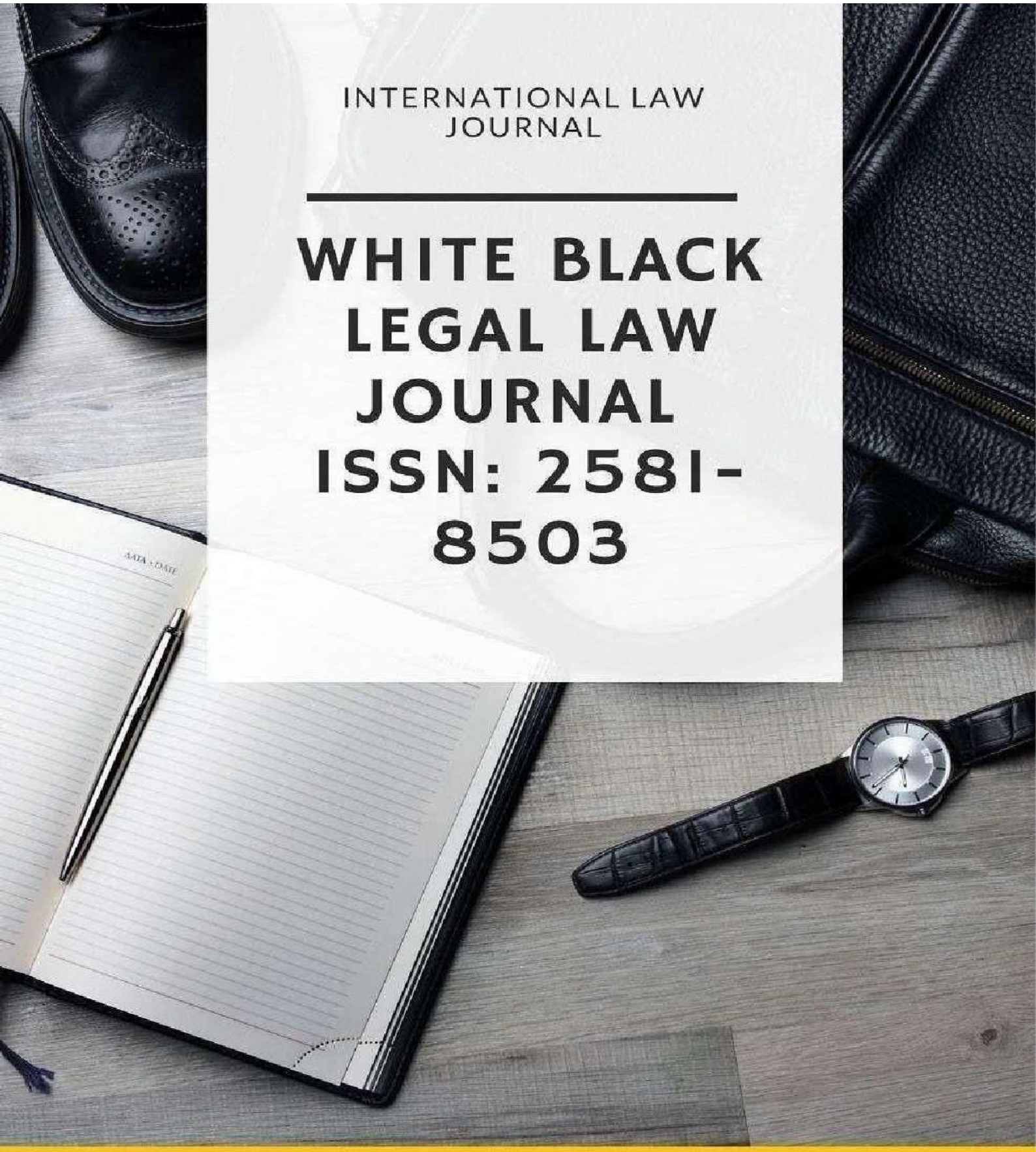


INTERNATIONAL LAW JOURNAL

WHITE BLACK LEGAL LAW JOURNAL

ISSN: 2581-8503

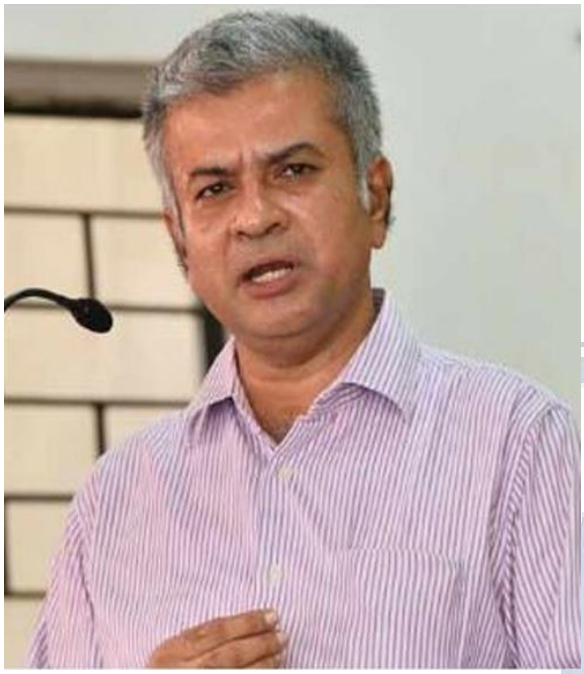
Peer - Reviewed & Refereed Journal

The Law Journal strives to provide a platform for discussion of International as well as National Developments in the Field of Law.

DISCLAIMER

EDITORIAL TEAM

Raju Narayana Swamy (IAS) Indian Administrative Service officer



Dr. Raju Narayana Swamy popularly known as Kerala's Anti Corruption Crusader is the All India Topper of the 1991 batch of the IAS and is currently posted as Principal Secretary to the Government of Kerala . He has earned many accolades as he hit against the political-bureaucrat corruption nexus in India. Dr Swamy holds a B.Tech in Computer Science and Engineering from the IIT Madras and a Ph. D. in Cyber Law from Gujarat National Law University . He also has an LLM (Pro) (with specialization in IPR) as well as three PG Diplomas from the National Law University, Delhi- one in Urban Environmental Management and Law, another in Environmental Law and Policy and a third one in Tourism and Environmental Law. He also holds a post-graduate diploma in IPR from the National Law School, Bengaluru and a professional diploma in Public Procurement from the World Bank.

Dr. R. K. Upadhyay

Dr. R. K. Upadhyay is Registrar, University of Kota (Raj.), Dr Upadhyay obtained LLB , LLM degrees from Banaras Hindu University & Phd from university of Kota.He has succesfully completed UGC sponsored M.R.P for the work in the ares of the various prisoners reforms in the state of the Rajasthan.

Senior Editor

Dr. Neha Mishra

Dr. Neha Mishra is Associate Professor & Associate Dean (Scholarships) in Jindal Global Law School, OP Jindal Global University. She was awarded both her PhD degree and Associate Professor & Associate Dean M.A.; LL.B. (University of Delhi); LL.M.; Ph.D. (NLSIU, Bangalore) LLM from National Law School of India University, Bengaluru; she did her LL.B. from Faculty of Law, Delhi University as well as M.A. and B.A. from Hindu College and DCAC from DU respectively. Neha has been a Visiting Fellow, School of Social Work, Michigan State University, 2016 and invited speaker Panelist at Global Conference, Whitney R. Harris World Law Institute, Washington University in St.Louis, 2015.

Ms. Sumiti Ahuja

Ms. Sumiti Ahuja, Assistant Professor, Faculty of Law, University of Delhi,

Ms. Sumiti Ahuja completed her LL.M. from the Indian Law Institute with specialization in Criminal Law and Corporate Law, and has over nine years of teaching experience. She has done her LL.B. from the Faculty of Law, University of Delhi. She is currently pursuing Ph.D. in the area of Forensics and Law. Prior to joining the teaching profession, she has worked as Research Assistant for projects funded by different agencies of Govt. of India. She has developed various audio-video teaching modules under UGC e-PG Pathshala programme in the area of Criminology, under the aegis of an MHRD Project. Her areas of interest are Criminal Law, Law of Evidence, Interpretation of Statutes, and Clinical Legal Education.

Dr. Navtika Singh Nautiyal

Dr. Navtika Singh Nautiyal presently working as an Assistant Professor in School of law, Forensic Justice and Policy studies at National Forensic Sciences University, Gandhinagar, Gujarat. She has 9 years of Teaching and Research Experience. She has completed her Philosophy of Doctorate in 'Intercountry adoption laws from Uttranchal University, Dehradun' and LLM from Indian Law Institute, New Delhi.

Dr. Rinu Saraswat

Associate Professor at School of Law, Apex University, Jaipur,
M.A, LL.M, Ph.D,

Dr. Rinu have 5 yrs of teaching experience in renowned institutions like Jagannath University and Apex University. Participated in more than 20 national and international seminars and conferences and 5 workshops and training programmes.

Dr. Nitesh Saraswat

E.MBA, LL.M, Ph.D, PGDSAPM
Currently working as Assistant Professor at Law Centre II, Faculty of Law, University of Delhi. Dr. Nitesh have 14 years of Teaching, Administrative and research experience in Renowned Institutions like Amity University, Tata Institute of Social Sciences, Jai Narain Vyas University Jodhpur, Jagannath University and Nirma University.
More than 25 Publications in renowned National and International Journals and has authored a Text book on Cr.P.C and Juvenile Delinquency law.

Subhrajit Chanda

BBA. LL.B. (Hons.) (Amity University, Rajasthan); LL. M. (UPES, Dehradun) (Nottingham Trent University, UK); Ph.D. Candidate (G.D. Goenka University)

Subhrajit did his LL.M. in Sports Law, from Nottingham Trent University of United Kingdoms, with international scholarship provided by university; he has also completed another LL.M. in Energy Law from University of Petroleum and Energy Studies, India. He did his B.B.A.LL.B. (Hons.) focussing on International Trade Law.

THE RULE OF EXHAUSTION OF LOCAL REMEDIES AND ITS EXCEPTIONS IN THE CONTEXT OF INTERNATIONAL INVESTMENT ARBITRATION

Shushaanth. S,
LL.M (ADR) Student at O.P.Jindal Global University,
Jindal Global Law School (2021-2022)

Abstract: It's an axiomatic fact that foreign investments are a sine qua non for the development and improvement of the financial and economic status of a country. Foreign investments are often made by a national of a State in another State through direct and indirect methods and in most cases the national is a company of a particular State. The concept of foreign investments has been prevalent for a long time in the international business practice. In the gamut of international investments, disputes, conflicts, grievances relating to investments between an investor and a contracting host state or vice versa are inevitable. The moot question which elicits a great deal of response in this juncture is where do such disputes relating to investments arising out of an international investment agreement or a Bilateral Investment Treaty get resolved. The customary rule in international law is to primarily exhaust the prescribed local remedies, which would be the judicial system of the contracting host state before the foreign investor could approach any international forums for adjudication of that dispute. Thus, this article would be an earnest endeavour to elucidate the mandatory or obligatory rule of exhaustion of local remedies (*hereinafter referred to as* "ELR") in the international investment scenario and address the quandary that exists in the application of this rule and further investigate if this customary rule could be eschewed under any circumstances and some of the exceptions to this rule.

Keywords: Local remedy, foreign investor, Investment disputes, Domestic courts, Exceptions

Introduction: - The ELR rule has been in existence for quite a long time and the rule was initially developed to be made applicable only to the traditional concept of diplomatic protection in

international law[1]. However, the application of this rule was later expanded to be made applicable to various areas of international law wherein the underlying objective was to insulate the sovereignty of the host state. Numerous States are now rethinking their stance with respect to this antiquated rule in the context of international investment agreements and BIT's, MIT's as the rule puts harsh obligations on the foreign investor to exhaust local remedies before resorting to international investment arbitration for dispute resolution[2]. Majority of the States incorporate the ELR rule in their BIT's mainly due to the fact that disputes that arise from an alleged breach of the investment treaty, mandatorily has to be adjudicated in the local courts of the host State which acts as a means to eschew escalations to International Forums. A notable example is this context is Clause 13.3 of the "Model Text for the Indian Bilateral Investment Treaty"[3]. On the contrary many States have now dispensed with this rule in their investment treaties as an advance consent is obtained to refer an investment dispute to international arbitration institutions like the ICSID for dispute resolution[4]. The dispensation of the ELR rule would place the foreign investors in a stronger position by allowing them to sidestep this mandatory rule and resort to ICSID for dispute resolution. Nevertheless, there are also States which have reincorporated the ELR rule in their BIT's and MIT's only to avoid being lugged into unnecessary acrimonious international arbitrations. It is imperative to note that for a State to espouse its national's claim in the international forum, the ELR prerequisite has to be satisfied.

The Question of Mandatory Rule of ELR: The rule of "ELR" which is most notably seen in areas of diplomatic protection and human rights law, refers to the basic requirement of an aggrieved party to approach the judicial forum of that State which caused such grievance for remedy before approaching an international forum[5]. The idea behind this rule is to allow the State that is responsible for the grievance to provide reparations on its own[6]. It is to be noted that the ELR rule is

[1] Martin Dietrich Brauch, "Exhaustion of Local Remedies in International Investment Law", (IISD Best Practices Series, January 2017), <https://www.iisd.org/system/files/publications/best-practices-exhaustion-local-remedies-law-investment-en.pdf>, Accessed on 15th May 2022.
[2] Matthew C. Porterfield, 'Exhaustion of Local Remedies in Investor-State Dispute Settlement: An Idea Whose Time Has Come?', (2015), Vol.41, The Yale Journal of International Law Online, <https://www.law.georgetown.edu/wp-content/uploads/2017/09/Porterfield-Exhaustion-of-local-remedies-2015.pdf> Accessed on 15th May 2022.
[3] Government of India, Model Text for the Indian Bilateral Investment Treaty, <https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf> Accessed on 15th May.
[4] See n.1.
[5] International Justice Resource Center, 'Exhaustion of Domestic Remedies', <https://ijrcenter.org/exhaustion-of-domestic-remedies/> Accessed on 18th May 2022.
[6] Ibid.

inescapable in human rights law[7]. However, in international investment law, the position of this rule remains nebulous and silent in certain aspects as some investment treaties expressly incorporate this rule in their BIT's and some do not[8].

In the event of an investment dispute between the host state and a foreign investor, the host state in most circumstances tends to invoke this rule unilaterally in order to protect its sovereignty and to avoid unnecessary escalations to the international forums. The preponderant trend in international investment practice has made the ELR rule non-derogable, and almost all BIT's that originated from the 60s to 90s have included ELR as a prerequisite before a dispute could be referred to international forums[9]. But from the mid 90's, a multitude of States have taken a lenient approach towards the inclusion of this rule in their BIT's and regard international arbitration as an alternative dispute resolution instead of mainstream traditional litigation[10]. Numerous BIT's now have an ISDS (Investor-State dispute settlement) clause in order to allow a foreign investor to use the ISDS mechanism to resolve their investment disputes with the contracting State directly in an international forum[11].

Even the internationally recognized Arbitration Rules such as UNCITRAL, ICC, SCC, LCIA, etc., lack clarity on the mandatory requirement of the ELR rule as the very object of framing these rules was to facilitate commercial arbitration and if the ELR rule is mandated as a precondition, the same would thwart the objectives of the commercial arbitration which is to avoid adversarial litigation and allow the parties to resort to international arbitration for dispute resolution[12].

"ELR" a Procedural or Substantial Requirement: There is a certain kind of apprehension that shrouds the question of ELR being a substantial requirement or a procedural requirement as in the context of international investment law. The rationale behind this rule in public international law is

[7] Convention for the protection of Human Rights and Fundamental Freedoms as amended by Protocol 15, Article 35 <https://rm.coe.int/1680a2353d) Accessed on 18th May 2022.
[8] See n.1.
[9] United Nations Conference on Trade and Development, Bilateral Investment Treaties, (1995-2006), 'Trends in Investment Rulemaking', ISBN 92-1-112710-6, <https://unctad.org/system/files/official-document/iteiia20065_en.pdf>, Accessed on 19th May 2022.
[10] Ibid.
[11] International Arbitration Report, Norton Rose Fulbright, (June 2017, Issue 8), <https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/imported/international-arbitration-review---issue-8.pdf?revision=16973aeb-ce33-4a2f-8885-cd14854c2e90&revision=16973aeb-ce33-4a2f-8885-cd14854c2e90>, Accessed on 19th May 2022.
[12] Dalibor Ribicic, 'Is Exhaustion of Local Remedies Procedural in Investment Treaty Arbitration', (Master's Thesis, Department of Law Spring Term 2020, Master's Program in Investment Treaty Arbitration, 15 ECTS), <https://www.diva-portal.org/smash/get/diva2:1435936/FULLTEXT01.pdf> Accessed on 20th May 2022.

to give an opportunity to the State where the violation occurs to redress the grievance by its own judicial system[13]. Though by virtue of customary international law the ELR rule is procedural and mandatory, in Investment Treaty Arbitrations (ITA) the rule is not given a mandatory procedural undertone, in order to enable the Tribunal to exercise its jurisdiction. Hence, in the absence of an investment treaty expressly mandating the ELR rule, the foreign investor can resort to the international arbitration for dispute resolution[14].

The quandary that exists in determining whether ELR rule is procedural or substantive is that if the rule is procedural, unless ELR is complied with, the claims made by the investor state would not be allowed in the international forums and even if it's admitted the same would disentitle the Tribunal to have jurisdiction on that dispute. And, if the ELR rule is substantive, international law would not be attracted unless the local remedies are exhausted[15].

As the principle of *Stare Decisis* does not perse exist in international law and Art. 59 of the ICJ Statute[16] clarifying that the decision of the Court would have binding effect only on the parties to that dispute, it would be appropriate to refer the decisions of the ICSID Tribunal only for the purpose of better understanding of this concept[17]. In *Elettronica Sicula S.P.A. (ELSI) (USA Vs. Italy)*[18] the ICJ in paragraph 50 opined that it was *"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"* and observed that the ELR rule was applicable even if it was not explicitly mentioned in the treaty.

ELR & ICSID CONVENTION: In this juncture it is pertinent to note that the second sentence of Art. 26 of the ICSID Convention refers to the concept of ELR which explicitly states that *"A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention"*[19], which on a plain reading would give the notion that the ELR rule is mandatory in order to enable the ICSID to have jurisdiction to

[13] Switzerland v. United States of America, 1959 I.C.J 6 (21st March), <https://www.icj-cij.org/public/files/case-related/34/034-19590321-JUD-01-00-EN.pdf>, Accessed on 20th May 2022.
[14] See n.12.
[15] Ibid.
[16] Statute of the International Court of Justice, <https://www.icj-cij.org/en/statute>, Accessed on 24th May 2022.
[17] Harlan G. Cohen, *'Theorizing Precedent in International Law'* (2015),(Digital Commons, University of Georgia School of Law), <https://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=2286&context=fac_artchop>, Accessed on 27th May 2022.
[18] Elettronica Sicula S.p.A. (ELSI) (Italy v. U.S.), 1989, I.C.J. Rep.15, Para 50, <https://www.icj-cij.org/public/files/case-related/76/076-19890720-JUD-01-00-EN.pdf>, Accessed on 27th May 2022.
[19] ICSID Convention, Regulation and Rules, Article 26. <https://icsid.worldbank.org/sites/default/files/ICSID%20Convention%20English.pdf>, Accessed on 27th May 2022.

adjudicate, however, the term used is "may" in the context of a contracting state requiring the ELR. The first sentence states that there is a need to ELR before approaching ICSID, unless the contrary is stipulated[20]. Hence, the first sentence of Art. 26 of the ICSID Convention made it clear that ELR was not required unless expressly stipulated in the Treaty and the second sentence addressed the waiver of this rule. In *Generation Ukraine v. Ukraine*[21] the Tribunal held that a ELR requirement in order to approach ICSID must be expressly mentioned in the treaty. However, in *Maffezini v. Spain*[22] the Tribunal by referring to Art. 26 of the ICSID Convention, observed that "the contracting State in the absence of a precondition to give its consent to ICSID arbitration on the prior ELR, no such requirement would be applicable". The Tribunal further opined that "Art. 26 reversed the customary international rule which implied that the ELR was not required unless it was expressly or implicitly mentioned as a requirement"[23].

Thus, it is apposite to state that Art. 26 of the ICSID Convention makes it amply clear that it provides an implicit waiver of the ELR rule and it is the prerogative of the contracting States whether to or not incorporate this rule as a precondition to approach the ICSID.

Exceptions to the ELR Rule: As observed in the preceding paragraphs, the ELR rule though cannot be jettisoned in diplomatic protection law, cannot be made applicable under every circumstance in the international investment law unless it is expressly or impliedly waived by the parties. It is to be noted that this customary international rule under certain exceptional circumstances can be bypassed without triggering negative consequences. When a claim is made by a foreign investor before an international arbitration forum without exhausting the local remedies, the forum may try to ascertain whether any of the exceptions could be made applicable in order to exercise its jurisdiction[24]. In other words, the burden is on the claimant to prove that the ELR rule would not be applicable to them.

Reliance can be placed on Article 15 of the Draft Articles on Diplomatic Protection 2006 for better

[20] Lanco International Inc. v. Argentine Republic, ICSID Case No. ARB/97/6, Preliminary Decision on Jurisdiction, Para. 37 (Dec. 8, 1998), <http://www.italaw.com/sites/default/files/case-documents/ita0450_0.pdf>, Accessed on 29th May 2022.

[21] ICSID Case No. ARB/00/9, Award, Para. 13.5 (Sept. 16, 2003). <http://www.italaw. com/sites/default/files/case-documents/ita0358.pdf>, Accessed on 30th May 2022.

[22] ICSID Case No. ARB/97/7, Decision on Objections to Jurisdiction, para. 22 (Jan. 25, 2000), <https://www.italaw.com/sites/default/files/case-documents/ita0479.pdf>, Accessed on 1st June 2022.

[23] Ibid.

[24] International Justice Resource Center, Exhaustion of Domestic Remedies in the United Nations System, (August 2017), <https://ijrcenter.org/wp-content/uploads/2018/04/8.-Exhaustion-of-Domestic-Remedies-UN-Treaty-Bodies.pdf>, Accessed on 2nd June 2022.

understanding of the exceptions to the ELR rule[25]. Nonetheless, the exceptions that are applicable in the international investment sphere are discussed in brief hereunder: -

i. **Futility:** When it is prima facie clear that the available local remedies would not provide any effective remedy or there is no reasonable possibility of a remedy in a domestic court, such futile remedies shall be used as an exception from the ELR requirement. In many cases the Tribunals have excused the foreign investors from ELR requirement even if it were to be expressly mentioned as a precondition to approach the international forums[26]. In simple terms when the foreign investor has a reasonable apprehension and proves that the local Courts of the contracting host State would not give any appropriate remedy or the local remedies would obviously be futile due to previous judgments, deliberate apathy on part of the host State or when there is a threat in exhausting the local remedy, then the Tribunals can excuse the ELR rule[27]. The task of determining and evaluating whether there was a possibility of obtaining appropriate remedy from the local courts is of the Tribunal's[28].

   In *Abaclat & Others v. Argentine Republic*[29], the Tribunal observed that in view of the emergency law in Argentina, which prohibited them from entering into settlement agreements, opined that none of the local remedies that were available would have been able to effectively resolve the dispute in 18 months and held that Abaclat's non satisfaction of the ELR requirement did not preclude them from approaching ICSID arbitration[30]. Similarly, in *Ambiente Ufficio S.P.A. & Others V. Argentine Republic*[31] the Tribunal by observing that the claimants did not have a "reasonable possibility of obtaining an effective redressal from the local courts", upheld the futility exception[32].

[25] Draft Articles on Diplomatic Protection, 2006, <https://legal.un.org/ilc/texts/instruments/english/draft_articles/9_8_2006.pdf>, Accessed on 2nd June 2022.
[26] Zachary Mollengarden, 'The Utility of Futility: Local Remedies Rules in International Investment Law', (2019), Vol. 58:405, Virginia Journal of International Law, <https://static1.squarespace.com/static/5f0a3654a47d231c00ccd14f/t/5f3fe9102231bd3bf52cded8/1598023952646/mollengarden_final-draft.pdf>, Accessed on 5th June 2022.
[27] See n.24
[28] See n.12
[29] ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, para. 247 (Aug. 4, 2011), <http://www.italaw.com/sites/default/files/casedocuments/ita0236.pdf>, Accessed on 6th June 2022
[30] Ibid.
[31] ICSID Case No.ARB/08/9, Decision on Jurisdiction and Admissibility <https://www.italaw.com/sites/default/files/case-documents/italaw1276.pdf>, Accessed on 6th June 2022.
[32] Ibid.

ii. **Undue Delays:** The ELR rule is not applicable when it is shown that there is an unreasonable inordinate delay in the adjudication process and in providing appropriate remedy and when the host State is responsible for that unreasonable delay. Undue delay can be taken as a valid ground for the exception of ELR. It is to be noted that there is no specific prescribed time period or any explicit definition of undue delay but some BIT's have an eighteen-month litigation requirement, beyond which the investor can freely approach the ICSID Tribunal. Again, the Tribunal has to determine this, based on the facts and circumstances of the case and by taking into consideration various factors such as the subject matter of the dispute, complexity and whether the State is responsible for the undue delay. In *TSA Spectrum de Argentina S.A. v. Argentine Republic*[33], the claimant after pursuing the local remedies for fifteen months, decided to approach the ICSID Tribunal, wherein there were objections to the non-completion of the eighteen-month litigation requirement, the Tribunal observed that "at that point of time it was most likely a satisfactory decision could have been obtained from the local courts of the host State, but in the absence of such decision at the national level, the Tribunal acknowledging the premature initiation of the ICSID proceedings, held that it would be highly formalistic to reject jurisdiction on the ground that eighteen-months requirement was not fulfilled completely and further held that such rejection would not prevent the initiation of new ICSID proceedings"[34].

iii. **Waiver of ELR:** As discussed earlier in one of the preceding paragraphs about the waiver of ELR, this exception takes a different approach from the customary requirement of the ELR in the sphere of diplomatic protection which mandates ELR into a broader approach in international investment law by allowing the investors to directly submit their disputes to the international forums. The waiver of ELR is usually mentioned in the treaty either expressly or impliedly. But in some cases, waiver of ELR has been determined even from the conduct of the States[35]. The waiver of ELR can be expressly made in the Treaty, priorly or if the dispute had already aroused, then through a separate written instrument like an Ad hoc arbitration agreement[36]. When an express waiver of ELR is absent but from the interpretation of the treaty or the Investment Agreement it could be inferred that the intention of the parties was to waive the ELR rule, then

[33] ICSID Case No. ARB/05/5, Award, paras. 108–112 (Dec. 19, 2008), <http://www.italaw.com/sites/default/files/case-documents/ita0874.pdf>, Accessed on 10th June 2022.
[34] See n.1
[35] See n.28
[36] Ibid

the same can also be considered as a waiver of the ELR rule[37]. An example of express waiver is the first sentence of Art.26 of the ICSID Convention which states that consent to ICSID arbitration from the parties will oust the ELR rule.[38]

Thus, the ICSID Tribunal considering the facts and circumstances of a dispute may apply one of the exceptions to a dispute in order to enable itself to exercise jurisdiction and adjudicate that dispute and thereby exempt the investor from complying with the customary ELR rule.

CONCLUSION: The sum and substance of the above discussions can lead us to the conclusion that the rule of exhaustion of local remedies in an international investment treaty/agreement is a double edged sword and at the same time it is understood that the contracting host state would require this customary rule to protect its sovereignty, on the other hand, the investor would have to exhaust the local remedies of the host State to enable the home State to provide diplomatic protection and to espouse its claims in the international dispute resolution forum. Further, from the decisions of the ICSID Tribunal it is clear that it is not always mandatory or obligatory for an investor to exhaust local remedies in order to resort to international arbitration. With respect to the question of exceptions to this customary rule, it appears that the Tribunal, depending on the facts and circumstance of the case can decide whether the local remedy rule can be exempted in order to exercise its jurisdiction. It is also observed that the exhaustion of local remedy requirement rule is being expressly and sometime even impliedly waived by the parties and international arbitration is resorted for dispute resolution directly by the parties. Hence, by virtue of Art.26 of the ICSID Convention and the other international arbitration rules which are silent on the local remedy requirement, it is felt that international commercial arbitration is gaining swift momentum which is an encouraging development in the international investment arena.

While it's the complete prerogative and discretion of the States to draft their own BIT's and other investment treaties or agreements, it is felt that if the ELR clause is not incorporated, the same may consequently attract many potential foreign investors and the foreign investments of that State to grow exponentially which would benefit the State and would also provide the investor a comfortable ground to do their business and certain levels of protection against expropriation and discrimination. Thus, if the parties waive the ELR requirement clause in the investment treaty and refer the dispute to international arbitration, the investor and the host state can both be benefitted.

[37] Ibid
[38] See n.19

WHITE BLACK
LEGAL