Exhaustion of Local Remedies in Bilateral Investment Treaties—A Guide for Foreign Investors

Foreign investors perceive exhaustion of local remedies in the Host State as a hurdle before initiating an investment treaty claim. This article assesses factors foreign investors or Host States must consider while negotiating a local remedies clause in investment contracts or BITs. It briefly refers to the current dispute resolution regime in India, and highlights the importance of building effective judicial courts and specialized national investment courts to resolve investor-State disputes.

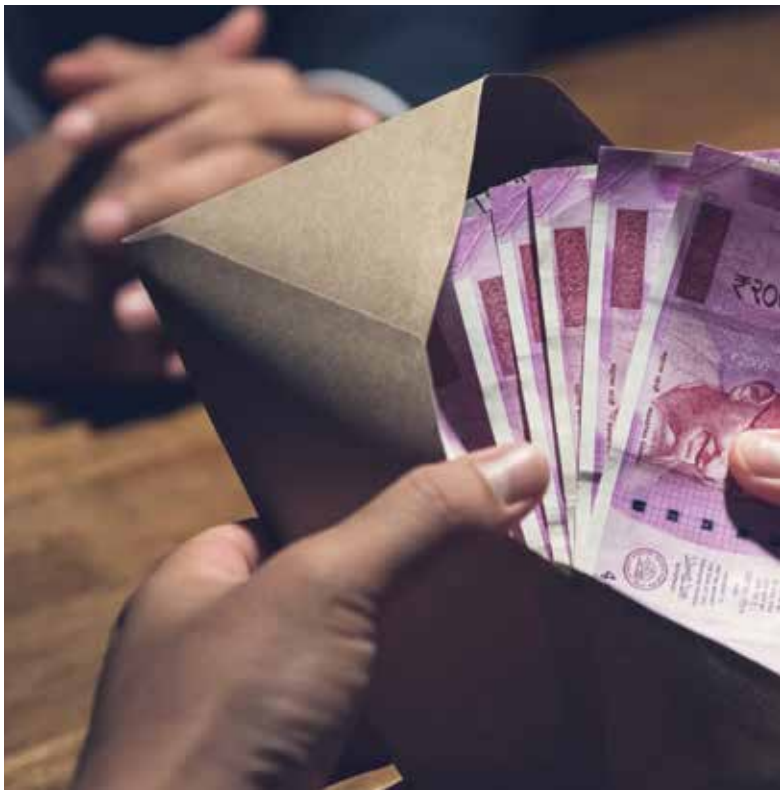
Introduction

Foreign investors contemplating a bilateral investment treaty ('BIT')[1] claim against the Host State occasionally face a clause requiring them to resort to local remedies. Some present-day BITs mandate pursuit of local remedies (administrative, judicial or both) in the Host State for a certain period of time, before commencing international arbitration. Very few age-old BITs require exhaustion of local remedies for an indefinite time, as opposed to pursuit of local remedies for a certain duration. Various BITs treat local remedies clauses differently, some even expressly waiving the local remedies rule. To a foreign investor, it is therefore important to examine if the stairway to international arbitration is built on steps such as cooling off periods and resort to local remedies. This is more so for countries like India and Argentina that have suffered a huge onslaught of investment disputes under BITs; it is a crucial decision to vest jurisdiction over BIT disputes in their own administrative or judicial bodies, at least as a first step.

India tops the list of countries standing as Respondent in investor-State disputes, with more than 15 investment treaty claims filed against it. The majority of its disputes are pending before international arbitral tribunals. The impact of an investment treaty claim is more significant on a country that is adopting critical regulatory measures, making ground-breaking economic decisions to revamp its national landscape and making an international footprint.

This is possibly the reason why India has revamped its investor-friendly regime of the past two decades by unilaterally terminating several BITs and introducing a new Model BIT in 2016—with an exhaustive 'local remedies' clause. The clause requires the investor to first submit its claim before the relevant domestic courts or administrative bodies and exhaust all judicial and administrative remedies relating to the measure underlying the claim for at least a period of five years before initiating international arbitration proceedings.

This article sets out the significance of local remedies as a mark of investment attractiveness for the Host State. At a bilateral State level, it evaluates the gains and pitfalls of adopting a local remedies clause in a BIT. For foreign investors and Contracting States, this article assesses factors to be considered while negotiating a local remedies clause under investment contracts or BITs. It briefly refers to the current dispute resolution regime available to foreign investors in India. While doing so, it highlights the importance of building effective judicial courts and specialised national investment courts to resolve investor-State disputes.



Local Remedies: Snapshot of State's Legal Environment

The legal framework of a Host State is a sum of its laws, rules and regulations, public administration, dispute resolution mechanism, execution or enforcement machinery and the international obligations of the Host State. Transparency and due process in introducing legislative changes and enacting legislation, in addition to political will and macro-economic factors, help determine the stability of the legal framework of the Host State.

The state of local remedies provided by a host State through its administrative and judicial bodies is a critical determinant for foreign investors to invest in a State. The majority of investment operations entail working with administrative bodies of the Host State (for site-related aspects, approvals, registrations and functions, among others). These administrative bodies often carry out governmental functions or are considered instrumentalities of the Host State acting under their direction or control. Their acts are often attributable to the Host State. Local administration therefore plays an important role in day-to-day operations of a foreign investor. Further, certain primary redressal mechanisms are also vested in administrative bodies and tribunals.

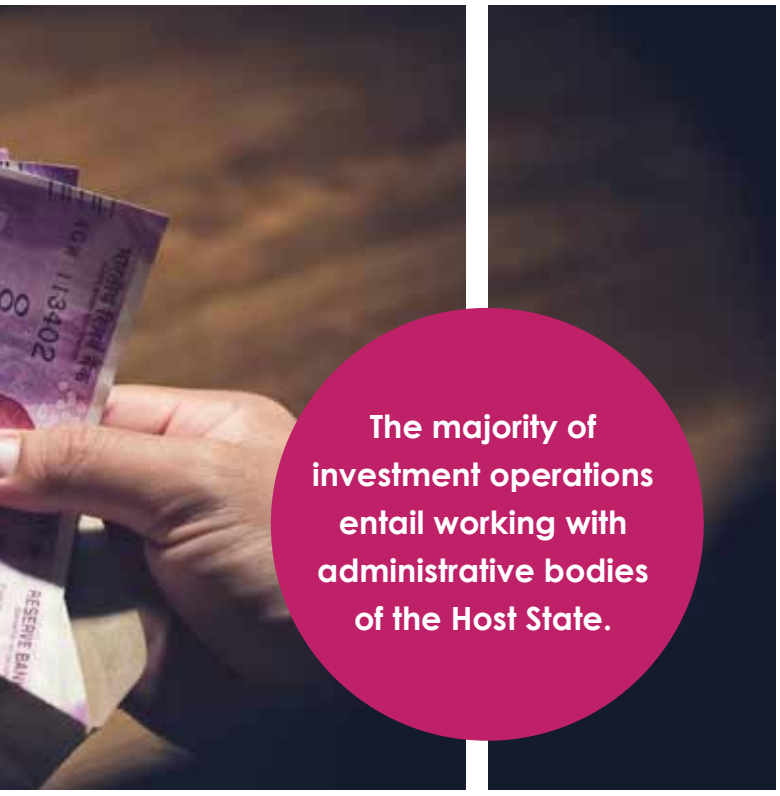
Domestic courts and the judicial appellate machinery constitute an important part of the judicial legal framework. The enforcement machinery of the Host State plays a critical role in assuring finality and culmination of judicial decisions and proceedings. Local remedies shape the legal environment and help in assessing the time and costs involved in adjudication of disputes—thereby informing the decisions of foreign investors.

In addition, a foreign investor may also keep sight of the international obligations of a Host State, the nature of international treaties it has signed and the international conventions of which it is a part. These obligations form a part of the international legal framework of the Host State and play an important role in informing the foreign investor of a State's outlook towards other nations and international issues.

Contracting States: To Resort or Not to Resort to Local Remedies

Resort to local remedies comes with several advantages and disadvantages. The issue is a matter of debate for Contracting States.

This customary international law rule of exhaustion of local remedies aims at safeguarding state sovereignty. For the Host State, the number of disputes and quantum of claims awarded in international arbitration can be catastrophic for the public exchequer. Host States find comfort in believing that it is safer to place the fate of the public exchequer in the hands of its local courts than with an international arbitral tribunal. It is assumed that local courts are in a better position to fully understand the exigencies of a nation, its public needs and the nuances involved while adopting regulatory measures, as opposed to an international arbitral tribunal.



A certain degree of subjectivity may also be assumed. In addition, pursuit of local remedies, particularly for a certain period of time, offers time to the Host State to evaluate its options prior to initiation of international arbitration. Put in reverse, it results in delaying international arbitration and the resultant award. Resort to the local remedies rule can therefore, in practice, be a tactical decision for the Host State. This may also compel the foreign investor to incur greater legal costs and expenses.

However, this may also be disadvantageous for the Host State. Adjudication of an international investor-State dispute before domestic courts of a country opens the dispute to the public eye, in contra-distinction to confidential international arbitration. Foreign investors would be wary of being a party to tiresome litigation which may, during its course, open a can of worms or damage goodwill and reputation. More importantly, it can have an adverse impact on the global image of the Host State—thereby affecting its attractiveness for foreign investment.

Further, local courts often apply domestic law as opposed to international law. The domestic law of a country may not be sufficient or at the level of international law to protect the interests of foreign investors. We are witnessing an era where international investment law constitutes *lex specialis*. General, non-special domestic law may not rise to the level and sufficiency of protection and standards offered by the specialised body of international investment law.

Negotiating a Local Remedies Clause in Investment Contracts and BITs: What to consider

Negotiation skills, conversationally called 'bargaining powers', of the parties shape the contours of a treaty. A treaty or an agreement is a product of negotiation—the strength of its provisions being a factor of good or bad negotiation. A local remedies clause can be incorporated either in an investment contract between the foreign investor and the State agency or in a BIT.

For a Contracting State that is relatively developed and more often a capital-exporting State, it is crucial to understand the impact of a local remedies clause on its investors in the capital-importing Host State. While the traditional gaps between the two sets of countries has now been minimised, certain strongholds remain in the world with respect to making or accepting foreign investment. While one State moves forward to compel the foreign investor or another State to adopt a local remedies clause under the investment contract or the BIT respectively, it is essential to consider a range of factors before forming a decision and shaking hands.

First, the foreign investor or the Contracting State must assess the 'ease of doing business' in the Contracting State and examine its regulatory framework. These serve as stepping stones to provide a bird's-eye view on the procedural and administrative efficacy of the Contracting State. The quality of administration, that is, the working of administrative bodies in a country helps assess the ground-level realities with respect to operation of the investment activity, among other functions. Administrative or quasi-judicial bodies engage in a series of functions relating to establishment and conduct of investment. The common functions include grant, termination or renewal of licenses, permits, tax assessment and demands.

The quality of administration has a close bearing on subsequent local remedies available to investors in the event an administrative or quasi-judicial measure contravenes the law or violates the investor rights. The

next step in the ladder is to examine the quality of administrative redressal mechanisms. Every violation by a public body does not witness court adjudication. Specialised administrative tribunals provide specific remedies to the aggrieved investors. It is important to assess whether the tribunals can be approached with ease, work in a time-bound manner, have certain stable procedures, follow procedures efficiently and deliver effective decisions while resolving administrative disputes.

The judicial machinery of the Contracting State plays a key role in informing the decision on adopting a local remedies clause. Certain pertinent questions are: whether it is simple to understand and distinguish between the jurisdiction of courts in the Contracting State (helps reduce parallel proceedings); what is the hierarchy of courts (to understand levels of appeal); and what is the scope of preferring an appeal (to understand grounds and extent of review). Other important factors are the legal costs and expenses involved in a litigation in the Contracting State. The time normally consumed in the investor-State dispute litigation is a critical factor, considering the value of investments at stake, the losses being caused and the consequent erosion of expected economic benefit.

The quality of judges will also matter. Investor-state disputes before local courts will demand the need for specialised and trained judges who have a sound understanding of commercial disputes. The execution machinery in the Contracting State, its laws on execution of administrative and judicial decisions, the hurdles in terms of public policy or grounds objecting to execution and the timelines involved in final execution, are important factors.

Another important, perhaps the most significant factor, is the strength of national law governing the investment. A body of laws that are incoherent or inconsistent with each other or are volatile and subject to constant change and conflicting interpretation, can reduce confidence in the legal framework of the Host State, standing on the edge of instability. Thus, it is relevant to consider if the Host State maintains a *judicial constante* that forges uniformity of interpretation and application of its laws.

A Host State's outlook towards international treaties and conventions throw light on its commitment to fulfil international obligations and assume the responsibility of a global player. While it may appear that the aforesaid may not affect the local remedies in the Contracting State, it is essential to note that a country party to several international treaties and conventions will normally be expected to have a legal framework and a judiciary that respects and furthers the international obligations assumed by the State.

Further, the other provisions of a BIT itself offer factors to inform the decision to adopt or reject a local remedies clause in the investment contract or the BIT. Presence of a most-favoured nation ('MFN') clause can help a foreign investor to wriggle out of the local remedies clause—if the local remedies clause is absent in other treaty (ies) between the Host State and other State(s). A denial of benefits clause can have the opposite impact. An effective means for dispute resolution in another treaty may be imported by way of an MFN clause. A forum selection clause in an investment contract that refers disputes to local courts may compel investors to resort to local remedies—this in turn being dependent on several other factors such as the basis of the dispute, umbrella clauses, approach of tribunals in elevating contract claims, etc. A fork in the road leading to choice of local remedies will foreclose the ability of the investor to initiate international proceedings. Thus, these factors can play a significant role in negotiating a local remedies clause.

India Model BIT: Peculiar Local Remedies Clause

India's initial investor-friendly approach to investment treaties started undergoing a sea-change after the case of *White Industries*[2] in 2011. It is not surprising to note that the White Industries case entailed an investment treaty award against India under the India-Australia BIT for failure to provide effective means of dispute resolution to *White Industries*—after enforcement of an international commercial award in favour of White Industries remained pending in Indian courts for nine years. Thereafter, several cases were filed against India between 2011 and 2016. As a result of the growing surge of BIT claims, India unilaterally terminated several BITs in 2016.

In 2016, India introduced a Model BIT with an exhaustive chapter on 'Settlement of Disputes between an Investor and a Party'. This chapter contains the most peculiar dispute resolution provisions in a BIT so far.

The road to investment treaty arbitration under the 2016 India Model BIT is extremely long and exhausting for the foreign investor—in as much as the investor is required to exhaust local remedies before the relevant domestic courts or administrative bodies of the Defending Party in respect of the same measure or similar factual matters for which a breach of BIT is claimed. If, after exhausting all judicial and administrative remedies for at least a period of five years, the investor may commence international arbitration proceedings by transmitting a notice of dispute to the Defending Party. This five-year period for exhaustion of local remedies is absolutely onerous and regressive. It deviates from the equivalent international standard term of three to 18 months.

However, a silver lining appears for the foreign investor. The requirement to exhaust local remedies is not applicable if there are no available local remedies that can provide relief with respect to the relevant measure. Accordingly, the onus to demonstrate non-existence of an appropriate domestic remedy lies on the foreign investor.

Strengthening Local Remedies: Investor Versus India

Are Indian courts better equipped to handle BIT disputes in the present-day than they were during *White Industries*? The India Model BIT, 2016 may appear to protect the State but the changed Indian judicial system has geared up to protect investors and commercial players. In the last two years, significant efforts have been made by the Indian legislature and judiciary in providing effective and efficient dispute redressal machinery for commercial disputes. In 2015, India enacted the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act ('Commercial Courts Act') to cater to commercial disputes of a specified value, create special courts to adjudicate and amend civil procedure for speedy and efficient disposal of commercial matters. A commercial dispute[3] includes disputes related to transactions of the nature of dealing in mercantile documents, partnership agreements, intellectual property rights, joint ventures, shareholders agreements or exploitation of natural resources.

The judicial machinery of the Contracting State plays a key role in informing the decision on adopting a local remedies clause.

The Commercial Courts Act provides an express explanation while defining commercial disputes. It also provides that a commercial dispute shall not cease to be a commercial dispute merely because one of the contracting parties is the State or any of its agencies or instrumentalities or a private body carrying out public functions. The explanation clearly envisages governmental contracts and disputes arising therefrom to be commercial disputes. A typical investor-State dispute would fall under the ambit of a commercial dispute. Considering the high stakes often involved in such disputes, they would certainly fulfil the threshold of 'specified value' of INR10,000,000 (approximately USD155,000) to fall within the jurisdiction of commercial courts.

The special courts include Commercial Courts (at the District Court level), Commercial Division (where original jurisdiction vests in the High Court) and Commercial Appellate Division (established in the High Courts to hear appeals from Commercial Courts and Commercial Division). Commercial courts have already started functioning under the jurisdiction of the Delhi High Court, Bombay High Court, Himachal Pradesh High Court and the Gujarat High Court. Further, the Commercial Courts Act provides for appointment of more judges with special expertise in handling commercial disputes; to ensure adequate and continuous training facilities for the judges. Further, the Act significantly curtails scope and time for appeals, in addition to amending the Code of Civil Procedure, 1908 for time and cost-efficiency.

Conclusion

The decision to include a local remedies clause in an investment contract or a BIT is difficult. However, once incorporated, it is incumbent upon the Host State to strengthen its investor-State dispute resolution machinery. It is quintessential that administrative and judicial bodies of the Host State build expertise and commercial knowledge to effectively adjudicate upon BIT claims. It is also critical to develop a bar having specialisation in investment treaty law to assist the foreign investors, Host States and the judiciary.

The enactment of the Commercial Courts Act in India is a welcome example. While its provisions are optimistic, efforts will have to be taken both by the judicial bodies and the bar to help the provisions see the light of the day. On similar lines, the author proposes that national investment courts must be established in countries (for India, in cities such as New Delhi and Mumbai), manned by expert judges with sound commercial acumen and knowledge of international investment treaty law—to effectively adjudicate upon claims arising out of BITs. This will go a long way in promising sound local remedies to foreign investors.

Notes:

[1] 'Bilateral Investment Treaties are agreements that protect investments by investors of one state in the territory of another state. These treaties articulate substantive rules governing the host State's treatment of the investment, and establish dispute resolution mechanisms applicable to alleged violations of those rules': 41 *Harv. Int. L.J.*469, 469-470 (2000).
[2] *White Industries Australia Limited v The Republic of India*, Final Award, 30 November 2011 ('White Industries').
[3] Section 2 (c) of the Act.

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