The improvement of the international investment dispute settlement mechanism under the return of the exhaustion of local remedies rule

O Aprimoramento do Mecanismo Internacional de Solução de Controvérsias em Investimentos sob a Regra do Retorno do Esgotamento dos Recursos Internos

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ABSTRACT

The exhaustion of local remedies rule is an old customary rule that was gradually marginalized in the eighties of the twentieth century, but in recent years it has been gradually returning. This paper analyzes three basic issues: what is the exhaustion of local remedies rule, why the exhaustion of local remedies rule returns, and the measures to improve the international investment dispute settlement mechanism under the trend of the return of the exhaustion of local remedies rule.

Keywords: Exhaustion of local remedies rules； International Settlement of Investment Disputes； ICSID

RESUMO

O esgotamento dos recursos internos é uma antiga norma de direito consuetudinário que foi gradualmente marginalizada na década de 80 do século XX, mas nos últimos anos foi gradualmente revertida. Este artigo analisa três questões básicas: o que é a regra do esgotamento dos recursos internos, por que a regra do esgotamento dos recursos internos retorna e as medidas para melhorar o mecanismo internacional de solução de controvérsias em investimentos sob a tendência do retorno da regra do esgotamento dos recursos internos.

Palavras-chave: Regra do esgotamento dos recursos internos; Solução de Controvérsias em Investimentos Internacionais; ICSID

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SUMMARY:

1.INTRODUCTION

The exhaustion of local remedies rule, an ancient rule of customary international law that dates back to the thirteenth and fourteenth centuries, was originally based on the resolution of a conflict between the judicial sovereignty of a State and the diplomatic protection of a citizen of that State by the State of nationality to which that State had been injured. With the development of economic globalization, it has gradually been applied to the field of international investment. Since the 80s of the 20th century, with the rise of the concept of investment liberalization, the rule of exhaustion of local remedies has been gradually marginalized. However, in recent years, under the influence of the economic crisis, the global political and economic pattern is undergoing profound changes, "the world has undergone major changes unseen in a century. [2]The evolution of the world has accelerated", the trend of anti-globalization, trade protectionism and nationalism has gradually risen, and the exhaustion of local remedies rule, which is closely related to national sovereignty, is gradually returning in the field of international investment dispute settlement.

In the face of the changes in China's international investment situation and the "resurrection" trend of exhaustion of local remedies rules, what attitude should we adopt towards the exhaustion of local remedies rules? And how can the exhaustion of local remedies rule be better applied to meet the development requirements of the new era? To solve these problems, it is necessary to first explain in detail: what is the exhaustion of local remedies rule? What are the detailed reasons behind the trend of regression of the exhaustion of local remedies rule? This paper will use a variety of research

[2] In http://paper.people.com.cn/rmrb/html/2022-10/17/nw.D110000renmrb_20221017_1-01.htm. Last access: April 29, 2025.

methods such as conceptual analysis, case analysis, and comparative research to carry out systematic research, coordinate the exhaustion of local remedies rules with existing bilateral investment treaties and multilateral obligations, and improve the international investment dispute settlement mechanism.

2. OVERVIEW OF THE EXHAUSTION OF LOCAL REMEDIES RULE

In the field of international investment dispute settlement, the main content of the exhaustion of local remedies rule is that if a foreign natural or legal person has a conflict with the government of the host country, the dispute shall first be submitted to the administrative or judicial organs of the host country, which shall resolve the dispute in accordance with the substantive and procedural laws of the domestic authorities of the host country, and shall not seek international procedures to resolve the dispute until all remedies of the host country have been exhausted (Xin Baichun,2022).

A correct understanding of the exhaustion of local remedies rule should include two meanings: first, what is local remedies, and if they belong to local remedies, the parties are obliged to exhaust them; If it is not a local remedy, the parties are certainly not obliged to exhaust them (Xin Baichun,2022). Second, what is "exhaustion"?

2.1. LOCAL RELIEF

Local remedies usually refer to enforcement mechanisms such as administrative and judicial (generally courts) established by the wrongdoer country in accordance with its laws Procedure. The local remedies available to investors must be authoritative, the outcome of the award, whether correct or not, should be generally accepted by all parties in terms of the validity of the award itself, and there should be a state authority to ensure the implementation of the award (Yu Mincai,2003). In this way, the local remedies procedure can be binding on the parties, and for the investor, it is effective to commence the claim proceedings against the host State. Second, the local remedies procedure itself should be fair to the parties, and its procedural setup should correspond to the parties' needs to resolve the dispute.

2.2. EXHAUSTION

On the one hand, "exhaustion" means that a party should exhaust all possible remedies in the host country, including from local to central, from administrative to judicial remedies, from

consultation, mediation, litigation to enforcement, and other remedies until the final decision of the highest relevant state authority is made, before applying for international arbiteration; On the other hand, when applying the host country's remedies, the procedure should comply with all the provisions of the host country on relief procedures, including jurisdiction, recusal, evidence provision, appeal procedures, time limit, service, enforcement, etc., and if there are flaws in the application of the procedures, the remedies shall be deemed to have not been exhausted (Yin Min,2016).

By deconstructing the concept, we find that there is a lot of room for discretion in the principle of exhaustion of local remedies, such as: what kind of procedure meets the reasonable standard? What is the final decision? What is the "exhaustion" period? Is "exhaustion" procedural or substantive? On the one hand, these leeways have led to the emergence of numerous arbitration issues in the International Center for Settlement of Investment Disputes (ICSID) and the return to the exhaustion of local remedies rule, which will be analyzed below. On the other hand, it also leaves room for interpretation in the application of the exhaustion of local remedies rule in China.

3. THE RETURN OF THE EXHAUSTION OF LOCAL REMEDIES RULE

To analyze the regression of the exhaustion of local remedies rule, we need to analyze what caused the "resurrection" of the exhaustion of local remedies rule?

3.1. THE NEED TO EXHAUST LOCAL REMEDIES RULES INCREASES

The most intuitive reason for this phenomenon is that the host country faces a high risk of being sued. The signing of the "fork in the road clause" by the capital-importing countries was intended to give investors more choices and optimize their own investment environment, but it has become a safe haven for many investors to escape from the jurisdiction of the host country and initiate international arbitration at will.

3.2. THE CRISIS OF LEGITIMACY IN ICSID ARBITRATION

One of the factors that cannot be ignored in the current increase in the demand for local remedies rules in various countries is the host country's non-recognition of ICSID arbitration, under which investors can choose a way to resolve their disputes, but due to the many problems arising from the ICSID ruling, the host country can only focus on exhausting the local remedies rules. So, what are the issues with ICSID arbitration?

First, there is an infinite expansion of jurisdiction. According to the current practice of international investment arbitration, if an investment dispute has been initiated in the domestic proceedings of the host country, and the investor initiates the dispute to arbitration, the arbitral tribunal will determine whether it has jurisdiction over the dispute based on the judgment of whether the three conditions of "the cause of action is the same, the parties are the same, and the claims are the same" (Xu Chongli,2007). As long as these three conditions are not met, the international arbitral tribunal will be justified in rehearing the case. As a result of this highly formalistic approach, few cases met the "triple agreement" standard in the previous local relief proceedings and subsequent international arbitration proceedings, and the jurisdiction of the investment arbitration tribunal was expanded, the "fork in the road clause" was gradually hollowed out, and many of the pre-procedures set up by the host country were rendered useless (Ni Xiaolu,2007). This not only allows the host country's domestic remedies to be circumvented, resulting in duplicate litigation, or even the reversal of its original judgment, but also challenges the authority of the domestic judiciary.

Second, there is the crisis of legitimacy in ICSID arbitration. Siemens A.G. v. Argentine Republic v. Wintershall Aktiengesellschaft v. Argentine Republic (ICSID Case No. ARB/ 02/8) is an allegation by the German company Siemens that the emergency measures taken by Argentina during the 2001 economic crisis (such as freezing utility tariffs, abolishing concession contracts, etc.) violated the fair and equitable treatment (FET), protection and security obligations, and indirect collection clauses in the BIT. In 2007, the ICSID tribunal found that Siemens met the definition of "investor" in the BIT and that Argentina's failure to fulfill its contractual obligations constituted an "investment dispute". Argentina was ultimately found to have violated FET (Fair and Equitable Treatment) on the grounds that the government's measures were arbitrary and unpredictable, and that they did not grant due process protections to investors. At the same time, it was determined that it constituted indirect expropriation, because the measure essentially deprived the investment value. Argentina was ordered to pay Siemens approximately $217 million in compensation. In Wintershall Aktiengesellschaft v. Argentine Republic (ICSID Case No. ARB/04/14), the German company Wintershall (an oil and gas investor) similarly accused Argentina of violating the BIT by measures taken to the economic crisis, but the controversy focused on whether a change in tax policy (e.g., an increase in export tax) constituted a violation or imposition of FET. In 2008, the ICSID arbitral tribunal dismissed jurisdiction on the grounds that Wintershall had failed to meet the precondition of "18 months for domestic litigation" under Article 10 of the BIT. In terms of the interpretation of FET,

the arbitral tribunal held that it was necessary to prove "bad faith or serious misconduct", and that the policy adjustment under the economic crisis did not necessarily violate the FET, implying that the tax adjustment was within the scope of sovereignty and did not constitute collection.

Through these two cases, we can see the deep-seated problems of ICSID in terms of treaty interpretation methods, application of procedural rules and uniformity of substantive standards. The Siemens case ignored procedural flaws (similar to domestic litigation requirements without rigorous scrutiny) and the Wintershall dismissal on procedural grounds, highlighting the arbitrariness of the arbitral tribunal's interpretation of the BIT clause. In the determination of the applicable standard of FET, Siemens adopts the standard of "stable expectations", while Wintershall requires proof of "bad faith", but the same BIT clause (Article 2 of the German-Argentine BIT) is given different connotations, which is an example of the "fragmentation" of ICSID. On the other hand, one of the most criticized aspects of ICSID is that it was born out of commercial arbitration, and the arbitration results are too biased towards investors, and the host country often has to bear hundreds of millions of dollars in compensation, and many policies related to the public interest have even died as a result, which has seriously damaged the authority of ICSID arbitration.

4. APPLICATION OF THE EXHAUSTION OF LOCAL REMEDIES RULE

In the face of the trend of the return of local remedies rules, what kind of attitude and approach should we adopt to apply the exhaustion of local remedies rules in a more scientific manner? The author believes that it can be improved in the following aspects:

4.1. REFINE THE EXPLANATION OF THE CONCEPT OF DISPUTE

As mentioned in the previous analysis, one of the main problems with the exhaustion of local remedies rule at present is that there is so much room for interpretation in its concept, which has led to confusion in its application. Is the host country's final award procedural or substantive? In the author's opinion, in order to maintain the authority of the law, substantive disputes should be included in the finality requirement under the existing system. The time provided for in the time-limited exhaustion of local remedies rules refers to the time elapsed after the dispute has arisen or the time elapsed through the local remedies procedure in the host State (Chen Danyan,2017). In this regard, the author believes that the latter is more in line with the host country's establishment of a time limit

The starting point is to give the host country the opportunity and time to correct itself. In addition, in practice, we should proceed from the problem and the interests of our country, constantly refine the interpretation of controversial concepts, and make clear norms as much as possible when concluding treaties. When we are truly faced with international arbitration, we can rely on these agreements to strive for a favorable award for our countries.

4.2. IMPROVE ADMINISTRATIVE RELIEF MECHANISMS

Take China as an example, it is understandable that China currently adopts the practice of using administrative remedies as a pre-procedure, which is in the common interest of investors and our country (Li Fenghua,2015). However, with regard to administrative remedies, there is still an issue that needs to be improved, that is, the issue of international investment disputes arising from abstract administrative acts, which is also an urgent need for improvement in domestic administrative law. At present, according to China's legal provisions, administrative regulations and rules are excluded from administrative reconsideration and cannot be reviewed, and if an investor has a dispute with China because of an abstract administrative act, but cannot obtain relief, then it will also reduce the significance of China's pre-procedure for setting up administrative remedies. Therefore, China needs to respond to social demands, promote the pilot review of abstract administrative acts, summarize typical cases, straighten out the legal logic behind them, and introduce laws and regulations on the review of abstract administrative acts as soon as possible to fill in the gaps and enrich this pre-procedure.

4.3. PROMOTE THE APPLICATION OF THE CONSULTATION PROCESS

When discussing administrative or judicial remedies, an important dispute resolution procedure – consultation – is often overlooked. Resolving disputes through negotiation and conciliation without initiating a remedial procedure is a welcome outcome. In July 2019, China submitted to UNCITRAL Working Group III the "Possible Reform of the Investor-State Dispute Settlement System – Submission by the Chinese Government", which explicitly supports the pre-arbitration consultation mechanism (Ji Wentian,2021). According to the practice of ICSID, in dispute resolution, if an investor directly initiates arbitration with ICSID without a consultation process with the host country, the arbitral tribunal will generally refuse to accept it, for example, in Murphy Exploration and Pro-duction Company International v. Republic of Ecuador and Burlington

Resources Inc v. In the Ecuador case, the arbitral tribunal ruled inadmissible (Zhang Sheng,2019). Therefore, China should also improve the consultation mechanism, set up a special consultation committee, provide a "one-stop" platform and an "integrated" window resolve disputes efficiently and transparently, and clear the way for international investment (Ji Wentian,2021).

4.4. BROADER REFORM OF THE INVESTOR-STATE DISPUTE SETTLEMENT MECHANISM

One of the main reasons for the return of the principle of local remedies is that the legitimacy of ICSID arbitration has been questioned and its effectiveness has been greatly reduced. At present, the direction of ICSID arbitration reform can be divided into two aspects: on the one hand, it is oriented towards the dispute settlement mechanism, and on the other hand, it is oriented towards the dispute prevention mechanism. In terms of dispute resolution, first of all, some scholars have proposed that the appeal mechanism should be improved, and a permanent investment tribunal (such as the "Multilateral Investment Court" (MIC) proposed by the European Union could be modeled on the WTO model, and the arbitral award could be legally reviewed to ensure the consistency of the award. Article 9.22 of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) clarifies the criteria for the review of appeals, including procedural errors and errors in the application of law. This increases the predictability of cases. At the same time, the establishment of the ICSID appeal mechanism can also curb arbitrators' arbitrary interpretation of treaties, expand the scope of arbitral tribunals, help eliminate the phenomenon of conflicting interpretations of similar or identical terms between ICSID arbitrators, ICSID and other arbitral institutions, greatly improve the credibility of ICSID arbitration, and establish the legitimacy of the ICSID arbitration system in the long run (LIU Sun,2009). Second, it is necessary to clarify the degree of national regulatory authority. Article ANNEX 10B.4 of the Regional Comprehensive Economic Partnership (RCEP) [3]clarifies that regulatory measures taken by the host country for public welfare (e.g., environmental protection, labor rights) do not constitute indirect expropriation. To some extent to alleviate investor-state tensions in dispute settlement, Article 8.9 of the EU-Canada Comprehensive Economic and Trade Agreement[4] stipulates the right of the parties within their territory to regulate legitimate policy

[3] In http://fta.mofcom.gov.cn/rcep/rceppdf/d10z_fj2_en.pdf. Last access: April 30, 2025.
[4] In https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/08.aspx?lang=engCETA (2017). Last access: April 30, 2025.

objectives, such as the protection of public health, safety, the environment or public morals, the protection of society or consumers, or the promotion and protection of cultural diversity. Finally, to improve ICSID transparency, it allows non-disputing parties (e.g., NGOs, trade unions) to submit amicus curiae submissions[5]to enhance the authority of ICSID arbitration. These measures can greatly improve the fairness of ICSID arbitration, but the ICSID reform not only involves the system itself, but when the reform enters the "deep waters", it will face the non-dispute resolution mechanism itself such as the distribution of interests between countries, which may hinder the effectiveness of the ICSID reform (Liu Zijing,2024). Reforms oriented to dispute prevention mechanisms provide a new approach to ICSID reform, such as the establishment of regular communication and consultation mechanisms, and the USMCA[6] establishes a special committee to regularly review investment policies and resolve potential disputes in a timely manner. Chapter 12 of the Singapore-Australia FTA [7]provides for a "cooling-off period" and mandatory mediation, requiring investors to participate in mediation for at least six months before initiating arbitration. The ICSID 2022 Rules [8]add a new "dispute avoidance" clause, which allows the government to propose a settlement (e.g. compensation, license adjustment) to avoid escalation of disputes. It can also be seen that the ICSID has also placed greater emphasis on dispute prevention mechanisms. The ICSID reform has been jointly promoted by the two aspects of dispute resolution and dispute prevention, and the ICSID arbitration reform has provided more options for investor-state dispute settlement under the trend of the return of investor suitability rules.

5. EPILOGUE

As an ancient rule of customary international law, the application of the exhaustion of local remedies rule in the field of international investment has undergone a process of rise-decline-revival. Today, in the face of the trend of returning to the rule of exhaustion of local remedies, We should start from three aspects: the detailed interpretation of the concept, the improvement of administrative remedies, and the application of consultation procedures, and objectively and scientifically apply the

[5] In https://icsid.worldbank.org/. Last access: April 30, 2025.
[6] In https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14-Investment.pdf. Last access: April 30, 2025.
[7] In https://www.enterprisesg.gov.sg/-/media/esg/files/non-localised/free-trade-agreements/safta/safta-agreement-text.ashx. Last access: April 30, 2025.
[8] In https://icsid.worldbank.org/. Last access: April 30, 2025.

rule of exhaustion of local remedies.It is more necessary to focus on the overall situation, comprehensively and extensively reform the investor-state dispute settlement mechanism, provide more dispute settlement options for the international community by deepening the investor-state dispute settlement mechanism, build a fairer and more stable investor-state dispute settlement mechanism, and provide a guarantee for the freedom and fairness of world trade in the context of the rise of global trade protectionism！

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