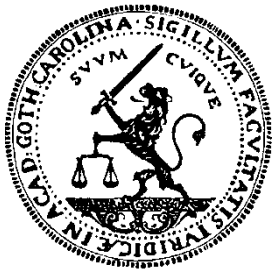

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How to BITe the Apple

Is There a Requirement to Exhaust Local Remedies in Investment Treaty Arbitration?

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Contents

Summary

The principle that a mistreated foreign national has to attempt to be remedied in the host State before resorting to international measures has deep roots in international law. It is regarded as customary international law within the field of diplomatic protection, from which it has spread into other legal fields, one of them being arbitral proceedings under international investment agreements.

Such agreements, most often bilateral (BITs), are concluded between States, guaranteeing investors from its counterpart a safe investment environment. They also include dispute resolution mechanisms, which virtually always give an aggrieved investor the option of international arbitration. This paper intends to explore the question on what is the default situation where such a BIT does not regulate the question of local remedies – does the established local remedies presumption from the field of diplomatic protection prevail: how many bites at the apple are needed?

After investigating how the local remedies rule evolved into customary international law, the relatively modern investment arbitration scheme is introduced. Then one chapter of the text discusses how BITs, and disputes arbitrated within their framework, have handled the rule – showing a discrepancy between several arbitral awards as well as the published scholar writings on the rule's position in investor-State disputes.

The paper is concluded by a discussion, in which the posed question is answered partly in the negative. It is argued that there is no procedural requirement to attempt at local remedies before an arbitral tribunal's jurisdiction can be established. The requirement might however be included in the merits of an arbitral claim, but it is the view of this author that this should be done with considerable caution. Outside of denial of justice-claims, and certain similar claims framed under other standards, the local remedies requirement should have a very limited role in investment arbitration and the purpose and driving force behind the system must be stressed when applying it.

Sammanfattning

Principen att en felbehandlad utländsk medborgare måste söka kompensation inom värdlandets rättsapparat innan internationella medel kan användas har djupa rötter i internationell rätt. Den anses vara sedvänja när stater utövar diplomatiskt skydd i folkrätten, och därifrån har principen spridit sig till andra rättsliga områden. Ett av dessa är skiljeförfaranden baserade på internationella investeringsavtal.

Sådana avtal, oftast bilaterala (BIT-avtal), sluts mellan stater och garanterar investerare från de fördragsslutande länderna en stabil och säker investeringsmiljö. De innehåller också tvistelösningsmekanismer, som i princip alltid ger en investerare möjlighet att påkalla internationellt skiljeförfarande. Denna uppsats ämnar undersöka vad som är, och bör vara, gällande rätt när en BIT inte alls reglerar frågan om krav på att uttömma lokala rättsmedel: står sig kravet från diplomatiskt skydd även i investeringstvister?

Efter en presentation av hur lokala rättsmedel-kravet utvecklades till sedvanerätt introduceras den relativt moderna rättsbildningen kring investeringstvister. Det därpå följande avsnittet diskuterar hur BIT-avtal, och tvister lösta inom deras ramverk, har hanterat regeln. En dissens mellan såväl flertalet skiljedomar som akademiska kommentarer kan här skönjas.

Uppsatsen avslutas med en diskussion och ett delvis nekande svar på den undersökta frågan. Det hävdas att det i processuell mening inte bör finnas något krav på att uttömma lokala rättsmedel innan skiljeförfarande kan inledas. Däremot kan ett sådant krav i praktiken ändå spela en roll genom att det kan anses vara en substantiell del av talan, vilket har visat sig vara fallet i flertalet av de studerade skiljedomarna. Författaren är av uppfattningen att denna tillämpning av regelns omfattning bör göras med betydande restriktivitet. Det finns ett antal anspråk - påstådd ”denial of justice” och några liknande standarder – där kravet har en viktig materiell funktion. I övrigt bör lokala rättsmedel ges en mycket begränsad roll i investeringstvister och systemets unika bakgrund måste betonas vid varje tillämpning.

Preface

The question on how to handle exhaustion of local remedies in cases when the relevant BIT is silent had been brewing in my mind for a while before I started working on this paper. It was however crystallized when I read a research sketch on this and other issues by The International Law Association's German Branch and, more specifically, Dr Ralph Alexander Lorz. I sincerely thank Dr Lorz for the inspiration and subsequent support during my writing. In this spirit, I would also like to lend a thank you to Peter Gottschalk, who turned me to the area in the first place.

Living with a paper for several months is a much more pleasant task when you can discuss both substance and style with friends who are smarter than you – for this, I am grateful to Jens Lidén and the always dissenting Niclas Martinsson.

Finally, to Mahogny Coffee at Gibraltargatan in Göteborg: thank you for allowing me to write this thesis, using the same table for hours a day while only paying for a cappuccino.

Needless to say, all errors in the paper can only be attributed to me.

Abbreviations

BIT	Bilateral Investment Treaty
FCN	Friendship, Commerce and Navigation (Treaty)
FDI	Foreign Direct Investment
ICC	International Chamber of Commerce (in reference to the Arbitration Institute)
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
ILC	International Law Commission
LCIA	The London Court of International Arbitration
MFN	Most Favoured Nation (Clause)
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
PCA	Permanent Court of Arbitration
SCC	Stockholm Chamber of Commerce (in reference to the Arbitration Institute)
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WBAT	World Bank Administrative Tribunal

1 Introduction

Specific protection of foreign investments is a relatively novel legal area that has evolved quickly over the last couple of decades, and so have the different dispute resolution mechanisms associated with it. The common feature unique for these is that two States normally conclude an agreement that allows legal and private persons from those States to initiate international proceedings against the other State. Private entities can thereby base claims on a treaty signed by two States and use this against a sovereign, without having been party to the original agreement – so called "arbitration without privity". Even though arbitration is the preferred way of solving disputes in the field, sometimes the claimant is obliged to first try his way in the court system of the host State (the "local remedies rule"), depending on what has been agreed upon between the States.

The principle that procedural remedies in the host state need to be exhausted or attempted at before an international proceeding can be initiated derives from the law of diplomatic protection. This field has deep roots in international law, giving any State discretionary rights to act against a second State that has injured a citizen of the first State, and to act on behalf of its citizens. It is commonly accepted that the local remedies rule is to be regarded as customary international law in such cases, evidenced in its inclusion in the latest ILC Draft on Diplomatic Protection.[1] It is within this framework that the principle has been developed and is most established. Before the relatively new investment treaty scheme, the remedies available through diplomatic protection were a foreign investor's only option to pursue compensation from a host state.

Protection of investors' rights is however something different than diplomatic protection, because it is based on the mentioned State agreement and not on a softer principle of international law. This investment protection scheme has evolved in an almost exploding manner over the last decades and the more precise character of many of its elements remains unclear, simply because it has not been tested and argued enough. Whether or not the local remedies rule, "borrowed" from diplomatic protection, applies if nothing contrary is agreed upon is one of these open questions.

Bilateral Investment Treaties (BITs), the most common agreement on which to base investment arbitration, often refer to a specific investment dispute rule set or institution, the most established being ICSID[2], but also other rules such as UNCITRAL.[3] The ICSID rules dismiss the local remedies rule by excluding it unless otherwise stated,[4] while the UNCITRAL rules are

[1] Article 22. See also Interhandel , the first ICJ case establishing this.
[2] International Center for Settlement of Investment Disputes, set up in 1965 and handling some 370 cases since then (ICSID Caseload Statistics Issue 2012-1).
[3] United Nations Commission on Trade Law.
[4] ICSID Convention art 26.

silent, leaving it entirely up to the parties. The reason for the UNCITRAL's silence is that these arbitration rules, though used frequently in investment arbitration, were drafted in a purely commercial context – meaning that pursuit of local remedies would undermine the premise for the rules.

This contradiction is what I find the most interesting with investment treaty arbitration: it has one leg in the field of public international law, and the other in the commercial world. It is also this inherent dichotomy that poses the basis for my research question: what happens to the local remedies rule, developed and established in public international legal disputes, when arbitration is issued under a BIT which does not mention the rule, and the applicable rules are silent?

If the rule *still* would apply, as is the case with diplomatic protection, this might mean that the rule constitutes a procedural obstacle, in the sense that arbitration could not be initiated unless the claimant/investor at least has attempted to exhaust the local court system in the host state. It might also mean, as will be developed in this paper, that the rule is included in the material claim, thereby allowing a claimant to file before a tribunal, but effectively stopping him from succeeding unless attempts have been made at local rectification of the alleged mistreatment.

There are at least eleven recent relevant investor-State cases when an arbitration tribunal has discussed the substantive or procedural function of the local remedies rule.[5] In several of these cases, governed either by ICSID or UNCITRAL rules, did the rule find its way into the tribunal's reasoning *even though the underlying treaties excluded it.* This was managed by applying the rule as part of the substance of the claim, as opposed to a procedural requirement. The development suggests that there is still room for the rule in modern investment arbitration and it might mean that it has a wider application than previously thought. It is this tendency that will be developed and evaluated in this paper.

1.1 Purpose

The purpose of the text is thus as follows: to investigate what happens when bilateral investment treaties do not explicitly include a provision providing for a requirement to attempt at local remedies before resorting to international arbitration, nor a release from the same requirement. Should such an obligation be regarded as implicit anyway?

This means that the paper has a purpose containing a two-folded aim and consequently will be split into two parts. First, the elusive figure that is the local remedies rule will be pinned down and its origin and modern application introduced, in order to establish how the rule has been

[5] Chevron-Texaco, EnCana, Feldman, Generation Ukraine, Helnan, Loewen, Pantechniki, Parkerings, Saipem, Waste Management, Yaung Chi Oo Trading.

interpreted in investment treaty arbitration. Second, based on these findings, the final part will discuss the ideal function of the local remedies rule.

1.2 Materials and Methodology

The main source of international law is treaties.[6] Older studies indicate that it is unusual that a local remedies rule is explicitly included in BITs,[7] and as will be shown in this text, it is still uncommon for treaties to include language on the issue at hand. This work, though seemingly focused on a very treaty-driven area of international law, will therefore mostly use other sources.

The area of diplomatic protection, and its different subcategories, is mostly developed through formally non-binding decisions. Such decisions – referred to by Amerasinghe as ”judicial, arbitral and quasi-judicial” – may still have the status of a source of law in the areas discussed in this text.[8] Absent of State practice, especially in the earlier 20th century when the local remedies rule was developed, different tribunals' and ad hoc bodies' awards on uncertain legal matters inserted at least some firmness and clarified previously untested matters. It is nonetheless important to note that there is no formal *stare decisis* doctrine in either international law or international arbitration, and there exists no single source which can be regarded as equivalent to that of legislation.[9] It is a “law of co-ordination”, in the sense that the system is being created and applied by the players themselves.[10] In the case of BIT-arbitration, this is primarily illustrated by the fact that it is the States that agree to arbitration and thereby set up the tribunals that form and develop investment “law”.

The traditional legal method, in which a legal question is answered using an established system of internally coherent norms, is the main method used in this text. This method presupposes a clear hierarchical order of sources, and in this respect the available material presents a challenge, because such an order seemingly does not exist within the field of study. I am relying on supra-national sources, primarily international courts, arbitral awards and treaty practice but also academic writing. It is primarily the first two that justify a deeper methodological reflection, since they are the peculiarities of the area and challenge the dogmatic method.

The presented purpose of this text does furthermore, as has been pointed out, contain two elements. The first is to map out how the local remedies rule has been applied in investment arbitration proceedings – the *de lege lata* aspect – and the second is, given the first part, an attempt at reasoning

[6] Rosenne 1984, p.7, ICJ Statute art. 38.
[7] Peters 1997, Adede 1977.
[8] Amerasinghe 2004, p.38.
[9] Rosenne 1984, p.91.
[10] Ibid, p.2.

about the rule's ideal function – the *de lege ferenda* aspect, if you will. The dual aim requires two different methodological approaches.

1.2.1 De Lege Lata

The area of investment treaty arbitration is a methodically challenging one. The leading sources, given the BIT silence on the subject matter, are primarily academic writers and arbitral awards: not seldom the same persons in different functions, disagreeing internally and articulating these differing views vigorously. The problem with such a situation, compared to most other legal areas, is that there is no explicit aim at uniformity. Tribunals are in principle set up to solve the dispute at hand and have no obligation to apply principles and rules according to preceding, or for that matter succeeding, tribunals' interpretation. The only obligation is towards the parties in the individual dispute. Given that the arbitral tribunal often consists of legal authorities picked by the parties just because they have voiced an opinion on an issue relevant to the dispute, a non-uniform system is encouraged. This inherent element is at the same time the area's attraction for an observing researcher. A legal standpoint is only as good as its underlying argument, and there is a big potential to participate in the legal development without being a high court judge, as long as one is able to sufficiently crystallize the problem at hand and suggest a sensible way to solve it. The question on local remedies' application in investment arbitration is one good example of this, in the sense that there have been several awards dealing with the matter in different ways – and that these have received approving as well as more sceptical reviews by academics.

There is therefore no doctrine of precedent within the field but, despite the fact that legal issues are solved on an ad-hoc basis, it is possible to argue that a de facto practice of precedent exists – it is of course hard to conceive of any legal system with no precedent at all.[11]

Despite this lack of formal uniform application, the individual arbitrators are naturally not solving specific legal questions in a vacuum. Much like court decisions in some civil law countries, arbitral awards in this respect are not formally binding, but nonetheless persuasive based on their legal reasoning.[12] The relatively small investment arbitration community is working together and looking at each others' published arguments and, even more so, on how previous tribunals have approached similar situations. In the case of local remedies, at present there are only a dozen or so previous awards, making it an easy task to survey. This is also demonstrated by the diligent reference made to other awards in the reasoning of tribunals; many of the awards studied in this work are cross-referencing each other. Put in another way: even though there is no *de facto* doctrine of precedent in investment treaty arbitration, there is definitely a *de jure* practice of "carefully considering" previous tribunals' work on similar questions.[13]

[11] Schreuer & Weiniger 2008, p.1196, Berger 1992 p.18.
[12] Commission 2007, p.129 with references.
[13] McLachlan, et al 2007, p.72.

Some commentators even argue that investment arbitration tribunals in this process form new global norms and shape a body of international administrative law.[14]

Regardless of the classification of the arbitral awards, when used in this text, it is as a hybrid between academic doctrine and precedent-bearing court decisions; carrying more weight than the former but still not binding and coherent in the same way as the latter. Though not being the law as such, international arbitral awards and decisions are strong evidence of what the law is.[15]

Arbitral awards furthermore differ from court rulings because they are not always published and when they are, they may not be as easily and publicly accessed as court judgments. I am accounting for a relatively large number of awards, in which the substantive/procedural requirement to attempt at local remedies was discussed as a part of the tribunal's elaborations. This selection is not intended to be exhaustive, but does rather consist of the awards that have been published and discussed publicly. Several other awards have applied the local remedies rule, but those selected are to my knowledge the only ones discussing the division between procedure and merits of a claim. The only two other articles on similar topics have analyzed most, though not all, of these eleven cases.[16] Given the tendency to comment on awards in academia, as well as the mentioned will to cross-reference other tribunals' reasoning and the limited amount of investor-State disputes, one can be fairly certain that these are all the public cases to date that discuss the issue at hand.

Furthermore, they are all extremely complex, detailed awards and in order to save space and make this master thesis possible to grasp, I have extracted the elements relevant for the purpose of the thesis. The description of the awards is present in the text to present the local remedies rule's division between substance and procedure. Thus, for the initiated reader, the account of the tribunals' reasoning might seem overly simplified, but there is plainly no room for a more thorough analysis within the given frames.

Another important source is various reports and drafts, authored by international organizations. In the cementation cycle of international norms, inclusion in such reports is a vital step towards achieving binding effect. These drafts, most notably those authored by the International Law Commission (ILC), are not binding and sometimes advanced *de lege ferenda*.[17] There is however an important interplay between these and other sources of international law and as evidence of customary international law, they are very valuable.

[14] Kingsbury & Schill, 2009.
[15] Sureda 2009, p.13.
[16] Kriebaum 2009, Forster 2010.
[17] Rosenne 1984, p.74.

In section 4.2, different ways of handling local remedies in BIT practice are discussed. Here I refer to several treaties, seemingly at random. There is a plethora of BITs available and I have used the UNCTAD online database to find the ones I refer to. This database includes most, but not all, BITs available. The function of the BIT-references is to illustrate a point and for natural reasons, those used tends to be those that have been arbitrated and therefore brought to the attention of the arbitration community. It would certainly be possible, but not necessary, to dig further and find multiple other treaties to illustrate the very same points. The function of the BIT-references is however not to establish a statistical sample but rather to exemplify the occurrence of certain provisions in the BIT-jungle.

1.2.2 De Lege Ferenda

Since my purpose is not purely to investigate what is the current legal value of the local remedies rule in investment arbitration, but also to suggest, in a normative sense, how the rule should be used in future instances, the traditional legal method does not suffice in providing me with methodological frames. Exploring what should be the legal solution to a given problem is different from investigating how the law is currently being applied, mainly because it contains the element of problematization.

It is naturally hard, some might argue impossible, to keep the two aspects strictly apart, but in the interest of analytical stringency, this is still my ambition. Though criticism, values and analysis all are allowed within the frames of a pure account of the law, and in fact is omnipresent in that context, [18] the methods used in this paper aims at separating these from the purely empirical sections.

In this respect, I am allowing myself to step outside of the somewhat tight costume that is sometimes casually referred to as traditional (or dogmatic) legal method. Instead, in the fifth and final part of the paper, I argue more freely, without anchoring the reasoning in positivistic legal sources. Here, I suggest from a normative perspective how the local remedies-requirement should be treated in investment arbitration.

1.3 Limitations

Due to the fast-evolving nature of investment arbitration, there are several open questions associated with the local remedies rule. This text focuses solely on its applicability in cases when treaties do not mention it, meaning that several interesting *material* aspects of the rule are left out. These include, for instance, how to sufficiently exhaust remedies, what is an (available) remedy and the difference between administrative decisions and court rulings in this respect.

[18] Sandgren 2006, p.535.

A neighboring legal area that is excluded from the text is human rights protection. The development of this field of international law share many features with investment protection and this work's research question on local remedies could be of equal relevance to this area. Though many parallels are to be made, human rights protection is intentionally excluded here; including it would simply require a much different, and much more comprehensive, text.[19]

The focus is furthermore exclusively on investor-State arbitration and not on the potential State-State conflicts that may arise out of the same agreement. Similarly, arbitration based not on BITs but directly on investor-State contracts, and thereby not covered by public international law as such, is also left out. The discussion on the local remedies rule in this text presupposes that there has been a breach of international law in one way or another. Pure contractual claims, so to speak, can probably not be invoked in this context.[20]

1.4 Terminology

The main focus of this text is the *local remedies rule*, which exists in many different shapes in international law. As has just been explained, no deeper exposé of the substantive aspects of the rule will be conducted, but it is important that by local remedies I mean "any forms of redress available to an aggrieved foreign investor under the host State's domestic legal framework".[21] The "rule" is the requirement that these remedies have to been attempted at, in one way or another, before a dispute can be elevated to an international level. As will be explained below, the rule was developed in the field of diplomatic protection and strictly speaking, it is only within this area that it is possible to talk about an established rule as such. The phrase will nonetheless be used an umbrella term for different requirements that demand, in way or another, domestic procedures over or before international adjudication.

This text's area of study is the case when an individual (as in a non-State entity) initiates arbitration against a State, based on an international treaty. There are several ways of addressing this phenomenon, and many are used alternatively in this text, intended to be interchangeable. The different phrases include *investment arbitration*, *investor-State arbitration*, *investment treaty arbitration* and may or may not include the word "international". The variation in use is purely for stylistic purposes.

Bilateral investment treaties (*BIT*s) have already been alluded to as the most important source of investment arbitration. These treaties, normally very short in scope and only exceptionally exceeding 20 provisions, are

[19] For a study of the modified application of the rule in these contexts, see Amerasinghe 2004.
[20] This is in itself a disputed matter, which will also be excluded from the paper.
[21] Forster 2010, p.204.

traditionally concluded between a more developed country and a country wishing to attract foreign investment – even if this is rapidly changing. Though investment arbitration often is initiated based on multilateral treaties, such as NAFTA or the Energy Charter, BITs exist in much greater numbers and are the focus of this paper. An umbrella term, used to describe all of the above is *IIA* – international investment agreements.

The thesis concerns disputes over foreign investment, which is traditionally divided into two groups: direct (*FDI*) or indirect (portfolio) investments. The major difference between the two is the degree to which the investor gains control of the investment. Indirect investments are typically in the forms of bonds, stocks or shares and are indirect in the sense that the investor does not acquire substantial voting power in the enterprise, usually less than 25% of the ownership.[22] The distinction between the two does have some importance, especially in the case of diplomatic protection, but generally the FDI-aspect is most relevant for this paper. When referring to "foreign investments", both concepts are included.

A very important notion for the text is that of *denial of justice.* Professor Dugard did consider it "as central to the study of the local remedies rule as the Prince of Denmark to Hamlet".[23] In short, denial of justice means that a State incurs responsibility if it "administers justice to an alien in a fundamentally unfair manner."[24] Claiming denial of justice means addressing a systematic flaw in the host State, as opposed to a single mistreatment.

In the absence of a neutral alternative, investors and claimants are addressed in the masculine form. There is no underlying reason for this - writing "him/her" would in my view simply disturb the rhythm of the text.

1.5 Disposition

Following the two-folded aim of the thesis' purpose, the text is split into two parts. The first three chapters constitute the main investigation, while the last one is a discussion on the findings.

In the first material chapter of this thesis, I explain the evolution of the local remedies rule and how it came to be customary international law. Then, I use chapter 3 to introduce the relatively modern investment arbitration system. Following these two background sections, the text is tied together in chapter 4, in which the rule's application in investment treaties and arbitral awards are discussed. It is demonstrated that the question on how to treat local remedies in this context is far from settled.

[22] Bernhardt 1995, keyword Foreign Investments.
[23] ILC 2002, p.4.
[24] Paulsson 2005, p.4.

In the fifth and final part of the text I abandon the fact-presentation and do instead discuss the findings in the previous sections, offering a conditioned conclusion and arguing about its practical implications.

2 The Origin of the Local Remedies Rule

In this chapter, the focus of this text – what will be referred to as the local remedies rule – is introduced and its background presented. In order to properly understand the rule's function in investor-State arbitration, it is crucial to first recognize the fact that it was developed in a very different time and context; both of which will be accounted for in this section.

2.1 Diplomatic Protection

2.1.1 Chronology

The notion that a foreign citizen, be it a private person or a corporation, must address a complaint to the authorities in the country from where it stems before turning to international remedies, originates from the field of diplomatic protection and has deep roots in international law.

Even though the basic principles of the rule have firm connections to the sovereignty of the national State, there is a lot of evidence suggesting an older history, predating the modern concept of sovereign States. Chittaranjan Amerasinghe, WBAT director and distinguished legal scholar, shows in his major work on the subject that the local remedies rule, like many similar principles of international law, was established through non-judicial practice – in this case mainly diplomatic means – way before it received recognition in a formal dispute resolution body.[25]

Aliens resident in another region has had some kind of protection since at least the 14th century. In its infancy, diplomatic protection was only applied as giving an individual right to reprisal against an individual from the host area, where none was provided there.[26] This kind of private reprisal with public sanction was practiced in international relations for a long time and the injured party needed to exhaust local remedies before requesting right to reprisals. In the 1600s and 1700s, as nation States were formed, the principle that reprisals could only be sought after a failed or delayed attempt at local rectification entered the growing treaty body. As centralized State power grew over time, so did the tendency for States to protect their citizens abroad and exercise their interests; it even grew into an obligation, as opposed to only a right. As private reprisals slowly changed into public ones, the idea that local judicial mechanisms should be tried first persisted.[27]

[25] Amerasinghe 2004 p.35.
[26] Ibid p.25.
[27] Ibid p.27.

The first time the local remedies rule was actually applied in a structured context was in 1863, in a case between Peru and USA, [28] preceding a long history of tribunal and court applications. From the mid-20th century, the local remedies rule was established as customary international law in cases of diplomatic protection, as demonstrated in judgements and awards such as Interhandel, Finnish Ships and Ambatielos Arbitration. All of these regarded exhaustive attempts at local remedies as a condition precedent for exercising international diplomatic efforts against the host State, even though the Finnish Ships tribunal found that the remedies had been exhausted in that case. Towards the end of century, the ambitious efforts of the International Law Commission to codify international law on diplomatic protection included the local remedies rule in both the first 1996 draft and the current 2006 version.[29]

2.1.2 Contextual And Material Development

The local remedies rule did not evolve in a legal vacuum. International law is traditionally by definition created by States and diplomatic protection is no exception from this.[30] The sovereignty of nations is the basis for the development of the local remedies rule and it is in this context that it has to be understood, even though it existed in more elusive shapes before States. The right to exercise diplomatic protection, and consequently the requirement to exhaust all local remedies, has never been a right assigned to the injured individual but rather to his home State.[31] The injured alien only has rights under international law by virtue of the State-State relationship.

It is furthermore important to point out that the birth environment of the rule was a very violent one. Resorting to peaceful dispute resolution within a regulated framework before insisting on reprisals or diplomatic means might seem natural in a modern context, but in a world torn apart by war, conflict and lack of rule of law, it was an extraordinary principle. It is only relatively recently, in the latest century, that institutional and organized means to achieve this end of non-violence have been established. A less structured tendency of solving high-profile disagreements between sovereigns, on an ad-hoc basis, has however been present through history,[32] and in this instance the local remedies rule has played an integral part.

The local remedies rule is a good example of international comity and recognizes that by entering foreign territory, individuals subject themselves to the domestic authorities.[33] It was thus an impressively sophisticated tool in a world where international relations otherwise were conducted with the help of armed forces, in one way or another. Its strength and sophistication is demonstrated beyond doubt in the fact that the rule has survived hundreds

[28] The Montano Case, Amerasinge 2004 p.35.
[29] Arts. 22 and 44 respectively.
[30] Dixon 2007, p.3.
[31] Amerasinghe 2004 p.45 with case references.
[32] Merrils 2011, p. 284.
[33] Bjorklund 2004, p.258.

of years of international dispute evolution, [34] even though several limitations and exceptions to the rule always existed, expanding and cementing over time: remedies need to be available and reasonable, only certain claimants have standing, et cetera.

Diplomatic protection as such implies a two-folded obligation, in the sense that both involved States have a duty: the host State against the injured party's home State, and the home State against the injured individual. The rule in this context represents a weighing of interests between the parties. The underlying and fundamental basis is the privileges of the host State, granting it a right to address an alleged injury before having to stand a sometimes-humiliating international proceeding. A basic premise for the rule is thus that the "sovereign rights of the host or respondent State should be recognized and respected."[35] Judge Córdova formulated this eloquently in his separate opinion in the seminal Interhandel case, when the rule got its most unambiguous recognition in ICJ practice:

"The main reason for [the local remedies rule's] existence is the absolute necessity of harmonizing international and national jurisdictions – thus ensuring the respect due to the sovereign jurisdiction of States – to which nationals and foreigners are subject and in the diplomatic protection of governments to which only foreigners are entitled. This harmony and respect for the sovereignty of states is achieved by granting priority to the jurisdiction of the State's domestic courts in cases where foreigners appeal against an act of its executive or legislative authorities. Such priority is in turn guaranteed only by respect for the principle of local remedies."[36]

Even though the sovereignty of the host State is at heart of the local remedies rule, it would be a mistake to consider this interest the sole motivation for the rule's persistence. Firstly, there are several other interests at stake in the average proceeding to which the rule applies. These include the interest of the home State, good relations between the affected States and the international community at large. Secondly, the rule is more than anything else a pragmatic option for both States: the home State does not have to be involved in any way unless it sees it as pressing to be so, but can instead let the proceedings be initiated without the costs associated with public involvement in international disputes. Both States do of course generally want to avoid not only the costs, but also the attention and potential bad-will, that a high-profile conflict outside of domestic courts is sure to bring. The logic behind the principle also recognizes that the host State cannot be held responsible for every single public act by officials within its jurisdiction, without having been given a change to rectify it.[37]

What is not taken into account, however, is the interest of the injured individual. The rule in its general form – restricted and modified as it may be – is not a safeguard for an alien claimant and does on a regular basis result in gratuitous hardship and arbitrary treatment. In a system drawn up

[34] Amerasinghe 2009a, p.1.
[35] Amerasinghe 2004, p.15. See also Interhandel, para 27.
[36] Interhandel, para 45.
[37] Dodge 2006, p.6.

by States intended to avoid sometimes violent confrontations between sovereigns, allowing the conflict to slowly escalate to the detriment of the occasional individual complainant before any major attention should be directed at it, does not seem as such a big a sacrifice to make for the States.

Though the ancient roots of the rule are found within the field of diplomatic protection, where it is still regarded as customary international law, it has in modern times spread into many other areas of law. Thus it can be found in different shapes in everything from article 26 of the European Convention on Human Rights to cases where international organizations claim against states.[38]

A vivid debate during most of the 20th century revolved around the legal classification of the local remedies rule within diplomatic protection: is it a procedural or a substantive rule? As will be shown later in this text, the distinction carried on into modern investment protection as well but its roots will shortly be presented here. Holding that exhaustion of local remedies is a substantive principle necessarily means there can be no violation of international law before local remedies are exhausted. Thus diplomatic protection could never be exercised unless the individual claimant first had exhausted the available legal remedies. The rule would then be "embedded", so to speak, in any claim before an international body – in effect making denial of justice a necessary part of any international claim. This would also mean that a waiver of the rule is impossible.

On the other hand, viewing the rule as procedural strips it of its substantive character and means that it only governs admissibility. The general view is that within the field of diplomatic protection, those arguing that the rule is "merely" a procedural principle have won the debate: acts outside of denial of justice can be brought to international tribunals and States can waive the rule.[39] The substantive reasoning was most prevailing in the early part of the previous century, but has now largely been dispensed with. It has however been re-introduced in a different shape in investment arbitral proceedings, a phenomenon that will be discussed later in this thesis.[40]

2.1.3 Diplomatic Protection of Foreign Investments

Before the relatively new investment treaty scheme, explained below in section 3, the remedies available through diplomatic protection were generally a foreign investor's only option to pursue compensation from an allegedly mistreating host State. Protecting the property of aliens has always been an integral part of diplomatic protection, but increasingly so towards

[38] See Reparation for Injuries for the first time ICJ recognized the principle within this area.
[39] Bjorklund 2004, p.259.
[40] Section 4.3.

the end of the 20th century, thereby making exhaustion of local remedies an integral part of any effort to achieve justice.[41]

In this respect, the ELSI judgement, delivered at a time when diplomatic protection was a foreign investor's best chance and the BIT explosion was still around the corner, deserves some attention. The United States did in this case initiate proceedings against Italy on behalf of two American owners of an Italian company whose assets had been requisited by the Italian government. The US government argued breaches of several provisions in the Treaty of Friendship, Commerce and Navigation (the FCN Treaty) signed between the two countries. This bilateral treaty, not being a BIT and signed slightly before including provisions referring disputes to institutional arbitration became customary, did not provide for exhaustion of local remedies as a pre-requisite for bringing claims to the specially established chamber. The Chamber did however find this to be of less importance:

"[…] the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so."[42]

The rule was thus inserted and applied to the case, even though none of the treaty-concluding States had expressly intended so. The Chamber, consisting of several ICJ judges, did apparently not find this decision a controversial one, but rather following from established customary international law. That view has been re-iterated time and again. States can choose to waive the local remedies requirement – which is possible because it is a procedural and not a substantive standard – at their own discretion, but in the absence of such a clearly expressed waiver, the rule is still valid international law in the field of diplomatic protection.[43]

It is thus safe to assume that, before the entry and explosion of BITs, the exhaustion of local remedies was established enough in international law to be read into cases of international proceedings.[44] The rule was sometimes included in different treaties nonetheless, but this "merely [as] a precautionary measure to avoid any doubt of the rule".[45]

2.2 A Changing World – FDI, Local Remedies and Legal Safeguards Beyond Diplomatic Protection

Previous section's account of States traditional role as being the only players in the area of diplomatic protection might have to be slightly

[41] Kokott 2000, p.21.
[42] ELSI, p.42, para. 50.
[43] Dixon 2007, p.261.
[44] In fact, this has never been questioned, Amerasinghe 2004 p.3
[45] Adede 1977, p.8, note 19.

modified. Though not covered by the purpose of this study, there is a modern, vivid discussion about other actors changing and reshaping the traditional nature of international law as we know it. It is safe to say that States are no longer the sole actors on the international legal arena, and that interests other than those underlying State action are influencing the development.

Parallel with this development, investors are to a larger degree entering other markets than the traditional FDI areas North America, Europe and Japan. For different reasons, there is a trend away from established investment patterns. A comparison between the UNCTAD annual World Investment Report in 2001 and the 2011 version shows that developing economies' share of incoming FDI changed between barely 20% to almost half of global direct investments – even more if "transition" economies are included.[46] Both in terms of inflows and outflows, 2010 was a record year in terms of developing countries' share.[47] The rise in outflowing capital confirms the growing perception that corporations from the developing world are to a growing extent investing abroad, thereby changing the traditional perception of international investment law as a tool for richer countries to control transactions in less developed markets. This tendency is also demonstrated by a greater number of BITs concluded between two developing countries.[48]

Still, the development shows that many multinational corporations – be they from Canada or Cambodia - now place the majority of their direct investments in more immature markets such as Africa or Latin America, not to mention the so-called BRIC countries.[49] Immature markets are however generally weaker regulated, especially when compared to the relative stability of the mentioned traditional major areas, leading foreign investors to fear a risk of mistreatment. This fear can of course also be found when investing in more advanced jurisdictions, since a foreign citizen is more or less bound to worry that in unclear cases, judges and officials will tend to balance in favour of the interests represented by "their" State. Diplomatic protection, being a politicized instrument with many discretionary rights, has therefore not always sufficed in satisfying the interest on behalf of the investor and his home State - especially not when investing in less developed parts of the world.

As global investments started flowing into new markets towards the end of the 20th century, the demand for legal protection beyond that available through the, at times insufficient, diplomatic channels thus grew. It is important to point out that this tendency is encouraged by both investors and host States, the latter looking to attract and control foreign investments. In terms of investment protection, the traditional means offered by public

[46] UNCTAD 2001 and UNCTAD 2011. Both reports are available online http://www.unctad.org/Templates/Page.asp?intItemID=1485&lang=1.
[47] UNCTAD 2011, p.3.
[48] Muchlinski et al 2008, p.vi.
[49] Brazil, Russia, India, China.

international law – often involving seemingly arbitrary and costly proceedings in foreign courts – were not adequate any longer, and more and more States signed bilateral treaties including separate dispute settlement mechanisms.

3 The Infant Investment Arbitration Scheme

The previous section introduced the local remedies rule and its origin. To establish that there has been a modern development in protection of foreign investments, in many ways different than what has been described so far, is however crucial for the purpose of this text. The third chapter will consequently outline the nature of this area of international law and explain how the modern bilateral treaty has created an unprecedented system of international adjudication in a relatively short time.

3.1 A Brief Introduction

The modern practice of protecting foreign investments through international treaties stems from the middle of the 20th century but has increased tremendously during the last couple of decades. These treaties exist in a variety of forms: regional, multilateral and bilateral. It is the latter that are the focus of this paper and, as has been alluded to, they make up the vast majority of existing investment treaties.

The first modern BIT on record was concluded between West Germany and Pakistan in 1959 and since then more than 2800 now active bilateral treaties have been signed.[50] The development over 50 years has not been steady and regular: it has rather grown exponentially, peaking around the end of the previous millennium and now slowing down.[51] The explosion in treaty conclusion has been paralleled with a growth in arbitration based on these treaties: in 1995, only six investor-State proceedings were known; that number has now risen to some 400.[52]

Despite a long history in the shape of similar instruments – most notably the friendship, commerce and navigation treaties (FCNs) concluded from the late 18th century in order to establish good relations between trading nations[53] - the BIT practice did not gain speed until the later part of the 20th century. Unlike its FCN-predecessor, the bilateral investment treaties are directly aimed at regulating investment-related issues.

The attempts at securing investors' rights with treaties should be viewed through the prism of the post-war era: cold war, the spread of communism and colonial powers losing their global grip. International investments were at this time far from secure and subject to arbitrary expropriations and political changes. After the collapse of the Bretton Woods system in the

[50] UNCTAD 2011, p.100.
[51] UNCTAD 2007, p.1
[52] UNCTAD 2011, p.102.
[53] Vandevelde 2010, p.21.

early seventies, more than fifty expropriations of international investments took place every year; also outside the Soviet bloc to which it was previously restricted.[54] The attempts to regulate investments were under these circumstances naturally aimed at protecting investors' rights. The early BITs were largely initiated by developed countries and either an expression of colonial power or a way to safeguard the global economy, depending on whom you asked.

The scepticism from the developed world hindered the growth of BITs in the 70's and 80's. During the first 30 years of the instrument's lifetime, barely 400 BITs were concluded. Towards the end of the century however, as communist economies failed and global trade was liberalized, the hostility among developing countries changed and many policies were re-evaluated in the changing circumstances.[55] Countries that earlier opposed the BIT scheme now concluded their first own treaties, in order to signal a more open attitude towards FDI. A vast majority of the now active BITs were signed starting with these changes in the early 1990s, and the trend that most BITs are concluded between one developed country on the one hand and one less developed counterpart on the other prevails since then. [56] Two more advanced economies do not normally conclude this type of treaties, mainly because different types of free trade agreements already cover their mutual relations. At the same time, though, treaties are increasingly concluded between two States that are traditionally regarded as "developing".

Despite the enormous amount of treaties, there is a great degree of uniformity to the BIT-structure and not much has changed since the early days of treaty practice, when the standard form was set. One only needs to survey a few in order to realize that they still are fairly standardized. The average BIT is brief and contains between 10 and 20 provisions, expressing a few basic relevant principles:

- The scope of application (including the important definitions of "investment" and "investor")
- Standards of treatment (the substantial standard to which the host State can be expected to treat the investor, common standards are "fair and equitable treatment", "full protection and security" or other formulations expressing due process and protection against discrimination)
- Dispute resolution (one of the main reasons for concluding a BIT, this standard clause is maybe the biggest difference between a BIT and earlier trade treaties.[57])

These compose the main core for any BIT, even if they are changed and adapted in individual ways for each treaty. In recent years, BIT-practice has

[54] Vandevelde 2010, p.46.
[55] Vandevelde 1998, p.502-503.
[56] Ibid, Vandevelde 2010, p.59.
[57] Vandevelde 2010, p.58.

become more diverse, adding several novel clauses to this "boilerplate" structure. Such provisions include expanding the application beyond traditional investments, liberalization commitments and providing protection for various public interests.[58]

3.1.1 ICSID

An important milestone in the development of investment arbitration was the signing of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID convention or the ICSID rules) in 1965. The main driving force behind its drafting was to facilitate the flow of global capital by overcoming the costs associated with arbitrary judicature and expropriation in host States.[59] By establishing ICSID, and thereby a neutral forum, disputes over foreign investment were de-politicized and moved into the legal realm rather than the political territory of diplomatic protection.[60]

ICSID is an independent framework under the umbrella of the World Bank, and not itself a permanent tribunal; the phrase most often used to describe it is "facility". Much like other arbitration rules, such as the UNCITRAL, arbitration according to the ICSID system can very well be set up as an ad hoc proceeding applying the convention's procedural rules. The rules can apply either by virtue of the parties' nationality, if both belong to contracting States, or by being consented to in the case of a "non-ICSID" party.[61] The centre does however work as a facilitator and offers a variety of dispute resolution services in order to ensure an efficient administration of the proceedings. An award delivered under the ICSID regime cannot, unlike most other arbitral awards, be reviewed by national courts. The system does instead keep its own self-contained method for review.[62] Under this procedure, an award can be annulled if any of the grounds in the convention's art 52(1) are met. Such matters are decided by an ad hoc committee set up through appointment by the Chairman of ICSID's administrative council.

In accordance with the development of global investments outlined in the previous section, the main purpose behind ICSID dispute settlement was to set up a structure outside of State systems – an alternative rather than a subsidiary system.[63] In this respect, the introduction of the system is a brilliant compromise between the two opposing interests which had until that point hindered FDI: developing countries looking for investments would agree to submit disputes to a tribunal outside of their own jurisdiction, while host States would refrain from diplomatic protection

[58] UNCTAD 2007, p.1.
[59] Collier and Vaughnan, p.60.
[60] Vandevelde 2010, p.59.
[61] ICSID Convention Art. 25.
[62] Schreuer 2003, p.103.
[63] McLachlan, et al, 2007, p.128.

(which at times could be very coercive).[64] ICSID thus created a level playing field, providing a balance of interests through forcing both investors and hosts to become irrevocably committed to, and allowing either to invoke, the same neutral rules.[65]

In the last couple of years, a handful of countries have expressed concerned opinions on problematic aspects of investment arbitration and its ICSID-embodiment. Austria is not including investor-State arbitration in its BITs anymore, while Norway is questioning such clauses and blocking their inclusion in EFTA talks; Brazil is not concluding any BITs at all and Bolivia and Ecuador have recently withdrawn from the ICSID convention. These announcements highlight growing sentiments of scepticism towards the BIT regime.

3.1.2 Critique Against the BIT Regime

It is generally assumed that foreign investment is desirable and spurs economic development. This presumption is the fundament of investment law,[66] but is at the same time challenged from different angles. These challenges can be placed under the umbrella of a development perspective and will be briefly outlined here. Their common feature is the underlying argument that investment treaties affect global development problems but that disputes under such treaties are solved with a lack of this perspective.

Investment treaties – and in particular the powerful enforcement tool that is international arbitration – are controversial. It has often been argued that BITs shift power from public interest to private parties, whose aims more often than not do not correspond with those of the host State and its taxpayers. Unlike the average commercial arbitration proceeding, an investor-State dispute does by definition contain elements of public interest. Given the fact that one of the parties is a State, and that the disputed sums often are very significant, there is a growing concern that there should be a greater degree of transparency in investment arbitration. A big worry is that arbitration tribunals, as opposed to court proceedings, are closed to third parties, excluding interests other than the two disputing entities. An UNCITRAL working group is currently drafting new rules on this issue.

Another worry is the influence that investment arbitration might have on environmental policies in the host countries. Many commentators argue that investment treaties generally are imbalanced in this respect, favouring investors' interests over those of the State.[67] Environmental regulation is a complex area, requiring a certain degree of flexibility for the local authorities. By submitting the resolving of conflicts to a tribunal, whose only obligation is to the parties, and whose interpretation is restricted to a brief BIT that in the typical case does not regulate environmental concerns,

[64] Reisman 1992, p.46.
[65] Collier & Vaughnan, 1999, p.60.
[66] Legum 2006 p.522.
[67] Romson 2012, p.337.

there is a risk that other interests are circumvented. There are many inherent conflicts between the rationale behind investment treaty arbitration – which solve conflicts on an ad hoc-basis – and environmental regulations, which by definition require a broader perspective. These conflicts risk to restrain national as well as global authorities in their long-term policy planning.[68]

The International Institute for Sustainable Development, a Canadian NGO, has published several reports on problematic aspects of the growing BIT regime. Most significant of these is their Model International Agreement on Investment for Sustainable Development, in which alternative approaches to treaty drafting is suggested. The model agreement is the result of a general scepticism towards the BIT regime and the perception that their historical roots make treaties investor-friendly, while placing few or no obligations on investors and their home countries.[69] This alternative model agreement can also be viewed as a response to another inherent problem in the BIT practice: the fact that bilateral development lacks an institutional centre of gravity and a process for analyzing the outcome of the agreements.[70]

An even more critical approach to investment treaties is advocated by the Seattle to Brussels Network,[71] an umbrella NGO aimed at highlighting problematic aspects of the BIT regime: everything from the lack of human rights-aspects to the treaty-shopping system allowing MNCs to structure their investments in a manner that gives them the best possible BIT protection. The Network regularly funds research papers and organizes events which fit their overarching purposes.

Investment treaties can be attacked from several directions and from parties with seemingly opposing interests. The very rationale behind BIT arbitration – sidestepping national courts on behalf of international authorities, giving the latter power to review and criticize actions of domestic bodies – has been questioned on the ground of absolute sovereignty, not least in the US.[72] Ironically, this criticism can also be heard from countries traditionally not agreeing with the US on international trade policy. Many developing States feel that their domestic adjudication is undermined when foreign investors can set up ad hoc-tribunals instead of going to court in the host country. Criticizing BIT arbitration from this perspective, and insisting on the autonomy of the local authorities, is in many ways a remnant from diplomatic protection, as will be discussed below.

Finally, though the encouragement of free-flowing private capital is the main driving force behind the treaty explosion, it should be noted that BITs often are said to improve institutional modernization and reform in

[68] For a thorough analysis on this subject, see Åsa Romson's PhD thesis Romson 2012.
[69] IISD Model Agreement, p.x.
[70] Ibid.
[71] http://www.s2bnetwork.org/
[72] Bjorklund 2005, p.813.

developing countries.[73] This can of course also be criticized from ideological standpoints, but external pressure and the wish to attract investors is probably a fine incentive for improving the judicial infrastructure and good governance.[74]

3.2 Claims Under a Bilateral Investment Treaty

International arbitration is the main choice of dispute resolution in a BIT – virtually every treaty contains a clause with such a provision, and this has been the case since the birth of BIT-practice.[75] For the individual investor, a BIT claim carries with it one practical and very significant element different from diplomatic protection: the individual standing. Diplomatic protection requires the home State to exercise protection on behalf of the injured alien against the host State, while under a BIT, the alien himself is granted the option of initiating proceedings against his host. Unlike commercial contracts, where the consent to arbitrate is found in the contract between the parties, arbitration under BITs requires a general consent to arbitration from the State. The private entity, not being party to the BIT, then submits a written agreement to the procedure in the specific case. This possibility for a non-State actor to claim damages from a sovereign – without any kind of direct contractual arbitral agreement between the two – is something unique and very original in international law. It is also this aspect of BITs that are most often targeted by the mentioned critique of the regime, given the potential for powerful multinational private interests to indirectly shape public policy and in a sometimes-secret procedure receive big financial damages from states, essentially out of the taxpayers' pockets.

Concluding a bilateral investment treaty is an efficient way for two States to get rid of uncertainties associated with relying on customary international law and ensure protection for its investors, while at the same time appearing as a safe environment for foreign corporations looking to do business. What is more, a treaty concluded by two States carries a lot of weight: a bilateral investment treaty is an instrument recognized in international law, as opposed to an agreement between the individual investor and the host State – the international legal weight of the latter being highly disputed.[76]

The most common way of structuring a dispute resolution clause in a BIT is to incorporate several alternative ways of arbitrating – referring to ICSID, UNCITRAL and/or to an additional set of rules. This generally leaves the claimant with a certain degree of discretion as to where to proceed with his complaints. The treaty itself seldom contains more than a few purely

[73] UNCTAD 2007, p.100, Legum 2006 p.522.
[74] Studies suggest that this connection might not be as strong as previously thought, Romson 2012 p.62 with references.
[75] Supra, note 8, Broches 1995, p.447.
[76] Qureshi 2007, p.411.

procedural provisions, instead filling the gaps with the chosen institutional rules.

It is worth noting that a claim under a BIT in front of an arbitral tribunal is something other than a contractual claim. Whether or not a simple breach of contract, which does not violate international law, will suffice for a claim before a tribunal is unclear; the breach would probably at least have to amount to a denial of justice.[77] It is clear that a BIT, serving as the outer frame for the contractual environment, demands a more systematic mistreatment in order to establish a breach of international law, and thereby jurisdiction for a tribunal. Where to draw the line between the two types of claims is however far from clear, even though a widely accepted test was launched in the Vivendi II-award, focusing on the nature of the claim, as well as the right on which it is based – thereby allowing the action to be the determining factor.[78] Depending on which significance the BIT provision on jurisdiction is given by the tribunal, it is of course possible to extend the jurisdiction to "pure" contractual disputes. This is possible by giving the common BIT-formulation "any dispute relating to investments" a wide interpretation.[79] Understanding this relationship between a "BIT-claim" and a contractual claim is important when reading the rest of this text.[80]

3.3 Diplomatic Protection and BITs

Diplomatic protection, in the traditional sense, has to a large degree been replaced by the more precise protection available to investors under investment treaties. It is in fact common for BITs to block the host State from exercising diplomatic protection while arbitral proceedings are pending. [81] Such a requirement is also included the ICSID convention, preventing diplomatic protection in cases where arbitration has been agreed upon.[82] This does not mean that the connection between traditional protection and BIT-protection of investments can be ignored. The following will briefly outline how notions from diplomatic protection have followed into the modern treaty practice of protecting investments and how the two interact.

3.3.1 State Assistance

Creating a dispute solving system outside of national courts, and thereby in effect agreeing to circumvent diplomatic protection, was maybe the biggest rationale behind ICSID and the BIT practice following it. There is however

[77] Paulsson 2005, p.108 et seq.
[78] Van Haersolte-Van Hof & Hoffmann 2008, p.966 with case references.
[79] See for instance Salini, para 59 et seq.
[80] There is however a development of clause drafting aimed at circumventing this division through a so-called "umbrella clause", the scope of which are excluded in this paper. See Wong 2006, Schreuer 2004, Schreuer 2005 p.9 with references.
[81] UNCTAD 2007, p.100.
[82] Art 27(1).

another alternative procedure often included in such treaties, one which is much more related to diplomatic protection and is included in BITs as a complement to investor-State arbitration. The practice allows the home State to enter into an arbitral procedure against the host, trying to enforce BIT compliance in the individual case and thereby assist the claimant. This tool can be used effectively to put additional pressure on a non-cooperating host State by raising the level of the dispute to an international conflict between two sovereigns. This solution shares with diplomatic protection the feature that it places the conflict on a State-State level and in that respect firmly puts it under the tree of traditional public international law. It does however, much like diplomatic protection, require the home State's cooperation and interest in pursuing an award.

This type of interventionist assistance limits the home State's action to the arbitral proceeding agreed upon and is thus somewhat less flexible than diplomatic protection – under which it can choose from a wide variety of tools including informal diplomatic contacts, ICJ referral or even reprisals.[83] It could nevertheless be argued that these common clauses are a remnant from diplomatic protection, living on in bilateral investment treaties, though not exercised very often.

3.3.2 The Calvo Doctrine still alive?

The issue of local remedies is closely connected to the wider question on what standard the host State should be held to – what can be expected of it and what yardstick should be used in measuring its treatment of investors? This larger discussion within diplomatic protection, most of it only marginally relevant for the purpose of this paper, was very vivid during the 20th century and evolved into two roughly opposing doctrines. One, most prominently argued by the US, held that aliens could expect treatment according to an international standard, while the other suggested that hosts owed foreign citizens no duties beyond the level of the national treatment; not seldom providing less protection than the international. The latter doctrine came to be known, in its purest form, as the Calvo Doctrine, after an Argentinean lawyer and foreign minister named Carlos Calvo. The divergence in the emerging international law mirrored the strengths between involved parties in the typical dispute and illustrated how host States tried to assert control over actions within their jurisdiction.

During most of the early and mid-20th century, foreign investments mainly consisted of exploitations of natural resources, while the alleged mistreatments concerned mob attacks, capricious juntas or consequences of power-changes.[84] The global investment climate was thus much more infected than the current, and the level of protection to be expected was a key issue for States with a lot of outflowing capital. Developing nations however, and particularly the Calvo-dominated Latin America, came to

[83] Kokott 2000, p.25.
[84] Romson 2012, p.58.

view the exercise of diplomatic protection as a discriminatory exercise of power by the host States. The doctrinal insistence on local remedies instead of diplomatic protection became an integral part of calls for a new economical world order.[85]

A foreign citizen doing business in a State would according to this view be treated as if he were a national citizen – understandably a problematic position for companies from the more developed part of the world trying to invest in areas with less sophisticated judicial protection. This concern is also the motivation behind the successive abolition of the doctrine, as gaps between the two worlds shrunk, while the interests of private investors – of all nationalities - grew in significance.

The Calvo-notion is a very hardcore approach to diplomatic protection, generally considered to be fading away, but some commentators think is living on through different mechanisms. Following the Calvo logic, since a foreign investor should be treated no better than would his domestic counterpart, local courts should be the first (or – using the purest and oldest Calvo-reasoning – the only) choice for dispute resolution. It is accordingly among Latin American countries that the insistence on the local remedies rule is traditionally found most often; a tendency which followed the transformation from diplomatic protection to BITs. Several countries maintained, and in some cases still do, that a so-called "Calvo clause" be included in their BITs.[86] It could also be argued that this debate should have been more or less settled with the BIT regime, which in effect creates independent standards agreed upon by the parties; as has been shown earlier, the local remedies rule has been largely dispensed with in this context, despite a few countries insisting otherwise.

Others, most notably Christop H Schreuer, one of the greatest authorities on investment arbitration, argues that Carlos Calvo, whose influence after all largely has vanished from investment protection, still has "children and grandchildren that have an uncanny family resemblance to him".[87] The most relevant "grandchildren" for the purpose of this text, is the tendency among arbitral tribunals to include resorting to domestic courts as a substantive requirement of international standards. The reasoning behind these awards will be discussed extensively below, but the connection to the Calvo doctrine should be stressed. Schreuer calls it an "adopted child" of Calvo's[88] and warns that it "may well develop into something that resembles the old exhaustion of local remedies rule".[89] It cannot be excluded that some

[85] The Bennouna Report, para 29 et seq.
[86] Guatemala and Costa Rica are however currently the only countries on record with reservation notifications to ICSID that they will insist on a clause of this nature, both explicitly insisting on exhaustion of local remedies.
http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingMeasures&reqFrom=Main
[87] Schreuer 2005, p.3.
[88] Ibid, p.13.
[89] Ibid, p.17.

remnants of the doctrinal insistence on national treatment still influences international investment arbitration.[90]

3.3.3 The Shift from Diplomatic Protection to BIT Protection - Sovereignty Acted out in a Different Way?

As has been shown, the tendency has for some time been shifting away from diplomatic protection as a way of guarding investments. States are exercising their sovereignty by submitting themselves, and investors from their jurisdiction, to international arbitration instead of diplomatic protection, thereby greatly reducing the relevance of the latter in the FDI context.[91]

The exercise of diplomatic protection means that once an investor has exhausted the locally available remedies, the dispute is "transformed" into one in which the home State steps in and exercises its own sovereign rights – the State does thereby in theory replace the investor as claimant.[92] This exercise of the State's sovereignty is completely discretional, meaning that it could choose not to intervene and not have to justify such a decision. From the perspective of the individual, this discretion on behalf of the home State is of course problematic. Diplomatic protection as a mean of securing investment rights is actually objectionable for several reasons, besides the already mentioned risk for political instability and lack of rule of law in the host State's judiciary system.

As developed by the ICJ in the monumental Barcelona Traction case, diplomatic protection cannot be exercised to protect shareholders of different nationality than the company.[93] Accepting the underlying premise of diplomatic protection – the link between a State and its citizen – it is of course not strange that the same protection cannot be granted to individuals who are not nationals of the protecting State. Some commentators even go so far as to say that investors, in the form of shareholders, are "unprotected by international law" if they have no State-level investment agreement to base their claim upon.[94] This problem is even more present nowadays, given the multinational structure of many big corporations.

There is also something to be said about the fact that a dispute generally is exacerbated by being drawn into a public proceeding in the host State. As has already been mentioned, there might be actors other than the parties who benefit from a greater transparency in proceedings where a public entity is a party, but in the average investment dispute the involved investor and host State prefer to keep the proceedings out of the biggest limelight.

[90] Sornararajah 1997, p.137.
[91] Kokott 2000, p.25.
[92] ILC 1998, para 16.
[93] Barcelona Traction, para 44.
[94] Masa'deh 2000, p.160.

An additional problem with diplomatic protection, which has already been alluded to, is the lack of individual standing for the injured alien. Once the home State decides to exercise its protective discretion, the resulting proceedings are on a State-State basis only, and the investor is at least theoretically not a party to the process. From a legal standpoint, it is the home State, and not its citizen, which has been injured. Before the BIT-practice and the establishment of ICSID, the lack of individual standing led some leading scholars to argue that the ICJ's jurisdiction should be extended to individual claims.[95] That did however never happen, but through the investment treaty practice, individual claimants now have a forum to directly bring their claims.

[95] Lauterpacht, 1947, p.453 et seq.

4 The Position of Local Remedies Rule in Bilateral Investment Treaties

The previous two sections highlighted the fact that the legal area of diplomatic protections differs from the more recently developed field of investor-State arbitration. Section 4 will consequently outline how the local remedies rule has been applied in this different context, how it is treated by BITs and thus in investment arbitration.

4.1 The Framework

Under the ICSID-convention, the local remedies rule is explicitly waived unless the BIT-parties state otherwise.[96] It is still possible for a State to insist that the requirement should be included in the treaty; the convention includes several sample clauses for this purpose, as do most international instruments offering suggested draft language for investment treaties. Neither of these draft instruments expressly excludes the local remedies rule.[97] Since no hard-and-fast set of rules regulates local remedies, it is up to the drafting States to choose how to structure their preferred way of dispute resolution, leading to a plethora of different approaches.

Before the investment treaty development, the general understanding in international law seemed to be that the local remedies rule was prima facie applicable, even in cases where States submitted to arbitration and did not mention the rule.[98] When the ICSID Convention was introduced in the 1960s, its drafters made explicitly clear that the default exclusion of the rule was "not intended thereby to modify the rules of international law regarding the exhaustion of local remedies".[99] At the same time, however, it was pointed out that in the context of investor-State arbitration, it could be presumed that "the intention of the parties is to have recourse to arbitration to the exclusion of any other remedy".[100] From the outset, there was thus no intention to derogate from the previously accepted position of the local remedies rule, while at the same time the system's very raison d'être was to offer an alternative.

The ICSID rules have however come to use as an efficient way of avoiding local remedies. The more recent development in the later part of the 20th century, indicates that most treaties referring to ICSID arbitration do so

[96] Art 26. Another waiver can be found in NAFTA art 11.
[97] United Nations Code of Conduct 1989; OECD Draft Convention 1967 art 7(b).
[98] Supra section 2.1. See also The Interhandel Case, p.27, Amerasinghe 2009a, p.16.
[99] Report of the Executive Directors, §32.
[100] Ibid.

without altering the presumption in art 26. This is part of a more general approach, keeping the BIT's dispute provision as short as possible and leaving it to the institutional rules to fill the gaps with more detailed regulations.[101] Arbitration pursuant to ICSID therefore in effect has established an exclusive forum, sidestepping domestic litigation in investment matters. The picture is however more complex than that.

4.2 The Local Remedies Rule in BITs

Although virtually every BIT contains an arbitral clause, there is little to no uniformity in how these are structured. The few general tendencies one can extract is firstly that, at least in modern treaty drafting, ICSID is often referred to and secondly, it is common to leave the claimant some discretion to choose from other arbitral forms as well – most notably the UNCITRAL rules, but also the SCC and ICC.[102]

Many BITs condition dispute resolution in formal channels on attempts at amicable solutions.[103] In language similar to the "multi-tiered" standard dispute clause in commercial contracts, this clause means that the parties have to show some kind of – though not a very ambitious – effort to negotiate the disputed matter before filing for arbitration. It is likely that these clauses mainly try to set the tone, so to speak, and they have never been applied as an obstacle to arbitration.[104] They do however normally include a waiting period of negotiations under which no arbitration can be initiated. This time might be used by both parties for other things than negotiating, such as preparing for the case, but it is generally regarded that this time has to be waited out before proceeding to arbitration.[105]

Another option is to include a requirement to attempt at local remedies before initiating arbitration. This approach is a key element in the described Calvo doctrine and is consequently often found in older BITs involving Latin American countries[106] but also elsewhere.[107] As has been mentioned earlier, this approach is perfectly compatible with ICSID arbitration, since art 26 of the Convention gives parties the possibility to insert the local remedies rule in their agreement.

A common modification of the more rigid local remedies approach is to provide for arbitration if local remedies have not settled the dispute within a given time frame. A good illustration of a clause like this is the one in art 8 of the UK – Argentine BIT, which was recently put before an arbitral

[101] UNCTAD 2007, p.100.
[102] UNCTAD 2005, p.5, Amerasinge 2004, p. 268.
[103] For example Sweden – Kazakhstan art 8(1), Netherlands – Ethiopia art 9(1), France – Uganda art 7.
[104] Vandevelde 2010, p.439.
[105] Ibid.
[106] See for instance US – Argentina art VII(3), Switzerland – Argentina.
[107] China – Côte d' Ivoire art 9(3), Netherlands – Jamaica art 9. Austria – Armenia art 13(2). Romania has furthermore introduced the rule on a regular basis.

tribunal set up within the Permanent Court of Arbitration system, and pursuant to the UNCITRAL rules.[108] The BIT states that a claimant shall file a claim with the host State's courts and can only resort to international arbitration if either the domestic court does not reach a final decision within 18 months or "the parties are still in dispute" after such a decision. The claimant had not filed in Argentinean courts at all but argued that the 18-month clause simply meant a procedural waiting period and that actually filing would be futile and an unnecessary obstacle towards the inevitable arbitration. The tribunal therefore had to interpret the local remedies-clause in the BIT and agreed with the responding host State that the language had a mandatory character. The tribunal did however emphasize that the requirement was not to exhaust local remedies, but rather just at least submit the claim and wait for a decision.[109] The fact that the British investor had not made such an attempt lead the tribunal to decline jurisdiction.

This award is in line with an earlier one, Maffezini, which was based on the Argentine - Spain BIT. This treaty included the same 18 month-requirement and the claimant had failed to attempt at domestic litigation at all. The tribunal held that this clause would deprive it of its jurisdiction, if it were not for an MFN-clause in the BIT. With the aid of this clause, the claimant could benefit from the dispute resolution provision in the BIT concluded between Chile and Spain. The latter is silent on local remedies and therefore no requirement was imposed on the claimant.

In a recent case with the same clause and similar facts, Abaclat, the tribunal held that "it would have been unfair to deprive the investor of its right to resort to arbitration based on the mere disregard of the 18 months litigation requirement".[110] The reason for this was that the tribunal regarded attempts in domestic courts to be only theoretical and not means towards an effective resolution of the dispute.[111] Thus the tribunal in this award allowed the claimant to disregard the local remedies.

All of these awards, ICS Inspection, Maffezini and Abaclat, are left out of the following discussion, since the tribunals did not elaborate on the substance-procedure question but rather focused on the material aspects of what an available remedy is. It should however be noted that they present fundamentally different views on how to interpret a "waiting period"-clause.

Clauses leaving the claimant/investor with the discretion to decide how and where to initiate the proceedings – as opposed to those in the Argentinean BITs *conditioning* arbitration on amicable solutions and domestic attempts – are also common. Leaving the investor with this degree of discretion is often combined with a so-called "fork in the road"-clause. The essence of such a clause is to force the claimant to stick with the forum he has opted for,

[108] ICS Inspection.
[109] Ibid, para. 251.
[110] Abaclat, para 583.
[111] Ibid, para 582.

thereby precluding alternative channels.[112] Typically, this means that an investor has to make a tactical choice to pursue either domestic litigation or international arbitration. The fork in the road only prevents the claimant from proceeding in an alternative forum with the same dispute, involving the same parties. This qualification means that the clause has not always been interpreted as an absolute obstacle to international arbitration.[113]

Finally, an option is of course to expressly do away with the requirement, in order to make completely sure that it is not applied. This is not a very common approach, especially since it might be regarded superfluous when using ICSID, but can still be encountered in the plethora of BITs.[114]

4.2.1 "Silent" BITs

What is most interesting for the purpose of this text, however, is the fact that many treaties do not contain clauses that *at all regulate the question of local remedies*. This is most valid for BITs concluded before the late 1990s. Since, as has been shown above, ICSID arbitration caught on relatively late in treaty practice, there are a significant number of BITs not referring to this type of arbitration, while at the same time not mentioning the local remedies rule at all.

There might be several situations where the validity of an implied local remedies requirement is brought to the surface before a tribunal – for instance in discussing the limits or merits of vaguely drafted clauses containing such a requirement – but a completely silent BIT would by definition force a tribunal to discuss its implicit application. This completely silent category includes treaties such as those concluded by Bolivia - Sweden, Norway - Lithuania, and the now obsolete Netherlands - Czech and Slovak Republic.

BITs that can be regarded as silent in this respect furthermore include those where other sets of arbitral rules are referred to: model rules such as UNCITRAL or institutional rules such as ICC, LCIA or SCC are primarily intended for commercial arbitration and as such do not require an attempt at local remedies. In a purely commercial context, with a dispute between two private companies, a requirement to go to court would undermine the basic premise for choosing arbitration in the first place. Furthermore, these rules only apply after consent to arbitration has been established, logically making any reference to other remedies superfluous.

It is thus important to remember that the question could arise also in claims based on a BIT where ICSID seems to be the preferred choice, since, as shown above, most such treaties present the claimant with alternative arbitral choices. If one expands the "silent" category to BITs with no

[112] See for example those concluded between France – Argentina art 8(2) and US – Czech Republic art VI(3).
[113] Schreuer 2004, p.247-248.
[114] See for example Austria – UAE art 10(5).

explicit regulation of local remedies and the possibility to arbitrate under a non-ICSID regime, the potential for an unregulated situation grows tremendously. There is a great number of BITs when this could occur, including those referring to the important UNCITRAL complex. An UNCTAD study from 2005 showed that almost a third of all disclosed investment arbitration proceedings were conducted under the UNCITRAL rules (the undisclosed number, naturally, being hard to take into account).[115] Given the general increase in proceedings since then, nothing suggests that the number has shrunk.

As far as this author is aware, no quantified study has been conducted to explore how prevailing ICSID-arbitration is as a primary choice for claimants in cases when presented with an option, but the sheer number of awards delivered under different regimes should suggest that it is a practical reality.[116]

It would be very illustrative to conduct a more comprehensive statistical survey of BITs and what type of dispute resolution-clause is used most often. No such empirical study has yet been performed, probably due to the efforts and time strains associated with such a task. Ralph Alexander Lorz has however investigated a comprehensive sample of BITs, focusing on the 148 treaties concluded by Germany and their treatment of local remedies.[117] In short, he concludes that some tendencies can be detected in the treaty practice of Germany, a major BIT player. In the early BIT years, before the 1980's, the local remedies rule was either ignored or explicitly included. After that, the waiver starts to appear and in the most modern treaties, it is nowhere to be found. Lorz believes this clear development suggests that Germany over time tried different solutions but settled for what it and its treaty partners considered the most suitable option: a waiver of the requirement.[118]

There is no reason to doubt this conclusion. Any random selection of BITs confirms that when the rule is left out, it is generally because the treaty is from the early years of drafting. It is likewise very unusual to see a modern BIT, concluded in the 21st century, which does not waive the rule entirely by referring to ICSID arbitration, or in plain language. This aligns with the increasing sophistication of BIT drafting in general.

For the purpose of this text, as presented in this section, it is thus safe to assume that investment arbitration with no explicit regulation of the local remedies question occurs on a regular basis. This is mainly for two reasons:

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[115] UNCTAD 2005, p.5.
[116] To illustrate this point, the SCC in Stockholm – arguably the second biggest institution in this regard - has administered 45 investment proceedings since 1993, though some of them were not based on BITs (http://www.sccinstitute.com/?id=23696&newsid=42668).
[117] Lorz 2009, p.47.
[118] Ibid p.48.

- There are several older BITs still valid, not referring to ICSID and in which the local remedies rule is not mentioned at all.
- A common solution in more modern BIT practice is to leave the claimant with a certain degree of discretion in choosing arbitration form. Apart from ICSID, all alternative options are silent on the question of local remedies.

4.3 Substance or Procedure?

So far, the text has treated the local remedies rule as a purely procedural one, since this is the way it has generally been labelled in diplomatic protection. It is however not self-evident that this should be the case. In fact, most seem to think that the rule in the investment arbitration-context is not a procedural condition precedent for a tribunal's jurisdiction.[119] Some commentators, however, argue that the rule is established enough to be included in the *substantive* part of a claim: a division that has been discussed and all but abandoned in the diplomat protection-context.

Treating the matter as a procedural one would mean that an arbitral claim would not be admissible unless at least an attempt has been made at local remedies. Treating it as a substantive one, on the other hand, would allow the tribunal to hear the case but might mean that the lack of attempts at local remedies could cause the claimant to lose the case on the merits, because his rights have not been sufficiently violated.

It is clear that introducing this layer to the problem further complicates the question at hand. Whether or not there exists a requirement is of course dependent on how such requirement is legally classified. What is more, the doctrinal debate seems to have outlived the change of application from diplomatic protection to investment arbitration; evident in both differing scholarly opinions and in arbitral tribunals reaching different conclusions on similar cases. Below, some of these opinions and cases will be introduced and discussed.

4.3.1 Arbitral Cases

The local remedies rule has been applied in several recent arbitral awards where the substance/procedure-distinction was brought to the surface. The following outline introduces a comprehensive presentation of these cases, with no attempt at being exhaustive; such a task would naturally be futile, especially given the fact that many arbitral proceedings are kept secret. A handful of other awards have already been discussed but the following highlight the division between substantive and procedural properties of local remedies.

[119] McLachlan et al 2007, p.128.

In order to provide an overview and stay as concise as possible, these very complex cases are summarized and only the factors relevant for the paper are extracted and discussed. Consequently, the following features are summarized: the treaty upon which the arbitration is based, which arbitral rules were used, what the claimant argued (only the claims relevant for local remedies) and how the local remedies rule was or was not applied. They are presented in chronological order and the awards in which the tribunal elaborated on local remedies' function are discussed somewhat more thoroughly.

4.3.1.1 Feldman 2002

Treaty: NAFTA
Arbitral rules: ICSID Additional Facility Rules
Material claim: Authorities failed to grant claimant tax rebates, claimed to be tantamount to expropriation and denial of justice
Local remedies: Not applied as a substantive condition for expropriation but for denial of justice. The expropriation claim did however fail as well, and the failure to attempt at local remedies was one of several reasons for this and part of a bigger discussion.

4.3.1.2 Yaung Chi Oo Trading 2003

Treaty: ASEAN
Arbitral rules: ICSID
Material claim: Several expropriation acts, including armed seizure of factory.
Local remedies: The tribunal declined jurisdiction but not on failure to exhaust local remedies, which it stated is a "matter going to the substance of the claim and not the Tribunal's jurisdiction". [120]

4.3.1.3 Loewen 2003

Treaty: NAFTA
Arbitral rules: ICSID
Material claim: Mistreatment in domestic court proceedings violating fair and equitable treatment.
Local remedies: Substantive. Claimant could, at least in theory, had appealed the court's decision to the Supreme Court and failure to do so made the claim fail on its merits.

The Loewen case is arguable the most controversial and has been discussed and criticized heavily since its issuing. It presented a very narrow view of when a denial of justice-claim could succeed. The claimant had in this case been subjected to what the tribunal recognized was a disgracefully unfair and racist jury trial. He did not appeal to the US Supreme Court, because

[120] Yaung Chi Oo, para 40.

only a fraction of such appeals succeed and the requirement to post a bond during the waiting period would mean that the company would go bankrupt. Instead the claimant settled the case prior to initiating arbitration. This failure to appeal through the national US system was held to frustrate the possibility of international responsibility under the investment treaty.

4.3.1.4 Generation Ukraine 2003

Treaty: Ukraine - US BIT
Arbitral rules: ICSID
Material claim: Investment was spoiled through administrative acts and omissions tantamount to expropriation.
Local remedies: Not applied as a procedural requirement but "expropriation is doubtful in the absence of a reasonable [...] effort by the investor to obtain correction".[121]

Generation Ukraine was arbitrated under the ICSID system, with a BIT not mentioning the local remedies rule, and the tribunal reiterated that article 26 means the requirement thereby is waived [122] The circumstances in the case did however lead the tribunal to discuss the rule. The background was that an American investor-claimant sought damages for the construction of a commercial property in Kyiv. The American corporation had established a local investment company and initiated the construction on site, but claimed that local authorities over six years time gradually obstructed the process to such a large degree that it was tantamount to indirect expropriation. The host State objected to the tribunal's jurisdiction because, inter alia, "Ukrainian judicial remedies" had not been exhausted.

The tribunal, while finding it had jurisdiction, expected from the claimant a "reasonable effort" to overcome the alleged mistreatment from the Ukrainian authorities. Without such an, not necessarily exhaustive, effort, the expropriation claim could not succeed on the merits and was thus denied.

4.3.1.5 Waste Management II 2004

Treaty: NAFTA
Arbitral rules: ICSID
Material claim: Expropriation due to mistreatment by City authorities and local courts, tantamount to violation of "fair and equitable treatment"-clause.
Local remedies: "Incorporated into the substantive standard and not only a procedural prerequisite".[123] City's mistreatment could not be expropriation as long as claimant could have sought redress; the Court's mistreatment had to meet the bar of denial of justice, which was not the case.

[121] Generation Ukraine, para 20.30.
[122] Ibid para 13.4.
[123] Waste Management II, para 97.

4.3.1.6 EnCana 2006

Treaty: Canada - Ecuador BIT
Arbitral rules: UNCITRAL
Material claim: Local authorities failed to allow VAT refunds and claimed those previously granted should be refunded. Claimant argued this was tantamount to expropriation.
Local remedies: Applied as part of the merits and used to deny the claim. Dissent from Co-Arbitrator Naón arguing that the majority tried to re-introduce the rule when it was not in the BIT.

The EnCana award, though not primarily about the local remedies rule, held that the claimant, a Canadian company, could not succeed with its expropriation claim since it had not tried to invoke all mechanisms available under the host state's law. The award is interesting in this aspect since co-arbitrator Grigera Naón argued in a partial dissent that levying a requirement to exhaust local remedies, when no such requirement was in the BIT, would suggest "the existence of a public international law hard–and–fast rule [on local remedies], binding on international arbitral tribunals", something which he opposed.[124] The majority did not agree with this view and added in an extra note, after "careful consideration", that the award in their view discussed "whether the relevant rights have been expropriated as a matter of substance".[125] This holding clearly awarded the local remedies rule the dignity of a substantive standard.

4.3.1.7 Parkerings 2007

Treaty: Norway - Lithuania BIT
Arbitral rules: ICSID
Material claim: Expropriation and violation of fair and equitable treatment through City mistreatment and termination of contract.
Local remedies: Applied as substantive: no treaty violation (expropriation) since no complaint had been brought before appropriate local courts.

4.3.1.8 Helnan 2008

Treaty: Denmark - Egypt BIT
Arbitral rules: ICSID
Material claim: The State and the claimant's contractual counterpart conspired to force claimant to give up ownership of a luxury hotel, awaiting the State's ambition to privatize it. These actions amounted to expropriation and violated the "fair and equitable treatment"-clause of the BIT.
Local remedies: Applied as substantive. The tribunal recognized that attempting at local remedies was no procedural prerequisite to arbitration

[124] EnCana §200, appended to the award.
[125] Ibid note 138.

but that Egypt could not be held internationally responsible under the BIT, since the claimant had not attempted to rectify the respondent's conduct. In this incorporation of the requirement into the fair and equitable treatment-standard, the tribunal relied on Generation Ukraine.

The Helnan award is extra relevant in this respect, since it was partially annulled by an ICSID ad-hoc committee.[126] The reason for this was that the committee regarded the tribunal's holding on the substantive local remedies requirement as an attempt to do "by the back door that which the Convention expressly excludes by the front door".[127] Reading such a requirement into the substance of a claim would empty investment arbitration of its force and effect, the committee held.

The committee did however recognize that a failure to rectify misconducts in the local courts *could* be awarded a substantive relevance, as was made in Generation Ukraine. It did distinguish the facts in Helnan from those in Generation Ukraine and argued that the different level of the mistreating State official affected the respondent's international responsibility. In the case of Generation Ukraine, the alleged mistreatment concerned a decision by a low level official, while in Helnan it was on a ministerial level. A respondent state, the committee reasoned, can be held directly responsible for the latter, but not for the former.

4.3.1.9 Saipem 2009

Treaty: Italy - Bangladesh BIT
Arbitral rules: ICSID
Material claim: State courts collaborated with claimant's contractual counterpart in order to set aside an ICC award in which claimant was awarded damages. Claimant argued that this was expropriation under the BIT.
Local remedies: Held not to apply to expropriation claims as a matter of principle (but to denial of justice). In this case, the investor had framed the claim as an expropriation and spent so much time litigating the matter that the success of further appeals was improbable. Local remedies were found to have been reasonably exhausted.

4.3.1.10 Pantechniki 2009

Treaty: Greece - Albania BIT
Arbitral rules: ICSID
Material claim: Riots damaged claimant's equipment, the respondent State settled that claim but never paid. When claimant brought the failure to local courts for assistance, it was denied and the claimant initially appealed to

[126] Helnan Annulment Decision. For a brief description of the annulment system, see supra section 3.1.
[127] Ibid para 47.

Supreme Court but instead turned to ICSID arbitration. Claimed breach of "full protection and security", in form of the failed protection of the physical property, as well as violation of "fair and equitable treatment" through the Court's mistreatment (denial of justice).
Local remedies: Applied on the second claim as part of the merits: the failure to fulfil the appeal process to the Albanian Supreme Court made a denial of justice-claim impossible.

4.3.1.11 Chevron – Texaco 2010

Treaty: US - Ecuador BIT
Arbitral rules: UNCITRAL
Material claim: National courts handled investors' contract breach-claim in a manner which violated the BIT-obligation to "provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations".
Local remedies: Applied as a substantive "qualified requirement" of the clause. In this case, the claimants were found to have sufficiently attempted at local remedies and were awarded damages.

4.3.2 Scholarly opinions

The above described tendency by tribunals to introduce local remedies as an integral part of a claim's merits is far from an uncontroversial development. This section will briefly account for some of the academic writing on the subject.

Though the commentaries on the development differ widely, most seem to agree on one point: in order to claim denial of justice, an investor has to exhaust or at least attempt reasonably at local remedies. The very allegation does by definition contain a substantive element of local remedies and few scholars question this position as a general assertion. In order to establish an unlawful judicial act at the international level, an aberrant decision by a lower official does not generally suffice – the key reason for this is the fact that such a conduct can still be corrected at a higher level, and no justice be denied before the system has been given that chance.[128] There can thus be no denial without exhaustion.[129]

The most detailed academic text published on the issue is written by George K. Foster.[130] He argues that claims other than denial of justice may also include a substantive local remedies element, a view that is arguably shared by many of the presented arbitral cases. In short, three alternative assertions by claimants have been brought before tribunals and found to include local remedies, a result that Foster supports and explains:

[128] Crawford Report 1999, para 75, Vandevelde 2010, p.484, Paulsson 2005, p.108.
[129] Paulsson 2005, p.111.
[130] Foster 2010.

Violation of "fair and equitable treatment"-clauses. This standard BIT-clause is frequently used by investors in arbitral claims and its vague formulation has been given a wide interpretation by tribunals. The basic underlying argument for this, one which Foster agrees with and even analogically compares to the US Constitution's fourteenth amendment, is that a State with an established judicial system in place to reverse erroneous decision, seldom can be said to treat investors unfair or inequitable.[131] Foster's US analogy to the fourteenth amendment – the "due process" clause – builds on the fact that the entire procedural system of a state has to be tested in order for a federal court to question its fairness.[132] US courts recognize exceptions to this, if attempts at local courts would be futile or ineffective – an approach similar to the one articulated in for example Generation Ukraine, making the analogy a good tool in explaining what constitutes fair and equitable treatment.

Expropriation. BITs generally do not prohibit expropriation per se; such acts can be justified by public purposes, as long as they are compensated as well as prompt and adequate. It is these very grounds that are disputed and argued in the arbitral cases where investors claim expropriation. Foster has a US analogy ready for why local remedies can be regarded as inherent in these cases too: the Supreme Court's jurisprudence on the Fifth Amendment's Takings Clause. Under this doctrine, uncompensated expropriation is not allowed but in order to establish such an expropriation, compensation has to be sought and denied.[133] This requirement reduces the need for federal intervention and protects state sovereignty.[134]

Violation of "effective means of asserting claims"-clauses. This clause is similar to the fair and equitable treatment, and just as in the case of the latter, an arbitral tribunal will have a hard time assessing the effectiveness of the judicial system in the host State, if it has not been tested at all. This was most explicitly formulated by the Chevron-Texaco tribunal, which stated that "a failure to use these means may preclude recovery if it prevents a proper assessment of the 'effectiveness' of the system for asserting claims and enforcing rights".[135]

Foster thus finds four possible claims that may include substantive elements of local remedies: three more than the more established notion, which only attributes such a property to denial of justice. He finds support for this in several of the already presented arbitral awards, as well as by analogizing the relationship between federal and state authorities in the American constitutional order.

Despite the widespread acceptance of local remedies as part of a successful denial of justice-claim – and an arbitral development suggesting an even

[131] Foster 2010, p.245.
[132] Ibid, p.246.
[133] Ibid, p.249 with references.
[134] Ibid.
[135] Chevron-Texaco, para 324.

wider application – there are still notable academics who question the proposition that local remedies ever be included in the merits of an investment treaty dispute.

The most articulated of these opponents are McLachlan, Shore and Weininger, who in their ambitious work[136] on investment arbitration criticize the development of including local remedies in the merits of claims. In commenting the Loewen award, the authors argue in a broader sense that "one must be very careful not to borrow principles from customary international law which are inconsistent with the hybrid nature of investment arbitration."[137]

The investment arbitration community is relatively small, as has already been alluded to. A good illustration of this is that Campbell McLachlan, the co-author of the nominal work, sat on the ICSID committee that partly annulled the Helnan award because it regarded local remedies as a substantive part of the claim. The reasoning in that decision is more or less identical with the one in the book, stating that reading such a requirement back as part of the substantive cause of action would empty investment arbitration of force and effect and ignore the State parties' intentions to avoid the pursuit of local remedies.[138]

Christoph Schreuer, who has written the commentary on the ICSID convention, has expressed concern that this theory of local remedies as a substantive standard risks to undo a fundamental aspect of modern investment arbitration. Like most commentators, he feels its inclusion is "hardly surprising" in cases of alleged denial of justice,[139] but he is cautiously sceptical towards allowing it to be included in other claims. Schreuer draws parallels to the almost-abandoned Calvo doctrine, calling it an adopted child of this school of thought.[140]

Writing before many of the awards introduced in section 4.4.1, Schreuer claims that the oldest and most discussed - Loewen, Generation Ukraine and Waste Management II – do not develop a general principle of attempts at domestic requirement as a necessary element of a successful expropriation or fair and equitable treatment-claim. Viewing the development of investment arbitration as an intentional way of getting around the restraints of diplomatic protection, he is however wary that the rationale behind the awards may develop into a re-introduction of the rule "by the back door".[141]

This line of argumentation was echoed by co-arbitrator Naón in the EnCana case. In his partial dissent, he pointed out that the BIT – referring to the UNCITRAL arbitration rules – contained nothing as to indicate an intention

[136] McLachlan et al 2007.
[137] McLachlan et al 2007, p.232.
[138] Ibid, p.233.
[139] Schreuer 2004, p.14.
[140] Ibid, p.13.
[141] Ibid, p.15 and p.17.

by the State parties to require attempts at local remedies. Naón argued that the tribunal could not in such case apply the requirement in a different guise.

Furthermore, if an investor was forced to go to local courts and get a judgement on the State's conduct, a problematic situation may occur. Imagine that the court finds no violation has taken place, and does so in a fair and procedurally correct manner. Then the claimant might be precluded from moving on to international arbitration: no denial of justice is at hand, and the substantive claim, in this case an alleged expropriation, has already been denied by a fair local court. The majority in this case did however reiterate its insistence on local remedies and stressed that the procedural aspect, which it did not impose on the investor, has to be distinguished from the substantive issue on whether his rights had been expropriated. The "mere position of an executive agency" could not amount to such a violation.[142] It is relevant to note that the EnCana case is one of only two where neither the BIT nor the arbitral rules mention the local remedies at all.[143]

Along the lines of Naón, Ursula Kriebaum writes in an essay collection in honour of Schreuer[144] that the impartiality and effectiveness of arbitral tribunals rely on the fact that they can act independently of domestic courts. Having a court determine whether an injustice has occurred and then expect a tribunal to respect the decision unless there has been a denial of justice – the approach feared by Naón but applied in EnCana as well as Waste Management and Parkerings – would render investment arbitration to become a "less than subsidiary remedy."[145] This, Kriebaum argues, would run completely against the purpose with treaty arbitration, which is to establish an exclusive alternative to domestic litigation. She lines up a number of problematic consequences of re-introducing the local remedies rule in substantive terms for claims other than denial of justice:

- Legal uncertainty. The groundbreaking "reasonable efforts"-formulation from Generation Ukraine leaves much to wish for in terms of precision. What does an investor have to do in order to reasonably ensure himself that an expropriation or unfair treatment has been established? Nobody really knows and to be sure, the investor would have to spend considerable time and money.
- Investment arbitration risks turning into a subsidiary system. In addition to this development running afoul with the intention behind the system, it also risks hurting the global investment climate.
- The scope of protection of the investment would be minimized. In effect, an arbitral tribunal would be limited to supervise the domestic legal systems, thereby risking that most claims other than denial of justice would be impossible to raise before it.

[142] EnCana para 200, note 138.
[143] The other being Chevron-Texaco. The other cases were arbitrated under ICSID and/or based on ASEAN or NAFTA, each excluding local remedies as a general presumption.
[144] Kriebaum 2009.
[145] Ibid, p.46.

- Fork in the road-clauses. Such clauses force investors to chose one procedural path and stick with it: attempting at litigation precludes arbitration and the other way around. Treating local remedies like a part of the merits of most claims, and thus indirectly forcing investors to use them, would conflict with BITs containing a fork in the road-clause.[146]

4.3.3 Conclusion

To sum up, a tendency might be discerned from recent arbitral awards and academic commentary. The local remedies rule, traditionally regarded as a procedural prerequisite in its diplomat protection-shape, has not been applied as such in the investment arbitration context. This tendency seems to align with the background and intentions behind the development of investment protection.

Thus, since the local remedies rule is not regarded as procedural, while simultaneously abandoned in ICSID, NAFTA and most BITs, one might expect that an investor who wishes to arbitrate under one of these umbrellas could proceed straight to arbitration. The above cases, and the approving commentaries, have showed that it is not necessarily so. Depending on the nature of the alleged breach, local remedies might constitute a substantial requirement of the claim. It is far from clear when this is the case and the applications and opinions on the issue differ from never allowing such an inclusion, to doing so in most cases. In between these two extreme positions, there are those advocating for a flexible approach; domestic adjudication might constitute a part of the merits, depending on the individual case. This notion, uncertain as it may be, seems to be the predominant one. Furthermore, most authorities seem to agree that a denial of justice-claim should include an attempt at local remedies in order to succeed.

In the next and final chapter of this text, some of the reasoning behind the awards, as well as the academic debate surrounding them, will be used in discussing what conclusions can be drawn on situations when the BIT is completely silent on the question of local remedies.

[146] Kriebaum 2010, p.47-48.

5 Discussion

After presenting how the local remedies rule evolved in international law, how this is different from investment arbitration and thus has been applied differently in that context, the focus of the next and final chapter returns to answering the initial question: what should happen in an investor-State arbitration proceeding if the rule is not addressed at all in the underlying treaty?

The findings in the previous parts of this work suggest that the question is far from easily settled. Several tribunals have applied the rule, and done so in different ways. In this section, the different propositions are evaluated and the following discussion will then suggest the most suitable solution to the problem.

5.1 Proposition: The requirement shall be read into silent BITs as a procedural prerequisite

The basic argument to be extracted from this position is that it follows from established international law. A host State agreeing in a treaty to international arbitration is simply exercising its sovereign right and an investor's home State is by doing so in effect exercising diplomatic protection. This treaty, and the established legal principles it gives expression to, is the only thing granting standing to the individual claimant and there is no reason the local remedies rule should not apply.

In traditional diplomatic protection, the local remedies rule is recognized as a procedural prerequisite to international adjudication, and if one views investment arbitration as an expression of diplomatic protection, the rule would simply follow. Consequently, this view – though it seems to be losing most of its weight over time – is found in more traditional spheres, emphasizing the rule's roots in international law. Among these are Amerasinghe, who stresses that the ICJ and the international community have placed an important presumption on local remedies and that this should prevail unless an express provision states otherwise.[147]

This view is more or less derived from the ELSI case, delivered in a time before the development of BIT-based arbitration. It is mostly found in older texts and seems to be heavily influenced by traditional diplomatic protection.[148] ELSI, and several other cases in which the procedural character of the rule was reiterated, preceded the arbitral awards presented in this paper. Even though that case is relatively modern, the signing of the

[147] Amerasinghe 2009b, p.1.
[148] See also Sornarajah 1997, p.135, Amerasinghe 2004, p.249 et seq.

FCN treaty occurred shortly after the Second World War and States signing a contemporary BIT have arguably different expectations, and notions of the importance of State sovereignty, than did Italy and the US in the ELSI case.

As has been shown, investment arbitration filled a hole in international adjudication when it established a neutral forum for solving contentious FDI matters. Making access to this forum conditioned on first using domestic channels would completely run against the purpose of the entire structure. Furthermore, it makes no logical sense to rely on cases and principles from an older legal area in order to explain a superseding system whose primary motivation was to replace the older one. As has been shown in part 4.2, there is not an especially strong attachment to the rule among States concluding investment treaties. The mere fact that the rule is circumvented in many modern disputes should not be disregarded as an argument, especially since much if the rule's previous weight has been assigned to the fact that the world community traditionally adhered to it. There are several other international dispute settlement schemes where the rule is excluded, effectively undermining what was previously a very strong presumption.[149] References to ICJ rulings on diplomatic protection, or to the ELSI case, should therefore be awarded very little significance in explaining prevailing principles of investment treaty arbitration.

For a progressive, arbitration-friendly jurist, the procedural prerequisite-proposition would thus make no sense at all, and it seems that this opinion is spreading. None of the studied awards used the rule in this jurisdiction-blocking way, even though some of them definitely had the chance. This works to show that "investment law" is something else than traditional international law and that an otherwise applicable procedural rule is implicitly waived, unless the disputing parties have agreed otherwise. The claim that the local remedies rule should work as a procedural rule is arguably outdated and actively disregarded by all major modern arbitral applications. The rest of the discussion will thus focus on a much more relevant aspect of the rule: its substantive character.

5.2 Proposition: The requirement may constitute a substantive part of the claim

This notion is a highly contentious one, as has been shown in the previous section. Some authorities claim this to be the only reasonable model in applicable cases, while others suggest that it is an attempt to sneak local remedies in through the back door. As was shown in the previous section, a division tends to be made between claims of denial of justice and other claims. This division will now be explained and evaluated.

[149] Apart from ICSID, these include disputes under WTO, GATT and NAFTA.

5.2.1 Denial of Justice

In cases of denial of justice, the local remedies requirement ultimately derives from the duty imposed on the host State to provide a judicial system that allows for proper administration of justice – including the possibility to rectify wrongdoings. The international duty is not to treat every single matter dealing with foreign investors in a perfectly correct way; it is rather to provide a system which on the whole works to assure the rights of due process. Therefore, even though denial of justice sometimes is used as a rubber-like concept, flexibly reaching from procedural flaws in the individual case to systemic shortcomings of the entire judicial system of the host State,[150] not all cases should include attempts at domestic mechanisms.

In order to successfully claim denial of justice, a systematic failure of the host State's judicial system must be shown. It is in the very nature of the concept that an error or misconduct cannot be rectified within the domestic system: if not, justice has not been denied, and how can you prove otherwise if you have not tried the system? A requirement to at least attempt at, and probably also reasonably exhaust, local remedies is therefore inherent in any notion of denial of justice. If not, decisions of lower courts or administrative bodies would be second-guessed by arbitral tribunals on a regular basis, making the latter an appellate body of sorts, which has never been the intention of investment arbitration. Its purpose, as has been emphasized in different contexts in this paper, was to establish a separate and exclusive forum – not to function as a "last instance" in relation to domestic courts.

An opposing view against allowing local remedies to play a substantial part in denial of justice claims, as argued by McLachlan et al, claims that the host State is responsible for all actions of its officials and thus not only for the entire system as such. In the international sense, they argue, the State has a single legal personality. This leaves room to stipulate that a miscarriage by an official from the host State should produce international responsibility for the State, no matter the level or position of the official. An investor should therefore not have to go to courts in order to get a BIT violation "confirmed" by superior bodies, since all agents of the host can invoke its international responsibility.

This argument seems to make the attribution synonymous with the responsibility of the host State. Those two notions should arguably be separated in any analysis examining whether international law has been breached. An act that is attributable to the State, such as a peculiar decision by a low-level official, should not necessarily be something that the State should have to be held responsible for. The concepts are divided in the ILC draft on Internationally Wrongful Acts[151] and supported by Special Rapporteur Crawford.[152] This separation of the element of attribution and the element of an international breach is logical as far as local remedies are

[150] Bjorklund 2005, p.812.
[151] ILC 2001, compare chapter II and III.
[152] Crawford Report 1999, para 75.

concerned: if such a remedy is available, a wrongful official decision attributable to the State does not invoke responsibility as long as the remedy has not been attempted at.

It has been shown beyond doubt that a waiver of the requirement has not been applied to denial of justice-allegations, and nor should it. It is therefore natural to assume that local remedies remain an integral substantive part of these claims when they are brought under silent treaties as well. If applied even in cases, such as the "pure ICSID"-proceedings, where the parties have excluded it, why should it not be applied when the treaty parties are completely silent on the matter?

5.2.2 Claims Other than Denial of Justice

If denial of justice should be a relatively clear-cut case of the substantial function of local remedies, other spheres of application are more contested. As shown by the arbitral awards, and summarized by Forster, there are three other material claims that have been found to include elements of the local remedies rule.

A problematic aspect of this separation between denial of justice and other claims, as formulated most clearly in the Saipem award, is that it allows claimants – and ultimately tribunals - to introduce or avoid the local remedies requirement by labeling the claim as either denial of justice or something else, for example expropriation.

The key feature that Forster emphasizes to justify including the rule in expropriation claims is the issue of compensation. Given that expropriations per se seldom are forbidden in BITs, he argues that they have to meet a higher standard than simply seizing property and that this does not prejudge how the State chooses to provide compensation. Essentially, an investor has to seek compensation and have it denied before an expropriation claim can be successful – a view which corresponds with the applications in Generation Ukraine, Waste Management II, EnCana, Parkerings and Saipem.

This is a proposition with which I do not agree. Expropriation in the traditional sense, when the host State seizes assets from private entities because it is necessary on alleged public grounds, seems to be uncommon. A regular feature in the arguments in the studied arbitral awards is rather that a series of different public actions – tax decisions, contract terminations, obstructions – are alleged to be "tantamount to expropriation" or "indirect expropriation". Formulating claims in this manner, it might not be entirely clear what an expropriation really is and how this differs from a denial of justice. There are however important differences, explaining the local remedies rule's vital function in the latter case: for denial of justice, the entire treatment of the whole domestic system is relevant, while in expropriation cases the individual State organ's action should be enough to establish a breach. Consequently, whether or not a denial of justice has

occurred cannot be judged unless the entire system has been given a chance, which should generally not be the case for expropriation claims. Furthermore, in the cases at hand, the alleged expropriation has been connected to contractual rights: the host acted as a commercial counterpart and not, as in denial of justice-cases, as a State exercising its sovereign authority.

Given the emphasis put on avoiding local remedies that has been shown in treaty practice, one should exercise extreme caution in reading it back. Granted, it is hard to avoid in denial of justice-claims, but there is nothing to suggest that expropriation of contractual rights needs to be "confirmed" by a superior public body in the host State. Foster's analogy to the US Constitution's Taking Clause does not change this fact, since the relationship between a State and its citizens is fundamentally different than that between a State and a foreign citizen. Bilateral investment treaties exist simply because history has shown a need for an efficient and direct path to judicial protection for aliens and raising the bar for when this can be achieved in cases of expropriation would be very unfortunate. No comparison to domestic systems can change this.

The other examples of when local remedies were awarded a substantial property are alleged breaches of "fair and equitable treatment" and, in Chevron-Texaco, the similar "effectiveness of the means provided" by the host in order to assert claims and enforce rights. In my view, there is more merit to the local remedies requirement in these contexts; at least under certain circumstances.

Claims similar to denial of justice can be framed under these standards, when the host's misconduct does not reach the bar of denial of justice. On such occasions – if a decision, omission or order goes against the investor and he has easy access to a mean that could correct it – a host State is not very likely to have acted in a manner contrary to these standards. Using the above logic behind its inclusion in denial of justice, including some use of local judicial channels in order to allow an arbitral claim to succeed makes sense.

If, and it is a big if, there is an accessible mechanism to rectify the alleged mistreatment, a claimant who has not attempted at using it should have a hard time meeting his burden of proof that the host has not acted fair and equitable or provided effective means.

5.3 Concluding Remarks

Arbitration, generally speaking, is intended as a way to circumvent courts and used as a tool for consenting parties to solve complex disputes with a binding force outside of traditional legal systems. In traditional arbitration, a rule that forces the suing party to first try in courts is of course an alien notion. In dispute resolution within public international law, however, such

a rule is established as customary. Herein lays the inherent antagonism in investment arbitration: it allows two legal spheres to collide.

The only set of arbitration rules aimed explicitly at investment arbitration, ICSID, has established the default position that attempts at local remedies should not be required. All other rules are naturally silent on the matter and there are BITs referring not to ICSID but to these other sets – or, for that matter, to no rules at all but rather to ad hoc-arbitration under domestic law. Is the presumption of exhaustion local remedies strong enough to prevail even in a party-driven arbitration context where it does not seem to be so familiar? It is my general view that it is not.

Before a conclusion on the local remedies rule's function can be properly discussed, however, one reasonable question must be addressed: why not just resort to treaty interpretation? It is possible that any attempt at a general catch-all answer is futile, since it ultimately comes down to construing the individual BIT and extracting the intentions of the States involved. In any given situation when an agreement is silent, the obligation of the judge or the arbitrator is to fill this gap in a manner consistent with the circumstances at hand. Given the traditionally well-established position of the local remedies rule, an implied waiver would require special circumstances in the individual case and when interpreting any unclear legal situation, each situation is unique and should be treated accordingly.

This would be a convenient answer but is not really a sufficient counter argument to the solution sought here. No interpretation of an agreement exists in a vacuum and especially in the area of international law it is vital to discuss norms and standards among actors, in order to facilitate the straightening out of unclear provisions in the individual case. If a presumption, weak or strong, could be established, it would improve any interpretation. There are seldom enough information from the States' negotiations and drafting of BITs to set down their mutual opinion on the local remedies rule when it is left out of the treaty. Given the plethora of differing academic opinions and arbitral awards, a general presumption is thus highly desirable. The better defined the rule is, the more relevant it is and the more good it can do for the international community.

On this note, it is manifestly problematic that the local remedies-requirement, in its substantive dress, has been invented by arbitral tribunals. Its inclusion in some claims – as well as how to distinguish when to include it – is technical, unpredictable and built upon legal principles that are very complicated to grasp even for trained lawyers. Basically, it is everything that good law should not be. This is undesirable but can only be corrected by States in their treaty practice. Let States re-introduce the rule if they feel like it; a very improbable development, simply because few countries seem to feel it desirable.

The problem with this tribunal-invention is that trade treaties are sophisticated tools formulated and agreed upon by sophisticated players.

And what is more: the players are sovereign States! State sovereignty would be the ultimate reason to uphold a strict demand for the local remedies rule, but in my view it is the respect for this very sovereignty that justifies abandoning the rule. One might have problems with the nature and structure of BITs but the fact remains that it is a product of a State exercising its rights under international law and this source should not be disregarded lightly. As a general rule, judges and even more so arbitrators ought to exercise caution in extending the reach of principles that have not been agreed upon by the parties to a treaty.

Along these lines, one could also easily argue that the individual claimant-investor is acting to preserve and protect his own rights, and not the rights of his home State. Accepting that the home State has no vested interest in the typical investment arbitration must necessarily lead to the conclusion that these proceedings are different from cases of diplomatic protection, and consequently that there is no expectation from the home State to observe the rule.

To wrap up this text and answer the initial question, one would have to make it conditioned. There should be no general implicit procedural requirement to exhaust local remedies, in the sense that a failure to do so would deprive the tribunal of its jurisdiction. Such a principle can however be read into the *substantive* part of a claim, as has been done on several instances in recent arbitral awards. This is not true for all claims; if it were so, abandoning the procedural aspect would make little sense.

To put it in the simplest possible way: not every breach of a contract can be arbitrated directly in front of a tribunal, on the contrary - some claims do by their very nature entail an attempt at local remedies in order to meet the bar for succeeding with a treaty claim. This is definitely true for the denial of justice-ground but also for some similar claims. It should however be noted that these are to be viewed as exceptions, special cases deviating from the general rule that the local remedies requirement should be inserted with tremendous caution. For instance, the tendency to not allow expropriation claims to succeed unless several domestic institutions have confirmed it is undesirable and risks running afoul with the fundaments of investment arbitration. In this respect, several of the tribunals have in my view been too eager to extend the application of the rule. Alleged expropriation is on the contrary a good illustration of a claim that does not entail a substantive obligation to attempt at local remedies.

This answer to the question is satisfactory in the sense that failure to address miscarriages within the host jurisdiction never will lead to an arbitral tribunal losing jurisdiction. It is however likely that such a claim would be denied on its merits, but that question is left to the discretion of the tribunal to decide in the individual case, depending on the circumstances.

5.3.1 Practical Implications

Whether or not it might be worth at least pursuing domestic remedies is of course not as clear-cut as it might seem from this text. To be sure, any attempt at solving the dispute locally facilitates the eventual process in front of a tribunal. The higher up in the administration, or the more systematic, a host State's unfair behavior is, the more likely it is that an international tribunal will allow the claimant to bring the case – or, as the case now might be, to award on the merits. The easiest way to achieve this is, naturally, to at least try to rectify the alleged initial wrong-doing within the frames of the domestic court system.

There are furthermore many sound policy reasons for stressing the use of local remedies. Firstly, it puts pressure on the host State to enable an efficient and fair legal system. If attracting lucrative foreign investment could be clearly preconditioned on establishing a high judicial standard, then the local remedies rule could work as a great incentive. In addition, initiating any procedure in the country of investment instead of internationally, minimizes the risk for hostility associated with the latter. The investor might of course have an interest in keeping the dispute at a less provocative level, especially if he intends to keep doing business in the host State, which is usually the case. These policy considerations, praiseworthy as they may be in the long run, are however of little consolation for the individual investor who has been mistreated in a foreign jurisdiction. In such cases, a tool for rectifying the wrongdoing is naturally what most individuals and enterprises look for and in this case, the local judiciary is more often than not an unsatisfactory option.

What is more, the fact that resorting to local remedies makes good policy sense is not a reason to introduce it with legal interpretational tools. This is especially true when the interpretation is done by arbitrators. Good policy should be done by policy-makers, and in their absence, privately appointed tribunals should not step in their place.

As has been emphasized in this text, investor-State arbitration is a peculiar legal creature in the sense that private parties can arbitrate against foreign States without being party to the original arbitration clause. This is a delicate construction, one which should be treated with caution; especially given the critique against the powerful tools that are handed to corporations. Nevertheless, forcing investors to meet requirements that are not in the arbitration consent and that cannot reasonably be expected of them to anticipate, threatens to de-stabilize the entire investment arbitration scheme.

When it comes to local remedies' role in silent investment treaties, the text has shown that two countering interests are at stake and need to be balanced against each other: on one end is the investors' interest and those of an efficient arbitration system. On the other are opposing interests that are public in their nature and stress the host State's rights. All authorities would probably agree that the local remedies requirement should be applied

flexibly in the individual case, properly considering the interests involved and reaching a solution somewhere along this scale. As a general presumption, however, it is my view that the investor's right, flowing from the State concluding the treaty, should be prioritized over the public end of the scale. States negotiating BITs are free to include the rule in one shape or another, but in the absence of such an inclusion, agreeing to arbitration should definitely raise a presumption that the obligation to attempt at local remedies has been waived. This presumption might be altered by the merits of certain cases, but should nonetheless be regarded as an important principle, and anything else regarded as exceptions.

To argue differently would not only mean relying too heavily on outdated principles of international law but also second-guessing the intention of the treaty parties – the States that actively sought an alternative mean of dispute resolution. It would also mean undermining the purpose of arbitration in a wider sense, because any agreement to arbitrate, in order to function properly, necessarily must prorogate litigation. Thus any application of local remedies in investment arbitration should be done with great caution and understanding of the system's unique background.

The underlying premise for this conclusion, as it has been presented in the text, is the confrontation between two previously separate legal spheres: public international law and purely commercial disputes. This is a research field that has yet to be explored further. The discussion on whether or not the ICSID art 26-waiver of the local remedies should be valid given circumstance X and Z is interesting enough. Other arbitral rules, such as the UNCITRAL rules, and for that matter SCC, ICC and most other institutional arbitration regimes, were however drafted for commercial purposes. When these rules are applied in investor-State arbitration, the open question on local remedies is arguably only the tip of the iceberg of potential conflict areas. It feels appropriate to conclude this text with an urge for further research. The collision between commercial arbitral instruments and public international law has barely been subjected to scholar attention and there are arguably several aspects of this development, other than the local remedies rule, that would make an excellent area of study.

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