

proceedings at 3.73 years.¹⁶⁹ With regards to cost, the median cost of proceedings adjusted by inflation was found to be just over 6 million dollars.¹⁷⁰ In comparison to 'complex domestic court litigation', it was found that it 'is not clear that investment treaty arbitration is uniquely expensive'.¹⁷¹ With respect to the length of proceedings, one study found that arbitration proceedings in certain developed states were 'more than double the length' of comparable domestic litigation proceedings, but around the same length in other less-developed jurisdictions.¹⁷² Thus, the data surrounding the impact of imposing a duty to exhaust local remedies on costs and delays remain inconclusive. Of course, it may be the case that an investor is required to go through both the domestic system and the arbitration process if they are unable to find an adequate resolution domestically, with a subsequent exponential increase in costs. Nevertheless, subsequent arbitral proceedings are likely to be cheaper, as less time will be spent at the jurisdictional stage of proceedings. Furthermore, as noted by Porterfield, there is potential for a duty to exhaust local remedies to ultimately reduce the cost of subsequent arbitration proceedings 'by clarifying the factual background and relevant domestic legal context'.¹⁷³ Finally, the exhaustion of local remedies requirement could reduce the overall cost of the investment protection system by helping to reduce the phenomenon of frivolous and opportunistic claims. This is because the ability to submit frivolous claims is in part predicated on the ease of access to arbitration the current system provides to investors who can generally decide to initiate proceedings at any point due to the standing offer within the BIT.¹⁷⁴

Regardless, the futility exception should also function to prevent state's from purposefully stalling proceedings, and some BITs like the new Indian Model BIT have experimented with using a time limit to 'soften' the requirement to exhaust domestic remedies to a maximum of five years.¹⁷⁵ As

¹⁶⁹ Behn, Langford and Létourneau-Tremblay (n 162) 216.

¹⁷⁰ *ibid.*

¹⁷¹ *ibid* 208.

¹⁷² Bonnitca, Poulsen and Waibel (n 4) 149.

¹⁷³ Porterfield (n 75) 7.

¹⁷⁴ Tsai-Fang Chen, 'Deterring Frivolous Challenges in Investor-State Dispute Settlement' (2015) 8 *Contemporary Asia Arbitration Journal* 61, 64.

¹⁷⁵ Indian Model Bilateral Investment Treaty (2016), art 15.2.

long as the time limit is not too short as to render the duty to exhaust local remedies ineffective, this would help prevent unnecessary delay, and this is something that could be experimented with moving forward.

As a result, it is difficult to draw a definite conclusion on the impact a domestic remedies requirement would have on costs. Ultimately, costs are highly context-specific and dependent on the complexity of the dispute and jurisdiction in which it is located. However, it is nevertheless likely that, despite the mitigatory mechanisms discussed above, costs will increase for investors. This will particularly be the case where an investor is required to go through both the domestic court and the arbitration process in order to reach a satisfactory result. For them, costs will inevitably increase in comparison to the current status quo where they can immediately opt for arbitration. However, this concern may be exaggerated. Van Harten and Malysheuski's study found that investment treaty arbitration awards have been given overwhelmingly to 'companies with over 1 billion USD in annual revenue, and investors with over 100 million USD in net wealth'. Therefore, an increase in costs is unlikely to dissuade these investors from submitting claims even if a requirement to exhaust local remedies were implemented.¹⁷⁶ In light thereof, it seems reasonable to conclude that the harm caused by an increase in the cost of proceedings for these large MNCs is likely justifiable given the other benefits the duty to exhaust local remedies would provide.

Regarding the overall impact that this reform thus would have on the investment climate of host states, the reform is unlikely to radically alter investor decision making. Brazil, despite having never ratified a trade agreement including a mechanism of ISA still draws large-scale foreign investment and was the fourth largest destination for FDI in 2019.¹⁷⁷ Investors will still be drawn to the potential to make significant gains via investments in developing nations,

¹⁷⁶ Gus Van Harten and Pavel Malysheuski, 'Who Has Benefited Financially from Investment Treaty Arbitration? An Evaluation of the Size and Wealth of Claimants' (2016) Osgoode Research Paper 14/2016, 135, 140 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2713876> accessed 16 March 2022.

¹⁷⁷ United Nations Conference on Trade and Development, 'General Profile: Brazil' (UNCTAD *STAT*, 5 January 2019) <<https://unctadstat.unctad.org/EN/Index.html>> accessed 23 February 2022.

even if it requires more due diligence with regard to the potential for a dispute to arise. Furthermore, as discussed at the beginning of Part Two, recent empirical evidence has challenged both the assumption that ISA necessarily increases the flow of FDI and that more FDI is necessarily beneficial for development.¹⁷⁸ This is particularly true where the cost of that initial FDI may be a large award of damages against the host state should a dispute ultimately arise and be taken to arbitration.

3) Compatibility with the proposal for a Multilateral Investment Court

In response to the ongoing legitimacy crisis facing ISDS, various academic commentators have expressed their support for the European Union's proposal to create a permanent, specialised multilateral investment court with an appellate body to replace investor-state arbitration entirely. This type of 'systemic reform' has gained key advocates in the ongoing UNCITRAL reform process in Canada and the Mauritius, and the EU has completed BITs containing provisions for the future establishment of a permanent court with several other countries, including Mexico, Vietnam and Singapore.¹⁷⁹ However, in the drafting of the proposal for a multilateral investment court, the European Commission purportedly explicitly considered the possibility of including a duty to exhaust local remedies and ultimately concluded it unnecessary, and potentially harmful to ongoing reform efforts.¹⁸⁰ Nevertheless, a duty to exhaust local remedies is not only compatible with the proposal for a multilateral investment court, but highly synergistic in achieving the proposal's explicit goal of remedying the ongoing legitimacy crisis.

First, the precise nature of the legitimacy crisis that afflicts ISDS should be returned to. As noted by Radi, 'the lack of legitimacy faced by investor-State arbitration... is grounded, not only in the procedural features of investor-State arbitration but also in its international dimension'.¹⁸¹ As can be seen in the submissions of explicitly sceptical states like Brazil and South Africa, 'many (citizens) radically reject the idea that State conduct be reviewed and disputes

¹⁷⁸ Bonnichita (n 104) 54.

¹⁷⁹ Roberts (n 12) 416.

¹⁸⁰ Puig and Shaffer (n 26).

¹⁸¹ Radi (n 3) 261.

involving domestic public interest considerations be settled by tribunals that do not form part of the State apparatus' and in this respect, the 'proposals for a standing investment court appear to display the same defect... as investor-state arbitration'.¹⁸² This observation is evidenced by the results of the public consultation organised by the European Commission during the TTIP negotiations. These results demonstrated significant public support for the resolution of investment disputes in domestic courts, as opposed to an international mechanism.¹⁸³ As a result, in its public mandate for the TTIP negotiations in 2013, the European Council explicitly mentioned that 'consideration should be given... to the appropriate relationship between ISDS and domestic remedies'.¹⁸⁴ Thus, the addition of a requirement to exhaust local remedies to current proposals for a standing multilateral investment court could serve to rectify a notable weakness in the current proposal's aim to resolve the legitimacy crisis, whilst potentially catalysing further reform.

Additionally, much like the current system of ISA, any proposal for establishing a standing multilateral investment court should retain the explicit goal of furthering the development of the domestic rule of law. As noted by Kelsey, 'in the absence of a duty to exhaust local remedies' this goal might be seriously undermined, as the 'investment court model, much like ISDS, would generate a substitute system for the settlement of investment disputes that risks disincentivising... reform at the domestic level'.¹⁸⁵ Instead, any investment court should be equipped with mechanisms through which it can engage with domestic institutions, and positively impact the domestic rule of law. A duty to exhaust local remedies, for many of the reasons described earlier, would be a

¹⁸² *ibid* 20.

¹⁸³ European Commission, 'Report: Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)' (13 January 2015) 16 <https://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf> accessed 16 March 2022.

¹⁸⁴ Council of the European Union, 'Directives for the Negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America' (adopted 14 June 2013, declassified 9 October 2014) para 23 <<http://data.consilium.europa.eu/doc/document/ST-11103-2013-DCL-1/en/pdf>> accessed 2 February 2021.

¹⁸⁵ Kelsey, Schneiderman and Van Harten (n 30) 15.

good mechanism for achieving the repeat interactions between national and international courts that lead to a 'common understanding of legal obligations', thus encouraging the promulgation of good governance norms in the domestic context.¹⁸⁶ Any proposal for a multilateral investment court should not be designed as a substitute to domestic institutions, and thus should seriously consider implementing an exhaustion of local remedies requirement. Ultimately, if such a system intends to resolve the legitimacy crisis faced by ISA in its current form, it must be careful not to subject itself to the same fundamental concerns. To that end, achieving an effective combination of systemic and paradigmatic reform is fundamental. A standing multilateral investment court in combination with a duty to exhaust local remedies, as part of a wider multilateral investment institution that would allow states to choose to have investment norms directly invoked before national courts, thus represents a particularly promising solution for achieving an effective balance between international and national fora. At its core, this solution recognises the necessity of a system of ISDS that seeks not only to protect foreign investors, but to achieve better outcomes for the great variety of different actors currently engaged in the ISDS process.

CONCLUSION

This article has sought to contend that implementing the duty to exhaust local remedies represents a highly promising solution to a variety of the key concerns that underpin investor-State arbitration's current legitimacy crisis. First, it has argued that the duty to exhaust local remedies can resolve much of the underlying tension that arises from ISA's current framework for managing dispute jurisdiction. In doing so, it removes the need for increasingly complex treaty-provisions, rules of election, and tribunal jurisprudence that have failed to effectively clarify the conceptual separation between contractual and treaty-based claims that arise from the same factual scenario. It does this by acting as a dynamic rule of procedure that functions to ensure disputes are resolved as close to their epicentre as possible, whilst empowering domestic institutions to self-correct. In this way, it also suspends the damaging uncertainty that belies the current system. This uncertainty only further fractures the relationship

¹⁸⁶ Puig and Shaffer (n 26) 399.

between arbitral panels and domestic institutions whilst undermining the efforts of national governments to manage their risk through exclusive jurisdiction clauses and rules of election.

Secondly, this article has shown that reimplementing the duty to exhaust local remedies would enable ISA to fulfil its potential to improve the domestic rule of law and the quality of domestic institutions. It does so by providing the missing mechanisms that belie the current discrepancy between good governance narratives of ISA and on-the-ground empirical research in developing states. These complementarity mechanisms are also scalable, with States able to opt into higher levels of congruency by agreeing to certain additional conditions, such as the ability for investors to directly invoke treaty norms before domestic courts. To this end, there is good scope for this solution to be implemented in tandem with current proposals for an *à la carte* Multilateral Institute for Investment Dispute Settlement.

Finally, it has been argued that the duty to exhaust local remedies achieves these goals without necessarily placing an unduly onerous burden on investors in terms of costs or delays. However, it is admitted that investors are likely to face some additional costs, especially during the early stages of adoption. Nonetheless, this reassignment of costs is negligible when concerning the parties who usually bring claims under ISA. Alternatively, this reassignment is still equitable in light of the other benefits the duty provides. Finally, the duty is compatible with other reform efforts, including the ongoing efforts to introduce a multilateral investment court by the EU and other actors. To this end, if ISA is to seriously plug the legitimacy gap it currently faces the inherent tension that arises when domestic policy is challenged at an international level must be addressed. To simply assert that another international mechanism would be adequate would be to mischaracterise the nature of the current problem. In comparison, a duty to exhaust local remedies addresses this concern directly and could be readily integrated into current proposals. Thus, it is recommended that the duty to exhaust local remedies be included either as part of a reformed system of ISA, or as part of any adopted proposal for a multilateral investment court.