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Futility Exceptions to Local Remedies Rule in ISDS Proceedings:

Rethinking Futility Exceptions to Strike a Balance between State Sovereignty and Foreign Investor Protection

ISDS 개시를 위한 국내 구제절차 무용화 예외 – 국가 주권과 외국인 투자자 보호간 균형점 확보를 위한 '무용화 예외'의 재검토

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Abstract

The globalization of the economy has accelerated the development of international investment, which in turn this development has led to a surge in the number of international investment disputes. The disputes here generally refer to the ones between Foreign Investors and the Host State, that are mainly settled by Investor-State Dispute Settlement mechanisms, for instance, ICSID, UNCITRAL, etc., in which the local remedies are generally initiated prior to international arbitration. In recent years, there are some cases successfully circumventing the prior local remedies to recourse to international arbitration through futility exception to local remedies, which have sparked lots of controversies. The futility exception has been used as general rules to achieve specific purposes. What's more, misuse of futility exception undermines state sovereignty to a great extent. This thesis will focus on the issue of futility exception to local remedies from the perspectives of theory and practice, and try to find viable solutions to mitigate this problem in order to strike a balance between state sovereignty and foreign investment against the backdrop of balanced IIAs.

Keywords: ISDS, local remedies, futility exception, treaty interpretation, state sovereignty, balance

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Table of Contents

List of Acronyms and Abbreviations

BIT	Bilateral Investment Treaty
BLEU	Belgium-Luxembourg Economic Union
BRICS	Brazil, Russian Federation, India, China, South Africa
DSU	Dispute Settlement Understanding
ECHR	European Court of Human Rights
ECT	Energy Charter Treaty
FTA	Free Trade Agreements
ICC	International Chamber of Commerce
ICCPR	International Covenant on Civil and Political Rights
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
ISDS	Investor State Dispute Settlement
MFN	Most Favored Nation
NAFTA	North American Free Trade Agreements
SADC	Southern African Development Community
SCC	Stockholm Chamber of Commerce
TIP	Treaties with Investment Provisions
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNCTAD	United Nations Centre for Trade and Development

UK	United Kingdom
UNCLOS	United Nations Convention on the Law of the Sea
US	United States
USA	United States of America
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

Chapter 1. Introduction

1.1 Study Background

From the 19th century, developed countries have developed an overseas investment road all over the world funded by aggressive capitalism.[1] At that time, local remedies and diplomatic protection were the two main approaches to settle disputes if the foreign investors suffered damage in the host state.[2] After World War II, the new world order was established, not only politically, but also economically and in other fields.[3] Under the initiative of the World Bank and western developed countries,[4] the ICSID was born in 1965 based on the ICSID Convention providing that the investor as an individual could resort to an international tribunal against the Host State for remedies.[5] Afterwards, together with UNCITRAL rules,[6] and other arbitration rules,[7] the ISDS mechanism gradually matured, making the investors' subject position clearer in International Investment Law and aiming to protect foreign investment and the interests of investors.[8] With the development of the global economy and the further opening-up of global markets, IIAs and BITs have been springing up worldwide. The ISDS mechanism has been widely accepted and most of the BITs have incorporated ISDS provisions. So far, the number of BITs signed has been up to 2844, while the number of TIPs

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[1] YU JINSONG, INTERNATIONAL INVESTMENT LAW, 2 (Law Press, 5th ed. 2018).
[2] A. A. Cancado Trindade, *Origin and Historical Development of the Rule of Exhaustion of Local Remedies in International Law*, 12 REV. BDI 499, 514-15(1976).
[3] *See* FANG LIAN QING, GUOJIGUANXISHI 国际关系史 (POST-WWII), (Peking University Press, 1st ed. 2016).
[4] *See* ICSID PUBLICATION, HISTORY OF THE ICSID CONVENTION, VOL. I, (Washington D.C., 1970).
[5] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereinafter the ICSID Convention), March 18, 1965, https://icsid.worldbank.org/resources/rules-and-regulations/convention/overview (last visited July 19, 2021).
[6] UNCITRAL Arbitration Rules, General Assembly Resolution 31/98, https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/arb-rules.pdf. (last visited July 19, 2021).
[7] *See e.g.,* NAFTA Investor-State Arbitrations, (July 19, 2021, 12:11 PM), https://www.state.gov/nafta-investor-state-arbitrations/; *See also* Investment arbitration under the Energy Charter Treaty, https://www.energycharter.org/what-we-do/dispute-settlement/overview/. (last visited July 19, 2021).
[8] *See e.g.,* Netherlands-Sudan BIT(1970); Germany-Haiti BIT (1973); Sri Lanka-U.K. BIT (1980); Austria-Turkey BIT(1988); Canada-Poland BIT (1990); China-Hungry BIT(1991); Gerogia-U.S. BIT(1994); etc. UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements.(last visited July 19, 2021).

is 420.[9] Diplomatic protection as the main approach of protecting aliens' rights and interests before has been retired to the backstage.[10] Simultaneously, the traditional exhaustion of local remedies has gradually lost its exhausted characteristic, replaced by non-exhaustive local remedies presented as non-exhaustive local remedies provisions provided in IIAs, such as "Fork-in-Road", "No-U-Turn", "Waiting period", etc.[11] However, there is a downside to all of this.

The development of international investment and the ISDS mechanism triggered a surge of international investment disputes, especially during the Financial Crisis of 2008.[12] Due to the Crisis, Argentina ranked first as the Respondent State in international investment arbitration.[13] In order to resist the influence of the Host State, different tactics have been adopted to circumvent the non-exhausted local remedies provisions in practice.[14] One of the frequently invoked exceptions is the futility exception. Nevertheless, some claims of futility by investors have been accepted by the International Tribunals, however, these claims have gone against rules of International Law. The inconsistent rulings of tribunals also led to diametrically opposite decisions which have been highly charged. Misuse of futility exception has resulted in some negative consequences. Above all, the sovereignty of the Host State has been undermined.[15] Misuse of futility exception has allowed the investors illegitimately evade the local remedies available in IIAs and seek remedies from international tribunal directly. Without local remedies, the Host State lost its sovereign right to give adjudications

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[9] UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements (last visited July 13, 2021).

[10] John R. Dugard, *Historical Context of Articles on Diplomatic Protection* (2006), United Nations Audiovisual Library of International Law, https://legal.un.org/avl/ha/adp/adp.html (last visited July 19, 2021).

[11] *See* Tomoko YANASHITA, *Investors in the Formation of Customary International Law-An Insight from the "Futility Exception" to the Local Remedies Rule in Investor-State Arbitration*, 9-16, Melland Schill Perspectives on International Law, Manchester University Press, 2018.

[12] Jeffrey P. Commission, *The Global Financial Crisis and International Investment Regimes*, 104 AM. SOC'Y INT'L L. PROC. 443, 444-45 (2010).

[13] *Id.*, at 446.

[14] *See* 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 (last visited July 19, 2021).

[15] *See* Zachary Mollengarden, *The Utility of Futility: Local Remedies Rules in International Investment Law*, 58 VA. J. INT'L L. 403 (2019).

through its own legal system.[16] So far, the ISDS mechanism has received lots of criticisms and doubts are arising around it, both from practitioners and academia. Aside from the withdrawals of Bolivia, Venezuela and Ecuador from ICSID reflects negatively on the whole mechanism.[17] The United States and the Western European countries, who had been the proponents of the whole mechanism are now against it. In 2017, 230 Law and Economics professors in the United States urged President Trump to remove ISDS from NAFTA and other pacts.[18]

1.2 Problem Identification

In the past two decades, some investors have tried to circumvent the prior local remedies requirement provided in IIAs through different approaches.[19] One of the most common approaches is invoking the futility exception. Futility exception, in simple terms, means that requirement of local remedies need not be complied with since the local remedies are futile.[20] Exceptions should be applied only under extraordinary circumstances, while most of the futility claims acquired support from the Tribunals.[21] Additionally, the overuse of the futility exception helps the investors evade the local remedies provisions, at the same time, the direct initiation of international investment arbitration corresponds to the tendency of the tribunal to expand its jurisdiction.[22] The misuse of futility exception has undermined the sovereignty of

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[16] C.F. AMERASINGHE, LOCAL REMEDIES IN INTERNATIONAL LAW, 61 (Cambridge, 2nd ed. 2004) (1990).

[17] Clint Peinhardt and Rachel L. Wellhause, *Withdrawing from Investment Treaties but Protecting Investment, Global Policy* (2016), http://www.rwellhausen.com/uploads/6/9/0/0/6900193/10.1111_1758-5899.12355.pdf (last visited July 19, 2021).

[18] *230 Law and Economics Professors Urge President Trump to Remove Investor-State Dispute Settlement (ISDS) From NAFTA and Other Pacts*, https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/2017%20Letter%20to%20Pres.pdf (last visited July 19, 2021).

[19] Ye Yuting, *Dilemma and Solutions of the Jurisdiction in the "Belt and Road" Investment Arbitration Dispute Settlement Mechanism*, 106 ARBITRATION IN BEIJING 5, 6-8, (2018).

[20] *See e.g., Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (2001)*; Link-Trading Joint Stack Company* v. Department for Customs Control of the Republic of Moldova (2001); *Ronald S. Lauder v. The Czech Republic* (2001); *Siemens A.G. v. The Argentina Republic* (2004); *Abaclat and Others v. The Argentina Republic* (2011), *Urbaser S.A. and Consorcio De Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentina Republic* (2012), etc.

[21] *Id.*

[22] Giulia D'Agnone, *Recourse to the Futility Exception within the ICSID System: Reflections on Recent Developments of the Local Remedies Rule*, 12 LAW & PRAC. INT'L CTS. & TRIBUNALS 343, 363(2013).

host states, not only judicially, but also in the area of legislation and administration.[23] The protection of foreign investment should not be achieved at the cost of undermining state sovereignty.

With the background as mentioned above, the author would argue that the futility exception has been misused in ISDS, resulting in the undermining of state sovereignty of the host state. The following questions would be answered in this thesis:

- Has the futility exception been misused?
- What are the consequences of misuse of the futility exception?
- What are the reasons for the misuse?
- How to mitigate the misuse to achieve a balance between state sovereignty and foreign investment?[24]

1.3 Objectives

Through legal analysis of my topic, this thesis is trying to confirm the that futility exception to local remedies has been misused, making the applications illegitimate, and then find the causes which generate the misuse of futility exception.

When referring to objectives, considering the nature and applications of the futility exception, the overarching objective of this thesis is to identify a reasonable and viable standard among the three highly disputed standards provided by Special Rapporteur John R. Dugard[25] to mitigate the problem. If not, formulating a new approach that has both a theoretical basis and an easy application method.

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[23] *See e.g.,* AMERASINGHE, *supra* note 16; *See also* Julia G. Brown*, International Investment Agreement: Regulatory Chill in the Face of Litigious Heat?,* 3 WESTERN J.LEGAL STUD.1 (2013).

[24] *See* Yu Jinsong, *Research on the Balance of Rights and Interest Protection between Investors and Host Countries in International Investment Agreement Arbitration*, 2 CHINA LEGAL SCIENCE 132, (2011); *See also* George K. Foster, *Striking a Balance between Investor Protections and National Sovereignty: The Relevance of Local Remedies in Investment Treaty Arbitration*, 49 COLUM. J. TRANSNAT'L L. 201 (2011), etc.

[25] *See* Special Rapporteur John R. Dugard , *Third Report on Diplomatic Protection,* (International Law Commission, DOCUMENT A/CN.4/523 and Add.1, March 7, 2002).

Further, with the help of case studies that probes into the illegitimate issues related to the futility exception in investment arbitration, proposals to remedy the misuse of the futility exception will be provided to balance the main core interests -- state sovereignty and foreign investment.

1.4 Scope and Time Frames of the Research

Generally speaking, the damages that aliens may suffer are mainly twofold -- person and property[26], which later developed into human rights and investment protection. The scope of the thesis is limited to investor-state dispute settlement in the field of International Investment Law, and the focus is on futility exception to local remedies in ISDS mechanism.

With respect to the timeline, the scope of the research is twofold. The first part is the futility exception to local remedies in modern history, mainly from 1930 when the Hague Conference for the Codification of International Law was held[27] to 1965 when the ICSID Convention was ratified.[28] Discussion regarding this period mainly focuses on the historical aspect of the futility exception. Subsequently, the period from 1965 to the present day focuses on the contemporary development of investment disputes and their settlement. The latter is accorded more importance due to the fact that the theme that forms the core of this thesis developed exponentially during this period. Especially the recent thirty years are the core duration, in which a raft of investment disputes have taken place and jurisprudence has changed a lot. Certainly, even if analyzing the contemporary cases, the cases and viewpoints that took place before 1965, such as the early PCIJ cases and ICJ cases, are also taken into consideration to present a better idea of the development relevant to the topic of the thesis.

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[26] LEAGUE OF NATIONS, ACTS OF THE CONFERENCE FOR THE CODIFICATION OF INTERNATIONAL LAW, Vol. I, 43, (Plenary Meetings, Series of League of Nations Publications V. Legal. V. 14. 1930).
[27] *Id.*
[28] The ICSID Convention, *supra* note 5.

1.5 Research Methodology

To solve the problems we have identified and achieve the objectives we have set, different methods should be adopted in this thesis, including but not limited to the following ones.

1.5.1 Primary Sources

Primary sources are generally legislative law and case law, mainly from the official bodies.[29] In this thesis, the related primary sources included IIAs, BITs, TIPs, domestic statutes and regulations, decisions of the international arbitration tribunals, and decisions of the domestic courts, etc. These sources are also the main sources of this thesis, underlying the explanations, viewpoints, and arguments.

1.5.2 Secondary Sources

Secondary sources are background resources to explain, interpret and analyze the primary sources, mainly including encyclopedias, law reviews, treatises, restatements.[30] Concerning this thesis, the secondary sources are ILC reports of draft articles by special rapporteurs, treatises on International Law, treatises on International Investment Law, law reviews on local remedies, articles on futility exception, encyclopedias, etc. Additionally, empirical analysis is not necessary, but this thesis may invoke empirical analysis in the prior literature to support the arguments.

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[29] International Law and Organizations: *Primary and Secondary Sources*, Tufts University Libraries, https://researchguides.library.tufts.edu/international-law (last visited July 10, 2021).
[30] *Id.*

Chapter 2. Overview of the Futility Exception Issue

2.1 The History of Futility Exception

This section will present a historical overview of the futility exception. From inception, to taking shape, to an authoritative formulation, the evolution of futility should not be analyzed in a vacuum. Additionally, an insight into the competing interests and the policy considerations behind it will also be provided.

2.1.1 Origination from 1930 Hague Conference

To promote the development and codification of International Law, under the initiative of the League of Nations, the League of Nations Codification Conference was held in 1930 in Hague.[31] "Responsibility of States for Damage caused in their Territory to the Person or Property of Foreigners" was one of the agendas which were highly discussed.[32] The Conference focused on the responsibility of the Host State in the event of aliens suffering from damage, whether in person or in property. The delegates from various nations reached a consensus at the Conference on the exhaustion of local remedies.[33] The exception of local remedies also came up for discussion, which was proposed as "special circumstances that may ... justify exceptions to this rule".[34] The presentation triggered heated discussion on this issue. Some delegates contended the "obvious neglect of the foreigner's right",[35] while someone else argued that only the local remedies were "effective and meet the requirement of justice"[36] should the rules be observed. Nevertheless, when the British delegate expounded upon local remedies, the elaboration highlighted the other aspects of the issue, stating that

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[31] Wikipedia, *League of Nations Codification Conference, 1930*, https://en.wikipedia.org/wiki/League_of_Nations_Codification_Conference,_1930. (last visited July 19, 2021).
[32] LEAGUE OF NATIONS, *supra* note 26.
[33] 2 LEAGUE OF NATIONS CONFERENCE FOR THE CODIFICATION OF INTERNATIONAL LAW (Shabtai Rosenne), 136, in Zachary Mollengarden, *The Utility of Futility: Local Remedies Rules in International Investment Law*, 58 VA. J. INT'L L. 403, 419-20 (2019).
[34] *Id.,* LEAGUE OF NATIONS, at 136; Mollengarden, at 420.
[35] *Id.*
[36] *Id.,* LEAGUE OF NATIONS, at 137; Mollengarden, at 420.

local remedies were "the only principle which is correct in theory and which operates with justice and impartiality between the more powerful and the weaker nations".[37] According to the argument of a British delegate, the futility exception should not be a hurdle that the injured or damage-suffered aliens could easily evade.[38] This elaboration on the history of local remedies in the context of "Responsibility of States for Damage caused in their Territory to the Person or Property of Foreigners"[39] also showed the consideration of balancing the interests between the developed nations and the developing nations in terms of foreigner's sufferings abroad. The reason that the delegates reached to this conclusion is that the capital flow was single-tracked at that time. The developed countries were the capital-exporting countries, while the developing countries were the capital-importing countries.[40] In this regard and practically speaking, the developed countries were the states of foreign investors which operated on behalf of the state; while developing countries were those host states where the investment activities took place. So the competing interests behind local remedies and exceptions at that time were state sovereignty of developing countries and foreign investment of developed countries.

2.1.2 Emergence in the Pre-ISDS Era

I. *Finnish Ships* case

The *Finnish Ships* case is the first case that propounded the term "futile" and "futility" in the context of diplomatic protection.[41] In this case, the Finnish investors initiated claims against the British government before the Britain's Admiralty Transport Arbitration Board over the dispute of requisition of ships. Without exhausting the local remedies, Finland brought the case before the Council of the League of Nations and argued that "further appeal

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[37] Mollengarden, *supra* note 34.
[38] *Id.*, LEAGUE OF NATIONS, at 139; Mollengarden, at 420.
[39] LEAGUE OF NATIONS, *supra* note 26.
[40] *See* Wang Luyang, *Study on the Balance between Investor and Host State in ISDS: Reference and inspiration of US pathway to China,* 12 HEBEI LAW SCIENCE 134, (2016).
[41] *Claim of Finnish shipowners against Great Britain in respect of the use of certain Finnish vessels during the war* (Finland/Great Britain), (hereinafter the *Finnish Ships* case), U.N. Report of International Arbitral Awards, Vol. III pp. 1479-1550, 1498, 1503,1504,1536 (May 9, 1934), https://legal.un.org/riaa/cases/vol_III/1479-1550.pdf (last visited July 19, 2021).

was futile".[42] Arbitrator Bagge applied a strict standard to determine whether the circumstances could establish "futility", noting that:

> As regards finally the third question, whether the local remedy shall be considered as not effective only where it is obviously futile on the merits of the case which are to be taken into account, to have recourse to the municipal remedy, or whether, as the Finnish Government suggests, it is sufficient that such a step only appears to be futile, a certain strictness in construing this rule appears justified by the opinion expressed by Borchard when mentioning the rule applied in the prize cases. Borchard says (a.a. § 383): 'In a few prize cases, it has been held that in face of a uniform course of decisions in the highest courts a reversal of the condemnation being hopeless, an appeal was excused; but this rule was most strictly construed, and if a substantial right of appeal existed, failure to prosecute an appeal operated as a bar to relief.'[43]

Arbitrator Bagge used the words "obviously", "sufficient", "strictness", "strictly" to elaborate his support of the strict standard of futility. That is to say, futility was applied in an exceptional circumstance, with a high threshold. Only when the local remedies were "sufficiently" or "obviously" futile, could it be circumvented. He also invoked the Edwin M. Borchard's opinions in similar cases, stating that "failure to prosecute an appeal operated as a bar to relief ".[44]

II. *Certain Norwegian Loans* case

In the *Norwegian Loans* case, Judge Lauterpacht gave a separate opinion on the judgment based on different grounds.[45] When referring to local remedies, he first stated that, "The very question whether local remedies have been exhausted -- a question on which Norway has made dependent the international character of the dispute -- is a question of international law."[46] With support from the ground of Norway in the Preliminary Objection, he continued by clarifying the requirement of local remedies, "For the requirement of exhaustion of local remedies is not a purely technical or rigid rule. It is a rule which

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[42] Edwin M. Borchard, *The Local Remedy Rule*, 28 AM. J. INT'L L. 729, 729-31 (1934).
[43] The *Finnish Ships* case, *supra* note 41, at 1504.
[44] *Id.*
[45] *See* the *Certain Norwegian Loans* (France v. Norway) case, Judgement, Separate Opinion of Judge Sir Hersch Lauterpacht, 1957 I.C.J. Reports (July 6).
[46] *Id.*, at 38.

international tribunals have applied with a considerable degree of elasticity. In particular, they have refused to act upon it in cases in which there are, in fact, no effective remedies available owing to the law of the State concerned or the conditions prevailing in it."[47] Since the French government had made no attempt to exhaust local remedies, Judge Lauterpacht did not accept the French contentions, stating that, "the legal position on the subject cannot be regarded as so abundantly clear as to rule out, as a matter of reasonable possibility, any effective remedy before Norwegian courts."[48] He further stated, "there may be no sufficient reason for drawing final conclusions from the alleged previous practice of Norwegian courts and for asserting that it has been conclusively proven that there is in this case no remedy available under Norwegian law."[49]

Even in the absence of clarity regarding the term "futility", Judge Lauterpacht also agreed with the opinion that only under exceptional circumstances, could the local remedies be bypassed. When formulating "futility", he argued that the local remedies should be "effective", "available", "reasonable possibility".[50] On the other hand, he also accorded importance to proving, stating that the proof should be "abundantly clear"[51]. It is rather difficult to evaluate whether the futility standard construed by Judge Lauterpacht is stringent or not. According to his formulation, it is still ambiguous to apply the futility exception. It can be inferred from his views that the standard is rather subjective and great discretion is to accorded to the adjudicator.

In the same case, Judge Read gave a dissenting opinion, stating that, he "find difficulty in upholding the fourth Norwegian objection"[52] which is objected by Norway that France "institute international proceedings have not first exhausted the local remedies".[53] He prefaced this by stating that, "It is necessary to begin the consideration of the fourth Preliminary Objection with the assumption that France must establish resort to an exhaustion

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47 *Id*., at 39.
48 *Id.*
49 *Id.*, at 41.
50 *Id.*, at 39 and 41..
51 *Id.*, at 34.
52 *Id.*, at 99.
53 *Id.*, at 97.

of local remedies"[54] He explained the rationales and benefits of local remedies, stipulating that,

> The rule of international law requiring the exhaustion of the local remedies is of great importance. When a State adopts the cause of its nationals as against a respondent State in a dispute which originally was one of national law, it is important to obtain the ruling of the local courts with regard to the issues of fact and law involved, before the international aspects are dealt with by an international tribunal. It is also important that the respondent State which is being charged with breach of international law should have a fair opportunity to rectify the position through its own tribunals.[55]

Explaining a secondary requirement, he construed "futility" as "whether the bringing of an action in the Norwegian courts by a French bondholder is a course which could be reasonably expected of him, or whether it would have been a procedure of obvious futility."[56] And then in the third step, he analyzed that an action brought to Norwegian courts would be "in vain", because "the enactment of that law was contrary to the rules of international law".[57]

Similarly to the opinion of Arbitrator Bagge in the Finnish Ships case, Judge Read also invoked "futility", but reckoned it should be an "obvious" one and according to the laws and prevailing circumstances, it was "in vain"[58]. From my point of view, Judge Read assessed "futility" by adopting a combined approach. It seems like a subjective approach at first glance, but turned into an objective approach when evaluating the prevailing circumstances.[59] Another point to be noted here is Judge Read's reasoning on the rationales and benefits of local remedies, which was illustrated that the Respondent State should have "a fair opportunity to rectify the position through its own tribunals."[60] The rights of Respondent State should be given enough respect, which also shows the interests behind the local remedies rule.

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[54] *Id.*
[55] *Id.*
[56] *Id.,* at 98.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*, at 97.

2.1.3 Initiation of ICSID Convention

The contemporary ISDS mechanism traces its origin to the ICSID Convention.[61] It is the first "a multilateral agreement on a process for resolving individual investment disputes on a case-by-case basis as opposed to imposing outcomes based on standards" after World War II.[62]

Before the current version of the ICSID Convention was finalized, there had been a heated debate over the clauses of jurisdiction. Most of the delegates from different states reckoned that the exclusive jurisdiction of ICSID was necessary to achieve the purpose of investment protection.[63] Yet Mr. da Cunha, a delegate from Brazil, expressed his worries on the intervention of state sovereignty, stating that,

> The excessive breadth given by the Chapter in question to the range of disputes that may possibly be submitted to the Centre creates various kinds of obstacles that will be difficult to overcome. Among these are the obstacles arising from the very sovereignty of the States. The Centre cannot of course be transformed into a body to review the legislation of the various countries. It is understandable that a country may agree to submit to an international tribunal a dispute that arises by chance, regarding investments made in its territory by a national of another State. It is nevertheless inadmissible to expect that State to agree to the Centre's using, in settling a given dispute, legislation other than that of the host country.[64]

Considering the factors of striking a balance between domestic jurisdiction and international arbitration jurisdiction, as well as harmonizing with the rules of International Law, a compromise was made. Subsequently, the Chairman, Mr. Broches reported that,

> As was the case at the regional meetings, there was considerable discussion in the Legal Committee regarding the question whether the provision in the First Draft was intended to change the rule of international law with respect to the exhaustion

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[61] John E.C.Brierley, Memorial Lecture-*Continuity and Change in the ICSID System: Challenges and Opportunities in the Search for Consensus*, 2019, https://icsid.worldbank.org/news-and-events/speeches-articles/2019-john-ec-brierley-memorial-lecture-continuity-and-change (last visited July 20, 2021).

[62] Wikipedia, *International Centre for Settlement of Investment Disputes,* https://en.wikipedia.org/wiki/International_Centre_for_Settlement_of_Investment_Disputes. (last visited July 19, 2021).

[63] *See* ICSID PUBLICATION, HISTORY OF THE ICSID CONVENTION, VOL. II-2 (Washington D.C., 1968).

[64] *Id.*, at 838.

> of local remedies prior to the presentation of an international claim. I explained that that provision was merely a rule of interpretation. To avoid any misunderstanding on this score it was decided to add to the provision a second sentence which would make it quite clear that a Contracting State could make its consent to arbitration conditional upon prior recourse to local administrative or judicial remedies.[65]

The provisions of remedies on subrogation were supported by the majority of the delegates.[66] Finally, the provision of the jurisdiction of ICSID was formulated as,

> Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.[67]

The ICSID Convention also could be regarded as a watershed moment for the local remedies rule. The compulsory jurisdiction of the ICSID means the preclusion of local remedies. It used to be a customary International Law which had borne mandatory characteristic,[68] local remedies rule has become a rule which could be used only under the condition of explicit requirement.[69] Since then, the ICSID has been the main approach to solve foreign investment disputes abroad,[70] in place of the local remedies rule. As a result, the jurisdiction of ICSID has been expanded and the jurisdiction of the domestic courts have been restricted.

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65 *Id.*, at 936.
66 *Id.*, at 937.
67 The ICSID Convention, *supra* note 5, Article 26.
68 *See e.g. Interhandel* (Switzerland v. the United States of America), Judgement, 1959 I.C.J. Reports, 6, 27 (March 21); *Elettronica Sicula S.p.A.* (hereinafter *ELSI*) (the United States of America v. Italy), Judgement, 1989 I.C.J. Reports, 42 (July 20); *Ahmadou Sadio Diallo* (hereinafter *Diallo*) (Republic of Guinea v. the Democratic Republic of the Congo), Preliminary Objections, 2012 I.C.J. Reports, 599-600 (October 1); MALCOLM N. SHAW, INTERNATIONAL LAW, 619 (CAMBRIDGE, 8TH EDITION, 2017).
69 The ICSID Convention, *supra* note 5, Article 26.
70 Mollengarden, *supra* note 15.

2.1.4 ILC Codifications

I. *ILC 2001 Draft Articles on Responsibility of States for Internationally Wrongful Acts*

United Nations has endeavored to improve and codify International Law for decades.[71] Under the common efforts of the UN, ILC, jurists, and states in the international community, the ILC bore an important codification fruit namely the *ILC 2001 Draft Articles on Responsibility of States for Internationally Wrongful Acts.*[72] After being adopted by the ILC, *2001 Draft Articles* have been cited by ICJ and well recognized by the international community.[73] Just as Professor James Crawford commented, the rules are "rigorously general in character" in the context of state responsibility.[74]

Although *2001 Draft Articles* have not mentioned futility exception, Article 44 of ILC 2001 *Draft Articles* again confirm the precondition status to state responsibility claims,

> The responsibility of a State may not be invoked if:
> (b) the claim is one to which the rule of exhaustion of local remedies applies and any available and effective local remedy has not been exhausted.[75]

This provision expounds upon local remedies from the positive perspective, which means that only if the local remedies are "available and effective", could the exhaustion of the rule be a bar to the invocation of state responsibility. On the contrary, this article could be interpreted as saying that if the local remedies are not "available and effective", there is no need to observe the rules. In such a scenario, exceptional circumstances are logically deducted. But a specific and clear formulation of futility is not put forward here.

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[71] *See* the Home page of International Law Commission, https://legal.un.org/ilc/. (last visited July 19, 2021).
[72] *See* ILC, *Report on the work of the fifty-third session (2001), Chapter IV. State Responsibility*, https://legal.un.org/ilc/reports/2001/. (last visited July 19, 2021).
[73] Wikipedia, *State responsibility*, https://en.wikipedia.org/wiki/State_responsibility (last visited July 19, 2021).
[74] JAMES R. CRAWFORD, THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES, 12 (Cambridge University Press, 1st ed. 2002).
[75] ILC, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, Article 44, 2001.

However, this is not the latest authoritative document to present exceptions to local remedies. Concurrently, the ILC also worked on the issue of Diplomatic Protection in International Law, and afterwards, *2006 Draft Articles on Diplomatic Protection* has since been adopted by ILC.[76]

II. *ILC 2006 Draft Articles on Diplomatic Protection*

The *ILC 2006 Draft Articles on Diplomatic Protection* have been the authoritative documents that clearly incorporate exceptions to local remedies into the context of diplomatic protection;[77] Additionally, they have provided a formulation of futility based on a myriad of decisions, authoritative works, opinions of jurists, etc.[78]

Exceptions to the local remedies rule which are titled and incorporated in Article 15 of *2006 Draft Articles*, which stipulates that,

> (a) there are no reasonably available local remedies to provide effective redress or the local remedies provide no reasonable possibility of such redress;
> (b) there is undue delay in the remedial process which is attributable to the State alleged to be responsible;
> (c) there was no relevant connection between the injured person and the State alleged to be responsible at the date of injury;
> (d) the injured person is manifestly precluded from pursuing local remedies; or
> (e) the State alleged to be responsible has waived the requirement that local remedies be exhausted.[79]

Thereinto, (a) is summarized as the "futility exception".[80] Although at last the test of "there are no reasonably available local remedies to provide effective redress or the local remedies provide no reasonable possibility of such redress" was adopted by the ILC, the standards of futility continue to be highly debated in both practice and academia.[81] For

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[76] ILC, *Report of International Law Commission on the Work of its fifty-eighth session, Chapter IV. Diplomatic Protection*, 24, Supplement No. 10 (A/61/10), (1 May-9 June and 3 July-11 August 2006).
[77] ILC, *Draft Articles on Diplomatic Protection*, Article 15, 2006.
[78] *See* Dugard, *supra* note 25.
[79] ILC, *supra* note 77.
[80] Dugard, *supra* note 25, at 56-57.
[81] *See e.g., The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (2001); *Link-Trading Joint Stack Company v. Department for Customs Control of the Republic of Moldova* (2001); *Ronald S. Lauder v. The Czech Republic* (2001)*; Siemens A.G. v. The Argentina Republic*

clarification and some resolve to this debate, the Reports on Diplomatic Protection by Special Rapporteur John R. Dugard should be accorded due regard. From the Report three options provided by the Rapporteur should be studied further.

2.2 Theories of Futility Exception

Albeit the principle that local remedies should be available and effective,[82] if not, there is no need to exhaust the local remedies.[83] The general approach is well recognized by the international community, but the standard of futility exception has been quite obscure and highly disputed, especially the formulation of futility and how to examine what kind of situations constitutes futility.[84]

In the Third Report on *ILC 2006 Draft Articles*, Special Rapporteur John R. Dugard provides three options of futility exceptions which are based on comprehensive and deep research on the legal documents, cases, law reviews, etc. Three options are formulated as,

> Local remedies do not need to be exhausted where:
> (a) The local remedies:
> (i) Are obviously futile (option 1)
> (ii) Offer no reasonable prospect of success (option 2)
> (iii) Provide no reasonable possibility of an effective remedy (option 3)...[85]

In order to pick the most reasonable and appropriate standard, Special Rapporteur John R. Dugard started from the strictness of the three options, stating that,

> A local remedy is ineffective when it is 'obviously futile', 'offers no reasonable prospect of success' or 'provides no reasonable possibility of an effective remedy'. These phrases are more precise than the generic term 'ineffective' and are therefore preferred by courts and writers in describing the phenomenon of the ineffective local remedy. The test of 'obvious futility' is higher than that of 'no reasonable

(2004); *Yukos Universal Limited (Isle of Man) v. The Russia Federation* (2009); *Abaclat and Others v. The Argentina Republic* (2011), *Urbaser S.A. and Consorcio De Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentina Republic* (2012); *ICS Inspection and Control Services Limited v. The Argentina Republic* (2012); *Ambiente v. Argentina* (2013), etc.

[82] ILC, *supra* note 75.

[83] *Id.*

[84] *See* Dugard, *supra* note 25.

[85] Dugard, *supra* note 25, at 56.

prospect of success', while the test of 'no reasonable possibility of an effective remedy' occupies an intermediate position.[86]

This approach is summarized by a scholar as "three standards into a hierarchy of strictness".[87] The "obviously futile"[88] is the highest threshold, while "no reasonable prospect of success"[89] is the lowest and "no reasonable possibility of an effective remedy"[90] is in the middle. They will be further elaborated below.

2.2.1 "Obvious Futility"

"Obvious Futility" is the most stringent standard, which means if the local remedies are obvious futile, the parties could bypass the futile local remedies and directly initiate international proceedings. The origin of "obvious futility" can be traced to Arbitrator Bagge's statement in the *Finnish Ships* case. "Obviously futile" and "most strictly construed" are terms used by Arbitrator Bagge to assess futility.[91]

In the *Finnish Ships* Arbitration, the Tribunal stated that exhaustion is not necessary when remedies are obviously futile or manifestly ineffective;[92] While someone else reckoned that "an alien did not have to exhaust local remedies if they proved to be futile, waiting to reach the point of futility could be very frustrating".[93] Consider the situation in the *Interhandel* case where, notwithstanding twelve years of delay, the ICJ held that the possibility of remedy still existed in United States courts.[94] What's more, proving futility is not necessarily straightforward.[95]

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86 *Id.*
87 Mollengarden, *supra* note 15, at 428.
88 Dugard, *supra* note 25, at 56.
89 *Id.*
90 *Id.*
91 The *Finnish Ships* case, *supra* note 41.
92 *Id.*
93 *See Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (hereinafter the *Loewen* case), ICSID Case No. ARB(AF)/98/3, Award, (June 26, 2003), https://www.italaw.com/cases/documents/634 (last visited July 19, 2021).
94 The *Interhandel* case, *supra* note 68, at 26-27.
95 *Id.*

Sir John Dugard also invoked Mummery's comments for supporting his objection to "obvious futility", stating that the test of obvious futility "contributes very little to precision and objectivity of thought".[96]

Mummery's comments seem problematic with the absence of a standard objectivity in determining "obvious futility". But at the same time, I have not seen any objective characteristics in the other two standards with the descriptive terms like "reasonable" "effective" "available", as these terms also give great discretion for adjudicators to interpret.

Dugard continued to explain Amerasinghe's objection to the "obvious futility" standard, arguing that：

> The real objection, however, to the strict criterion enunciated in the Finnish Ships Arbitration would seem to lie in the absence of justification for applying such a strict criterion to the resort by aliens to local remedies when, pragmatically speaking, litigants can in normal circumstances be expected not to spend time and money exercising available recourse, if it appears reasonably rather than highly probable that they are not likely to succeed. The argument in the case of the alien is even more cogent. In his case what is involved is really not a choice between resorting to remedies both at the ordinary litigant. It is a choice between resorting to remedies both at the local level while invoking an international remedy which could result in adequate redress.[97]

I'm afraid that I cannot agree with Amerasinghe's opinions of "obvious futility". I argue that there are three problems for Amerasinghe's arguments. The first one is that his arguments stand by a firm foreign investor's position. What he discussed above is what kind of redress litigants could get, for instance, rapid or not, economical or not. But BIT is a kind of contract signed by two parties,[98] so the interests of host states should also be considered.

The second problem is that he ignored the benefits of local remedies. He established a preconceived notion that local remedies were time-consuming, procedure-complicated, and

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[96] Dugard, *supra* note 25, at 58.
[97] C.F. Amerasinghe, *The local remedies rule in an appropriate perspective*, 752 (1976), https://www.zaoerv.de/36_1976/36_1976_1_3_a_727_759.pdf (last visited July 19, 2021).
[98] *See* UNCTAD, s*upra* note 8.

unlikely to get satisfactory redress.[99] But it may not be the truth. Local remedies are the best place to reconstruct the facts based on convenience and full knowledge of local law.[100] Furthermore, domestic courts are public authoritative organs supported by the governments, so the proceedings of local courts do not cost much and some administrative remedies or rapid adjudication procedure does not take long.[101] Based on the prior literature of empirical analysis, local remedies may also be a reasonable choice for claimants with a time-saving and money-saving approach to obtain satisfactory redress.

Thirdly, Amerasinghe's arguments are also based on the assumption that International arbitration is more cogent than local remedies.[102] But, is that true? There is an argument to the contrary, and the drawbacks of the mechanism have been recognized by the international community. For example, bias and unfairness, inconsistency, lack of transparency are demonstrated by lots of empirical analyses.[103] For the time being, the ISDS mechanism has been jeopardized by the crisis of legitimacy.[104] In response to the issue, a multilateral investment court has been proposed to replace ISDS.[105]

Actually, I assert that Amerasinghe's arguments hold a strong position to favour international arbitration and foreign investors. He did not adopt an approach of neutrally analyzing advantages and disadvantages, while only illustrating the advantages of international proceedings and disadvantages of local remedies with strong subjective feelings.

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[99] Amerasinghe, *supra* note 97.

[100] *See* FREDERICK SHERWOOD DUNN, THE PROTECTION OF NATIONALS: A STUDY IN THE APPLICATION OF INTERNATIONAL LAW, 156 (Published by John Hopkins Press, 1932); *see also* Foster, *supra* note 24, at 262.

[101] *See* Matthew Hodgson and Alastair Campbell, *Damages and costs in investment treaty arbitration revisited,* December 14, 2017, https://www.allenovery.com/en-gb/global/news-and-insights/news/damages-and-costs-in-investment-treaty-arbitration-revisited (last visited July 19, 2021) ;*see also* Joachim Pohl, *Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence*, OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT, NO.3 (2018).

[102] Amerasinghe, *supra* note 97.

[103] Michael Faure and Wanli Ma, *Investor-State Arbitration: Economic and Empirical Perspectives*, 34, 41, (41 MICH. J. INT'L L. 1 2020).

[104] Agnone, *supra* note 22, at 64.

[105] *See* Colin M. Brown, *A Multilateral Mechanism for the Settlement of Investment Disputes: Some Preliminary Sketches*, ICSID REVIEW, Vol. 32, No. 36, 73-90 (2017); *see also* EU Parliament, *Multilateral Investment Court: Overview of the reform proposals and prospects*, https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/646147/EPRS_BRI(2020)646147_EN.pdf (last visited July 19, 2021).

Although I could not agree with Amerasinghe's arguments to object to "obvious futility", I also could not completely support this strict standard. Though the high threshold could restrict the rights of investors and jurisdiction of international tribunals, a lack of precision and accurateness[106] may also generate problems when applying this strict test.

2.2.2 "No reasonable prospect of success"

Next to be analyzed is the second option -- "no reasonable prospect of success".[107] Regarding this standard, John stated that,

> This test is less demanding than that of 'obvious futility', which requires evidence not only that there was no reasonable prospect of the local remedy succeeding, but that it was obviously and manifestly clear that the local remedy would fail.[108]

I contend that this explanation has no manifest distinction with "obvious futility", which also focuses on the wording "obviously" or "manifestly". Furthermore, neither of the standards require the precondition that futility has already existed. As long as it meets the requirements of "clearly" or "obviously" or "manifestly", the futility is established.

2.2.3 "No Reasonable Possibility of Effective Redress"

According to the elaboration of John R. Dugard, the futility standard of "No Reasonable Possibility of Effective Redress" is the most appropriate one, because the "obvious futility" is too strict to apply, while the "No Reasonable Prospect of Success" standard is too generous and may provide a way for the claimants to easily evade the local remedies by invoking the lenient standard.[109] Subsequently, he invoked the opinions of Judge Lauterpacht in the *Certain Norwegian Loans* case with the interpretation that "The legal position on the subject cannot be regarded as so abundantly clear as to rule out, as a matter of reasonable possibility, an effective remedy before Norwegian courts."[110]

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[106] Dugard, *supra* note 25, at 58.
[107] *Id.*, at 56.
[108] *Id*., at 58.
[109] *Id.*
[110] *See* the *Certain Norwegian Loans* case, *supra* note 45.

What cannot be ignored is the invocation of Mummery's approach to propose the third standard,

> This flexibility of approach is consonant with the social function of the rule...to give primacy of jurisdiction to the local courts, not absolutely but in cases where they can reasonably accept it and where the receiving state is reasonably capable of fulfilling its duty of providing a remedy. Thus the result in any particular case will depend on a balancing of factors...[111]

From my point of view, Mummery takes a correct approach to interpret futility, not in detail but direction. He explains futility in the most normal path, which is that an invocation of "local remedies" is the point of first departure, while exceptions are established in "reasonable" conditions. I am also deeply impressed by the phrase "balancing of factors". Here Mummery considers the balancing of different factors because the formulation is in the context of the exhaustion of local remedies; and what he is concerned about is the jurisdiction to the local courts is not absolute. Therefore, in the contemporary of non-exhaustive local remedies context,[112] protection of foreign investment also should not be the only factor concerned and the the jurisdiction of host states still holds the balance.

Finally, this intermediate standard was incorporated in Article 15(a) of *ILC 2006 Draft Article on Diplomatic Protection* with the revised version, which stipulates that, "there are no reasonably available local remedies to provide effective redress, or the local remedies provide no reasonable possibility of such redress".[113] But I still have not seen an accurate approach from this formulation.

2.2.4 Summary

I suppose that the reasons that John R. Dugard picked the intermediate standard of futility are too simplified, without any legal basis or even on the grounds of policy consideration. In his opinion, the strictness of "No Reasonable Possibility of Effective

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[111] Dugard, *supra* note 25, at 60.
[112] *See* UNCTAD, s*upra* note 8.
[113] ILC, *supra* note 77.

Redress" lies in the middle of the road, neither too stringent, nor too lenient.[114] But I reckon that this rationale of the standard is a compromise which cannot bear further analysis. Although the intermediate standard was finally adopted by ILC,[115] all three standards have their proponents and opponents. The grounds to support their arguments either have a linguistic basis, or a clear standing to support investors.[116] In current practice, the dispute over the threshold of futility continues to carry on.[117] Some claimants succeeded in invoking futility exception to evade local remedies provisions,[118] while some claimants' contentions that the local remedies were futile were dismissed by the tribunals.[119] Different tribunals have different opinions on this focal point. Regardless, the theoretical standards should return to an analysis of cases to see how they have been applied respectively. Cases will be dealt with in the subsequent Chapters.

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[114] *See* Dugard, *supra* note 25.

[115] ILC, *supra* note 75.

[116] *See e.g., The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (2001)*; Link-Trading Joint Stack Company v. Department for Customs Control of the Republic of Moldova* (2001*); Ronald S. Lauder v. The Czech Republic* (2001)*; Siemens A.G. v. The Argentina Republic* (2004)*; Abaclat and Others v. The Argentina Republic* (2011)*, Urbaser S.A. and Consorcio De Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentina Republic* (2012*),* etc.

[117] *Id.*

[118] *See e.g., Link-Trading Joint Stack Company v. Department for Customs Control of the Republic of Moldova* (2001); *Ronald S. Lauder v. The Czech Republic* (2001); *Siemens A.G. v. The Argentina Republic* (2004); *Yukos Universal Limited (Isle of Man) v. The Russia Federation* (2009); *Abaclat and Others v. The Argentina Republic* (2011), *Urbaser S.A. and Consorcio De Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentina Republic* (2012); *Ambiente v. Argentina* (2013), etc.

[119] *See e.g., The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (2001); *ICS Inspection and Control Services Limited v. The Argentina Republic* (2012).

Chapter 3. Futility Exception Cases and Implications

With the development of the global economy and the further opening-up of the global markets, IIAs and BITs have proliferated worldwide. So far, the number of BITs signed has been up to 2844, while the number of TIPs is 420.[120] At the core, there are five types of local remedies provisions in IIAs in this style, which respectively are "No Reference Type", "Fork-in-road Type" or "No-U-turn Type", "Paralleling Proceedings", and "Prior Exhaustion of Local Remedies", and "Waiting Period".[121] Among them, there are two main types related to futility exception which means that from the investors' position, local remedies provisions could be a stumbling block for them to seek international arbitration remedies. In such a situation the utility of futility exception is brought into play. Further the two related types of local remedies with respect to the futility exception will be discussed. Subsequently, an insight into new trends of local remedies in contemporary International Investment Law will be provided.

3.1 Local Remedies Provisions in IIAs Relating to Futility

3.1.1 "Fork-in-road" Clause or "No-U-turn" Clause

According to the "Fork-in-road" clause, the parties can choose the resolution to the investment dispute, either through domestic courts or an ISDS mechanism. Yet once the choice is made, they could not change the approach to dispute settlement.[122] The "Fork-in-road" clause in the BIT would make the initiation of the adjudication which the parties consent to irrevocable.[123]

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[120] UNCTAD, s*upra* note 9.

[121] Tomoko YAMASHITA, *Investors in the Formation of Customary International Law—An Insight from the "Futility Exception" to the Local Remedies Rule in Investor-State Arbitration*, Melland Schill Perspectives on International Law, Manchester University Press, 11-6 (2018).

[122] RICHARD HAPP, NOAH RUBINS, DIGEST OF ICSID AWARDS AND DECISIONS (1974-2002), 341-43 (Oxford University Press, 1st ed. 2013).

[123] *See Fork in the Road Provision in Investment Arbitration*, https://www.acerislaw.com/fork-in-the-road-provision-in-investment-arbitration/ (last visited July 19, 2021); *see also Fork-in-the-Road clauses: Divergent paths in recent decisions*,

The recently concluded China-Turkey BIT also included the "Fork-in-road" provisions with Article 9 of Settlement of Disputes Between One Contracting Party and Investors of the Other Contracting Party,

> 2. If the dispute that an investor of one Contracting Party claiming that the other Contracting Party has breached an obligation under Article 2 through 8, can not be settled through negotiations or administrative review procedures stipulated in paragraph (1) of this Article within six (6) months following the date of the written notification mentioned in paragraph l, the dispute can be submitted, as the investor may choose, to:
> (a) the competent court of the Contracting Party in whose territory the investment has been made,
> (b) the International Center for Settlement of Investment Disputes (ICSID) set up by the 'Convention on Settlement of Investment Disputes Between States and Nationals of other States',
> (c) an ad hoc court of arbitration laid down under the Arbitration Rules of Procedure of the United Nations Commission for International Trade Law (UNCITRAL).
> Once the investor has submitted the dispute to the one of the dispute settlement procedures mentioned in paragraph2 of this Article, the choice of one of these procedures is final.[124]

The "No-U-turn" provision means that the international proceedings could be initiated by waiving local remedies, but once the respondent party waives the approaches of local remedies, the parties cannot go back to the local remedies.[125] The most typical example is Article 1121 of NAFTA, which provides,

> A disputing investor may submit a claim under Article 1116 to arbitration only if:
> (a) the investor consents to arbitration in accordance with the procedures set out in this Agreement; and
> (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for

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https://www.nortonrosefulbright.com/en/knowledge/publications/0bd10ad8/fork-in-the-road-clauses (last visited July 19, 2021).

[124] Agreement concerning the Reciprocal Promotion and Protection of Investments, China-Turkey, Article 9, July 29, 2015, UNCTAD, Investment Policy Hub.

[125] YAMASHITA, *supra* note 121, at 13.

> proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.[126]

Sometimes futility exception could be applied in the "Fork-in-road" clause or "No-U-turn" provisions.[127] When the investors have chosen the local remedies, the decision prevents them from referring to ISDS arbitration. In this vein, the futility exception might work. With the help of the futility exception, investors have the possibility to get remedies from international arbitration avoiding domestic judicial proceedings.

Taking the *Waste Management* case as an example of "No-U-turn" provisions, the Claimant Waste Management contended that the said waiver was established. If the contentions of waiver grounded on Article 1121 of NAFTA were accepted, they could directly commence arbitration to NAFTA without prior local remedies.[128] This is a case that clearly shows the "No-U-turn" provisions and their relationships with local remedies and international arbitration. Yet, the Tribunal concluded that it did not deem the waiver as valid, and hence it lacked jurisdiction to give decisions to the issue in dispute.[129]

3.1.2 "Waiting Period"

"Waiting Period", also called "Cooling-off Period" is provided in IIAs which requires that the contracting parties should seek local remedies prior to commencing international arbitration,[130] like the Italy-Argentina BIT provides,

> 2. If the dispute cannot be settled amicably, it may be submitted to the competent judicial or administrative courts of the Party in whose territory the investment is made.
> 3. Where, after eighteen months from the date of notice of commencement of proceedings before the courts mentioned in paragraph 2 above, the dispute between

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[126] North American Free Trade Agreement, U.S.- Canada- Mexico, Dec. 17, 1992, https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between (last visited July 19, 2021).
[127] *See e.g., The Loewen* case*, supra* note 93.
[128] *Waste Management Inc. v. United Mexican States* (hereinafter the *Waste Management* case), NAFTA, CASE Num. ARB(AF)/98/2, Arbitral Award, 238, 240 (June 2, 2000).
[129] *Id.*
[130] YAMASHITA, *supra* note 121, at 15.

> an investor and one of the Contracting Parties has not been resolved, it may be referred to international arbitration.[131]

When applying the futility exception in this type, some investors claim that they could initiate the ISDS mechanism proceeding before the "Waiting Period" is up, because the prior local remedies are futile.[132]

In the *Siemens* case, the claimant argued that the 18-month local remedies "would be a futile exercise since it is well known",[133] and Siemens submitted an expert opinion in this respect to show that it is impossible for the local courts to decide a case of this nature within the 18 months provided for in the Treaty.[134] The Tribunal distinguished the 18-month prior local remedies from exhaustion of local remedies,[135] stating that:

> Article 10(2) does not require a prior final decision of the courts of the Respondent. It does not even require a prior decision of a court at any level. It simply requires the passing of time or the persistence of the dispute after a decision by a court. Then, even if this decision is one subject to appeal, the requirement of Article 10(2) would have been fulfilled. For these reasons, the Tribunal considers that Article 10(2) is not comparable to the local remedies rule and the issue of a tacit waiver of a rule of international law does not arise.[136]

The Tribunal accepted the claims of futility and retained the jurisdiction of Siemens' claims.[137] This case is a good example of how under the local remedies provisions which is determined by a waiting period, the Claimant utilizes futility as well as the rulings of the Tribunal, which gives us a clear recognition of the waiting period.

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131 Agreement for the Promotion and Protection of Investment, Italy-Argentina, May 22, 1990, UNCTAD, Article 8, Investment Policy Hub.

132 *See e.g., Link-Trading Joint Stack Company v. Department for Customs Control of the Republic of Moldova* (2001); *Ronald S. Lauder v. The Czech Republic* (2001); *Siemens A.G. v. The Argentina Republic* (2004); *Abaclat and Others v. The Argentina Republic* (2011), *Urbaser S.A. and Consorcio De Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentina Republic* (2012); *Ambiente v. Argentina* (2013), etc.

133 *Siemens A.G. v. The Argentine Republic* (hereinafter the *Siemens* case), ICSID Case No. ARB/02/8, Decision on Jurisdiction, 29 (August 3, 2004).

134 *Id.*

135 *Id.*, at 76.

136 *Id.*, at 42.

137 *Id.*, at 76.

3.2 Characteristics of Local Remedies Rule in International Investment Law

From the discussion in Chapter 2 and the previous section, preliminary conclusions could be drawn from the provisions of IIAs. The conclusions are: Firstly, local remedies could be used with explicit statement.[138] Secondly, local remedies do not require exhaustion.[139] Futility exception is discussed under the context of local remedies rule,[140] so the evolution of local remedies rule also has a great impact on the application of futility exception. The following sections will serve to explore these two traits in contemporary International Investment Law.

3.2.1 The Requirement of Explicit Agreement to Local Remedies

Exhaustion of Local remedies used to form part of customary International Law, which was well recognized in the international community.[141] As the ICJ states in the *Interhandel* case,

> The rule that local remedies must be exhausted before international proceedings may be instituted is well-established rule of customary international law; the rule has been generally observed in cases in which a State has adopted the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law. Before resort may be had to an international court in such a situation it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.[142]

In the *Elettronica Sicula SpA (ELSI)* case, the local remedies rule was conceptualized as "an important principle of customary international law".[143]

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138 ICSID, *supra* note 5, Article 26.
139 *See supra* note 8.
140 *See e.g.,* Dugard, *supra* note 25; also ILC, *supra* note 77.
141 SHAW, *Supra* note 68.
142 The *Interhandel* case*, supra* note 68.
143 The *ELSI* case*, supra* note 68.

In the *Diallo* (Guinea v. Democratic Republic of Congo) case, ICJ states, "The Court will recall that under customary international law, as reflected in Article 1 of the draft Articles on Diplomatic Protection of the International Law Commission." It continues:

> In the present case Guinea seeks to exercise its diplomatic protection on behalf of Mr. Diallo in respect of the DRC's alleged violation of his rights as a result of his arrest, detention and expulsion, that violation allegedly constituting an internationally wrongful act by the DRC giving rise to its responsibility. It therefore falls to the Court to ascertain whether the Applicant has met the requirements for the exercise of diplomatic protection, that is to say whether Mr. Diallo is a national o Guinea and whether he has exhausted the local remedies available in the DRC.[144]

As a customary International Law, the local remedies rule shall apply if there is no treaty between the disputing parties.[145] If the local remedies rule is stipulated in the treaties, the high contracting parties have all the more reason to be bound to comply with the rules.[146] Nonetheless, if there are no treaties or the local remedies rule has not been included in the BIT, the parties should also observe it. Professor Sean D. Murphy liken customary International Law to common law in the common law system,

> Consequently, there is a second main source of international law known as customary international law. For a lawyer trained in a common law system (like the United States), it may be helpful to think of customary international law as akin to common law. In other words, there may be a statute (treaty) addressing a particular issue but, if not, then a lawyer may resort to the common law (customary international law) to find the applicable norm.[147]

So in the traditional context of diplomatic protection, even if there are no explicit provisions in treaties, when an alien suffers damage in a foreign country, exhaustion of local remedies is the approach to acquire remedies prior to turning to the home state for diplomatic protection. Local remedies played the main role when the injured aliens sought remedies before the ICSID Convention came into force.

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144 The *Diallo* case, *supra* note 68.
145 JAMES R. CRAWFORD, BROWNLIE'S PRINCIPLES OF INTERNATIONAL LAW, 220-23 (Oxford University Press, 8th ed. 2012).
146 *Id.*, at 228-231.
147 SEAN D. MURPHY, PRINCIPLES OF INTERNATIONAL LAW, 86 (West Academic Publishing, 2nd ed. 2012).

Nevertheless, the 1965 ICSID Convention has totally changed the traditional rule with compulsory jurisdiction of the ICSID provided in Article 26, which stipulates that,

> Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.[148]

According to Article 26, ICSID arbitration has been provided as an "exclusive remedy"[149], which means that consent to the Convention precludes the jurisdiction of other remedies. Only when the contracting parties explicitly require exhaustion of local remedies, could the rule apply.

> It may be presumed that when a State and an investor agree to have recourse to arbitration, and do not reserve the right to have recourse to other remedies or require the prior exhaustion of other remedies, the intention of the parties is to have recourse to arbitration to the exclusion of any other remedy. This rule of interpretation is embodied in the first sentence of Article 26. In order to make clear that it was not intended thereby to modify the rules of international law regarding the exhaustion of local remedies, the second sentence explicitly recognizes the right of a State to require the prior exhaustion of local remedies.[150]

It could be seen that changes have taken place in the local remedies rule in International Investment Law. Although the local remedies rule has been retained, its main role in the context of diplomatic protection has been replaced. In the traditional context, local remedies should be complied with as a general rule.[151] Non-compliance with local remedies could be justified only under the precondition that exhaustion of local remedies is expressly excluded in the treaties. While in contemporary International Investment Law, the ICSID Convention changed the predominance of exhaustion of local remedies.[152] The jurisdiction of ICSID is based on the part of sovereignty concession to ICISD, while the change also means the

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148 ICSID, *supra* note 5.
149 ICSID PUBLICATION, *supra* note 63, at 1079.
150 *Id.*
151 SHAW, *Supra* note 68.
152 ICSID, *supra* note 5, Article 26.

interests of state sovereignty behind local remedies have been undermined to a certain extent.[153]

3.2.2 Non-exhaustive Local Remedies Rule

Another change that should be noted is the requirement of the local remedies rules. While previously requiring exhaustion, local remedies provisions in International Investment Law show that local remedies are not required to be exhausted prior to initiating international proceedings.[154] Generally speaking, the local remedies rule needs to be exhausted in the context of International Law, which has been widely recognized in practice.[155] For instance, the *Ambatielos* Tribunal stated in the Award that,

> The rule thus invoked by the United Kingdom Government is well established in international law. Nor is its existence contested by the Greek Government. It means that the State against which an international action is brought for injuries suffered by private individuals has the right to resist such an action if the persons alleged to have been injured have not first exhausted all the remedies available to them under the municipal law of that State. The defendant State has the right to demand that full advantage shall have been taken of all local remedies before the matters in dispute are taken up on the international level by the State of which the persons alleged to have been injured are nationals.[156]

The ICJ also elaborated in the *Interhandel* case, "the rule that local remedies must be exhausted before international proceedings may be instituted is well-established rule of customary international law..."[157] Many scholars also assert that local remedies rule bears exhaustive characteristics. Professor Shaw stated in International Law that, "Customary international law provides that before international proceedings are instituted or claims or

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[153] *See* Tuca Sabina, *Global Governance vs. National Sovereignty in a Globalized World*, CES WORKING PAPERS, CENTRE FOR EUROPEAN STUDIES, 7-1 ALEXANDRU IOAN CUZA UNIVERSITY 193 (2015).

[154] *See* YAMASHITA, *supra* note 121; *see also* Argentina-U.K. BIT (1990), Argentina-Germany BIT (1991), Argentina-Spain BIT (1991), etc., UNCTAD, Investment Policy Hub.

[155] *See* ILC, *supra* note 75; *See also* ILC, *supra* note 77.

[156] *The Ambatielos Claim* (Greece, United Kingdom of Great Britain and Northern Ireland), Reports of International Arbitral Awards, VOLUME XII pp. 83-153, 119, (March 6, 1956).

[157] The *Interhandel* case*, supra* note 68, at 6, 27.

representations made, the remedies provided by the local state should have been exhausted."[158]

The exhaustive trait of the local remedies rule is unambiguously included in many treaties. Article 35 of the European Convention on Human Rights provides exhaustion of local remedies as one of the Admissibility criteria,

> The Court may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognized rules of international law, and within a period of six months from the date on which the final decision was taken.[159]

Article 46 (1) of the American Convention on Human Rights provides that,

> Admission by the Commission of a petition or communication lodged in accordance with Articles 44 or 45 shall be subject to the following requirements: a. that the remedies under domestic law have been pursued and exhausted in accordance with generally recognized principles of international law.[160]

Similarly, Article 2 of Optional Protocol I to the ICCPR provides that,

> Subject to the provisions of article 1, individuals who claim that any of their rights enumerated in the Covenant have been violated and who have exhausted all available domestic remedies may submit a written communication to the Committee for consideration.[161]

Exhaustion of local remedies is also stipulated in Article 295 of UNCLOS,

> Any dispute between States Parties concerning the interpretation or application of this Convention may be submitted to the procedures provided for in this section

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[158] SHAW, *supra* note 68.

[159] European Convention on Human Rights, June 1, 2010, Article 35, https://www.echr.coe.int/documents/convention_eng.pdf (last visited July 19, 2021).

[160] American Convention on Human Rights, November 22, 1969, Article 46, https://www.oas.org/dil/treaties_b-32_american_convention_on_human_rights.pdf (last visited July 19, 2021).

[161] Optional Protocol to the International Covenant on Civil and Political Rights, (OP1), December 16, 1966, Article 2, UN Human Rights, https://www.ohchr.org/EN/ProfessionalInterest/Pages/OPCCPR1.aspx (last visited July 19, 2021).

only after local remedies have been exhausted where this is required by international law.[162]

All of these provisions in important international treaties show that the local remedies rule should be exhausted prior to recourse to the international plane. The ILC has also incorporated "exhaustion of local remedies" into *ILC 2001 Draft Articles* and *ILC 2006 Draft Articles*. In the legal text, the phrases like "exhaustion of local remedies", "exhaust all the remedies", "local remedies shall be exhausted" are clearly prescribed.[163]

From the treaties, legal instruments, decisions, or awards, there is no doubt that the local remedies rule bears the exhaustive requirement. Nonetheless, different from the traditional Public International Law, the local remedies provisions have their own characteristics in contemporary International Investment Law. Local remedies are not necessarily exhausted in the field of International Investment Law. There are two main facts to prove the non-exhaustive feature of local remedies in International Investment Law. Firstly, due to the compulsory jurisdiction of the ICSID, the local remedies rule could not be invoked or applied tacitly. If a state is a contracting party to the ICSID Convention, it cannot invoke exhaustion of local remedies without explicit agreement.[164] Secondly, some local remedies provisions unambiguously prescribe the non-exhaustive local remedies rule, proposing the "Waiting Period" provision, "Fork-in-Road" Clause, or "No-U-turn" type.[165] Exhaustion is not required in these provisions. Instead, they give the parties more rights to choose remedies or just limit the duration of local remedies.

3.2.3 Summary

Besides knowing that the local remedies have dispensed with the exhaustive requirements in International Investment Law, what should also be accorded importance to is the competing interests behind the changes.

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[162] United Nations Convention on the Law of the Sea, December 10, 1982, Article 295, https://www.un.org/depts/los/convention_agreements/convention_overview_convention.htm (last visited July 19, 2021).
[163] *See* ILC, *supra* note 75; *See also* ILC, *supra* note 77.
[164] *See* ICSID, *supra* note 5.
[165] YAMASHITA, *supra* note 121, at 9-16.

Originated from reprisals,[166] two requirements of exhaustion of the local remedies in Public International Law to provide redress for the alien suffered damage abroad show the important position of state sovereignty.[167] In brief, one is that the local remedies are the main approach for foreigners to obtain redress in the host state; the other one is that the exhaustive requirement of local remedies represents host states' jurisdiction to deal with the affairs within its boundaries.

In contrast, the disparate characteristics of local remedies in the ISDS mechanism reflect that the state sovereignty of host states has been undermined to a certain degree. "Fork-in-Road" Clause even makes it possible that the host state could not solve the dispute took place in its territory at all.[168] The policies to achieve better governmental governance or stabilize the society in crisis, or other policies to protect public interests[169] have led to huge compensation from international proceedings.[170]

3.3 Applications of Futility Exception in ISDS

3.3.1 Legal Basis to Invoke Futility

Futility exception has been used by the foreign investors to circumvent local remedies.[171] The reason that they could invoke futility exception, is not because of the explicit and specific provisions in IIAs, but based on the general rule of interpretation provided in Article 31.3 (c) of VCLT, stipulates that,

> There shall be taken into account, together with the context: (a) any relevant rules of international law applicable in the relations between the parties.[172]

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166 Trindade, *Supra* note 2, at 503.
167 CRAWFORD, *Supra* note 145, at 1143.
168 YAMASHITA, *supra* note 121, at 12-13.
169 *See* Lise Johnson, Lisa Sachs, Brooke Güven and Jesse Coleman, *Costs and Benefits of Investment Treaties Practical Considerations for States*, COLOMBIA CENTER ON SUSTAINABLE DEVELOPMENT, (March 2018).
170 *See Yukos Universal Limited (Isle of Man) v. The Russian Federation* (hereinafter the *Yukos* case), UNCITRAL, PCA Case No. 2005-04/AA227, Final Award, (November 30, 2009).
171 *See* ISDS cases, *supra* note 20.
172 Vienna Convention on the Law of Treaties (VCLT), May 23, 1969, Article 31, United Nations, Treaty Series, vol. 1155, p. 331.

When the investors want to evade the local remedies requirements provided in the treaties concerned, as a rule of International Law, the futility exception could be put into use. From the explanation in Chapter 2, the futility exception to local remedies forms part of International Law.[173] From the conception of the rule at the 1930 Hague Conference[174] to a full-fledged rule provided in *ILC 2006 Draft Articles*,[175] the futility exception has been widely recognized as a rule of International Law through decisions, international documents, and treatises.[176] Some jurists of International Law also recognize futility exception as customary International Law,[177] so there is no doubt that the futility exception could be invoked without explicit provisions in IIAs.[178] But here comes the issue. It is not the invocation of futility, but the interpretation and formulation of futility which have triggered so much controversies.[179] In the last chapter, I have theoretically talked about the three standards of futility test,[180] but cannot agree with Special Rapporteur John Dugard's reasoning. In the next part, I will analyze cases to further probe into how futility exception has been used and how the Tribunals interpreted futility and then try to give some preliminary conclusions.

3.3.2 Futility Exception Cases in ISDS

I. *The Loewen Group, Inc. v. United States*

The *Loewen case* is one of the most controversial cases regarding the futility and exhaustion of local remedies. Briefly speaking, the dispute arose from commercial litigation in Mississippi Courts of the United States. Loewen is a Canadian investor who invested in funeral enterprises in the U.S. In the domestic case, Loewen was sued by O'Keefe for

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173 SHAW, *Supra* note 68.
174 *See* LEAGUE OF NATIONS, *supra* note 26.
175 *See* ILC, *supra* note 77.
176 *See* the *Finnish Ships* case, *supra* note 41; *See also* the *Certain Norwegian Loans* case, *supra* note 45; *See also* ILC, *supra* note 77.
177 *See*, *e.g.,* AMERASINGHE, *supra* note 16; also *see* JAN PAULSSON, DENIAL OF JUSTICE IN INTERNATIONAL LAW, (Cambridge University Press, 2005) (2009).
178 *See* futility exception cases, *supra* note 20.
179 *See e.g.,* Mollengarden, *supra* note 15; *See also* Agnone, *supra* note 22, etc..
180 Dugard, *supra* note 25.

violation of the contract, antitrust law, etc.[181] Then the Mississippi District Court awarded $500 million compensation for O'Keefe and the Mississippi Supreme Court required a 125% bond of the compensation within seven days if appealed according to Mississippi law.[182] Although the Court stated that reduction or release of the bond was possible, the Court refused to reduce because Loewen had no "good cause".[183] As a result, Loewen suffered great damage and then brought claims to the ICSID under Chapter 11 of NAFTA.[184] Loewen contended that "application of the bonding requirement" and "the denial of Loewen's right to appeal" violated provisions of NAFTA.[185] Finally, Loewen voluntarily waived the local remedies, instead, the Claimant reached a settlement agreement with O'Keefe.

I argue that the Tribunal's reasoning regarding the futility test to local remedies is rather confusing and complicated. The Tribunal first referred to the *Finnish Ships* case and affirmed that the parties were bound to exhaust local remedies but on the condition that this is "adequate and effective" and "not obviously futile".[186] And then the Tribunal invoked the opinions of Judge Lauterpacht in the *Certain Norwegian Loans* case, stating that the test was "not a purely technical or rigid rule" and should be "applied with a considerable degree of elasticity". Afterwards, the Tribunal invoked Sohn and Baxter's commentaries to Convention on the International Responsibility of States for Injuries to Aliens (12th Draft 1961), stating that the local remedies should be "effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated"[187], including "its financial and economic circumstances as a foreign investor"[188]. Then the Tribunal gave a preliminary conclusion that the conditions to a right of appeal were impractical.[189]

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181 The *Loewen* case, *supra* note 93, at 2.
182 *Id.*
183 *Id.*
184 William S. Dodge*, International Decisions: Loewen Group, Inc. v. United States and Mondev International Ltd. v. United States*, 98 AM. J. INT'L L 155, 155(2004).
185 The *Loewen* case, *supra* note 93, at 10.
186 *Id.*, at 47.
187 *Id.,* at 49.
188 *Id.*
189 *Id*.

Later, the Tribunal confirmed that the question was whether the local remedies were "reasonably available and adequate".[190] The Tribunal stated that it was difficult to judge whether Loewen's decision to enter into a settlement agreement was "business judgment"[191] or the court decision. However, Loewen failed to disclose evidence to enter into a settlement agreement. Finally, the Tribunal concluded that Loewen failed to pursue the local remedies.[192]

II. *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova*

In the case of *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova,* the two parties also had a dispute over the "Waiting Period" provided in the BIT between Moldova and United State, which included in Article VI(3),

> 3. (a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that **six** months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration.[193]

According to the Claimant, the dispute had already arisen in September 1998 by its allegations made by its notice of arbitration to the Respondent, which were not rebutted by the Respondent. The Claimant asserted from that time, the dispute between the parties arose.

The Respondent included the the non-compliance with the six-month waiting period in its objection to the jurisdiction, stating that, "That Claimant did not wait the required six-month period under Article VI(3) of the BIT before commencing this arbitration."[194]

The Tribunal addressed its views on the waiting period issue as follows. First, the Tribunal accepted the Claimant's assertions that the initial point of dispute was at the latest

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[190] *Id.*, at 61.
[191] *Id.*
[192] *Id.*
[193] Treaty concerning the Encouragement and Reciprocal Protection of Investment, U.S. - Moldova, April 21, 1993, Article VI, UNCTAD, Investment Policy Hub.
[194] *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova* (hereinafter the *Link-Trading* case), UNCITRAL, Award on Jurisdiction, 3 (February 16, 2001), https://www.italaw.com/search/site/Link-trading. (last visited July 19, 2021).

from August 1998 by "notification of the elimination of the customs exemption for purchases by Claimant's customers in the FEZ"[195], and had already lasted for more than a year, exceeding the six-month waiting period. Then the Tribunal clarified the purpose of the six-month waiting period provisions which was "to encourage parties to exercise reasonable efforts to resolve disputes before resorting to the costly and time-consuming remedies of International Arbitration"[196], so "the waiting period should be interpreted restrictively"[197]. On the practical basis, the Tribunal affirmed that a restrictive interpretation instead of a liberal one should be adopted in the waiting period, because "the only consequence of adopting a liberal interpretation of the six-month waiting period...would therefore have been to aggravate the possible claim of damages."[198] Lastly, in the year following September 1998 by the Claimant's notice of arbitration which was not rebutted by the Respondent, there was "no peaceful settlement of the dispute proven possible".[199]

As far as I can see, although the word "futility" did not appeared in the Tribunal decision, the Tribunal confirmed that the waiting period was not effective in practice to produce any solution to settle the dispute. The Tribunal applied futility in a lenient way, stating that no "possible" solutions and the waiting period will "aggravate the damage".[200]

I would argue that none of the reasons the Tribunal expounded upon could be established. Firstly, I cannot agree on the initial point of dispute affirmed by the Tribunal. Although "notification of the elimination of the customs exemption for purchases by Claimant's customers"[201] was sent to the domestic authorities in August 1998, afterwards the notice of arbitration was not rebutted by the Respondent and the authorities of the Respondent continued to put pressure on the Claimants to comply with the customs rules which had been changed.[202] From this we may conclude that the Respondent did not admit to the initiation of the dispute. So August 1998 can not be regarded as the inception point of the dispute.

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[195] *Id*., at 6.
[196] *Id*.
[197] *Id*.
[198] *Id*.
[199] *Id*.
[200] *Id*.
[201] *Id*.
[202] *Id*.

Secondly, the Tribunal adopted a restrictive interpretation on the six-month waiting period, but I reckon that the Tribunal confuse it with a liberal interpretation which applying the definition of liberal interpretation to construe the waiting period, just like a scholar commenting on this decision as "reverses the plain meaning".[203] The correct application of restrictive interpretation was that the waiting period should be strictly and firmly observed and cannot be circumvented. Thirdly, no evidence could be proved that the procedures in the waiting period were not available.

Not much was found about the signs in applying the "No Reasonable Prospect of Success" standard of futility, but the threshold of futility applied in these two cases was rather low. The decisions of the Tribunals did not focus on the prevailing circumstances and the provisions of the BIT texts, making the party-consented provisions rather redundant.

III. *Ronald S. Lauder v. the Czech Republic*

In the case of *Ronald S. Lauder v. the Czech Republic,* Article VI of the Czech-U.S. BIT prescribes that the contracting parties shall resolve the dispute within six-months by consultation and negotiation, prior to recourse to international arbitration. It prescribed as follow:

> 2. In the event of an investment dispute between a Party and a national or company of the other Party, the parties to the dispute shall initially seek to resolve the dispute by consultation and negotiation, which may include the use of non-binding, third party procedures. Subject to paragraph 3 of this Article, if the dispute cannot be resolved through consultation and negotiation, the dispute shall be submitted for settlement in accordance with previously agreed, applicable dispute-settlement procedures; any dispute-settlement procedures, including those relating to expropriation, specified in the investment agreement shall remain binding and shall be enforceable in accordance with the terms of the investment agreement, relevant provisions of domestic laws and applicable international agreements regarding enforcement of arbitral awards.
> 3. (a) At any time after six months from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by conciliation or binding arbitration to the International Centre for the Settlement of Investment Disputes ("Centre") or to the

[203] Mollengarden, *supra* note 15, at 443.

> Additional Facility of the Centre of pursuant to the Arbitration Rules of the United Nationals Commission on International Trade Law ("UNICTRAL") or pursuant to the arbitration rules of any arbitral institution mutually agreed between the parties to the dispute. Once the national or company concerned has so consented, either party to the dispute may institute such proceeding provided... [204]

The Claimant initiated the proceedings to UNCITRAL seeking for international remedies aside from the the six-month period of negotiation and consultation as provided for by the BIT. The Respondent "requested that reference to arbitration by Mr. Lauder should be dismissed on the grounds that the Arbitral Tribunal has no jurisdiction over the claim"[205] with the merits of the non-compliance with the six-month cooling-off period by the Claimant.[206]

The Tribunal applied the lenient standard and finally concluded that "it has jurisdiction to hear and decide this case"[207] for three reasons.

Firstly, the Tribunal stated that the requirement of the six-month waiting period provided by VI(3)(a) of the U.S. and the Czech Republic BIT was not a jurisdictional issue which the Tribunal gave based on the merits of it. On the contrary, it was a procedural rule the parties should comply with.[208] Secondly, the Tribunal interpreted VI(3)(a) of the BIT, clarifying the intention of this six-month waiting period which was to create negotiation opportunities to settle the dispute, while there was "no evidence that the Respondent would had accepted to enter into negotiation with Mr. Lauder or with any of the entities he controlled and which were involved in the dispute during the waiting period"[209]. Oppositely, the Respondent did not "react at all" to the letter of the Claimants endeavoring to find a solution to settle the dispute.[210] Lastly, the Tribunal focused on the practical function of the waiting period, ie:

> To insist that the arbitration proceedings cannot be commenced until 6 months after the 19 August 1999 Notice of Arbitration would, in the circumstances of this case,

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[204] Treaty concerning the Reciprocal Encouragement and Protection of Investment, Czech-U.S., October 22, 1991, Article VI, UNCTAD, Investment Policy Hub.
[205] *Ronald S. Lauder v. The Czech Republic* (hereinafter the *Ronald* case), UNCITRAL, Final award, 5 (September 3, 2001), https://www.italaw.com/cases/documents/611 (last visited July 19, 2021).
[206] *Id.*
[207] *Id.,* at 74.
[208] *Id.*, at 38.
[209] *Id.*, at 39.
[210] *Id.*

> amount to an unnecessary, overly formalistic approach which would not serve to protect any legitimate interests of the Parties. Therefore, the Arbitral Tribunal holds that the requirement of the six-month waiting period in Article VI(3)(a) of the Treaty does not preclude it from having jurisdiction in the present proceedings.[211]

Given the "unnecessary" and "overly formalistic" characteristics of the waiting period, the Tribunal finally dismissed the Respondent's objection to jurisdiction and stated that the waiting period did not preclude the party from resort to other arbitration.

From the Tribunal's decision, it could be seen that the standard of futility applied is rather lenient. The keywords to examine the establishment of futility by the Tribunal in this case is "unnecessary" and "overly formalistic". That is to say, the procedures provided in Article VI(3)(a) were available but just "unnecessary" and "overly formalistic" in the Tribunal's eyes.

A fortiori, the duration from the moment of the Claimant sending the letter for negotiation, to the point of the Claimant commencing international arbitration was only 17 days.[212] Although the local authorities did not "react at all" to the letter for negotiation, it was too far-fetched to prove negotiations "futile" within 17 short days. Albeit being regarded as adopting the lenient standard, which was described as "No Reasonable Prospect of Success", the decisions in this case neither showed "reasonableness" or "prospect". In this case, it was not pertinent to say that the application of futility met the lenient requirements.

I analyzed this case from three perspectives. First, the six-month period was consented to by the parties in BIT which both of them should observe in good faith without easily avoiding. Secondly, the 17-day waiting period was not sufficient to prove the negotiation procedure was futile. Even if one would wait a little bit longer, The Respondent authorities have its own

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[211] *Id.*, at 40.

[212] *Id*., (" Here, although there were only 17 days between CNTS' and CME's letter to the Media Committee of the Czech Parliament of 2 August 1999 and the filing of the Notice of Arbitration on 19 August 1999, there is no evidence that the Respondent would have accepted to enter into negotiation with Mr. Lauder or with any of the entities he controlled and which were involved in the dispute during the waiting period. On the contrary, the Media Council did not react at all to CNTS's letter of 13 August 1999 requesting that CNTS and CET 21 be invited to the Media Council's ordinary session to be held on 17 August 1999 in order to try to find a solution to their dispute".)

procedures to settle the dispute domestically which the Claimant should respect instead of evading the requirements in accordance with its own wishes. Furthermore, the provisions just prescribe the precondition which the dispute does not need to be resolved through negotiation, but does not clarify how far the dispute negotiations should go. The Claimant should not take progress in negotiations as arguments, nor should the the *Ronald* Tribunal. The main point of this provision is the six-month waiting period, instead of negotiation. Therefore, futility is not justification for non-compliance with the waiting period, but a violation of *jus cogens*, grounded on *Pacta Sunt Servanda.*

IV. *Siemens A.G. v. The Argentine Republic*

This case involved a dispute between a German investor and the Argentine government. The Claimant had signed an investment contract with the previous Argentine government. However, a new Argentine government came to power and suspended the contract with the Claimant.[213] So the investors filed claims against Argentina. However, the Respondent objected to the jurisdiction according to Article 10 (2) of Germany-Argentina BIT, which provides that,

> (2) If a dispute within the meaning of paragraph 1 cannot be settled within six months from the date on which one of the parties concerned gave notice of the dispute, it shall, at the request of either party, be submitted to the competent courts of the Contracting Party in whose territory the investment was made.
> (3) The dispute may be submitted to an international arbitral tribunal in any of the following circumstances:
> (a) At the request of one of the parties to the dispute where, after a period of 18 months has elapsed from the moment when the judicial process provided for by paragraph 2 of this article was initiated, no final decision has been given or where a decision has been made but the Parties are still in dispute...[214]

The Claimant contended that there was no possibility for the local courts to give a decision within an eighteen-month period, and it "would be a futile exercise since it is well known".[215] Later, the claimant seemed to support an "obvious" standard when referring to

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[213] The *Siemens* case, *supra* note 133, at 6.
[214] Agreement concerning the Encouragement and Reciprocal Protection of Investments, Argentina-Germany, Article 10, September 14, 1991, UNCTAD, Investment Policy Hub.
[215] The *Siemens* case, *supra* note 133, at 29.

"Waiting Period", stating that, "Arbitration practice demonstrates that waiting periods are procedural rather than jurisdictional and need not to be observed if negotiations are obviously futile."[216]

The Respondent maintained that the Claimant cannot refuse to comply with the "Waiting Period" in terms of the ground that "local remedies is useless or expensive".[217] Additionally, the Respondent referred to *ELSI* in which ICJ maintains that the principle of the rule of International Law should not be tacitly dispensed with.[218]

When referring to the issue of whether the "waiting period" is futile or not, the Tribunal did not assess the local remedies or give an opinion on the futility test. The Tribunal first focused on the nature of the "Waiting Period", stating that,

> Article 10(2) does not require a prior final decision of the courts of the Respondent. It does not even require a prior decision of a court at any level. It simply requires the passing of time or the persistence of the dispute after a decision by a court. Then, even if this decision is one subject to appeal, the requirement of Article 10(2) would have been fulfilled. For these reasons, the Tribunal considers that Article 10(2) is not comparable to the local remedies rule and the issue of a tacit waiver of a rule of international law does not arise.[219]

This analysis distinguished the local remedies in the "Waiting Period" from the exhaustion of local remedies rule in the Public International Law, so a waiver issue did not exist. The Tribunal avoided discussion of futility but analyzed the "sensitive policy" contended by the Respondent. Through comparison with other BITs signed during the same period, the Tribunal found that the prior requirement to resort to local courts was not required in these BITs, the "foreign policy" contention could not be admitted.[220]

In this paragraph, it could be seen that the Tribunal analyzed whether the "Waiting Period" plays its function instead of objectively assessing the availability of futility. I argue that the Siemens Tribunal also adopted a subjective approach, stating that as the Respondent

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[216] *Id.*, at 68.
[217] *Id.*, at 20.
[218] *Id.*, at 18.
[219] *Id.*, at 42.
[220] *Id.*

had not exercised consistent practice on the prior local remedies requirement, non-compliance with the "Waiting Period" could not establish the objection to jurisdiction.

V. *Yukos Universal Limited (Isle of Man) v. The Russian Federation*

The *Yukos* case received attention mainly due to the extremely high damages which the final award was over US$50 billion. But we cannot overlook the Tribunal's application of a strict standard of futility exception. The provisions relating to the prior local remedies were provided in Article 26(3)(b)(i) and Annex ID of the ECT,

> (a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article.
> (b) (i) The Contracting Parties listed in Annex ID do not give such unconditional consent where the Investor has previously submitted the dispute under subparagraph (2)(a) or (b).

"List of contracting parties not allowed an investor to resubmit the same dispute to International arbitration at a later stage under Article 26" was provided in ANNEX ID. The Russian Federation is on the list. It is also notable that the list is "in accordance with Article 26(3)(b)(i)".[221]

The Claimants claimed that the International Tribunal had the jurisdiction to give an adjudication on this case, because "any referral made to the Russian Ministry of Finance or the tax authorities of the United Kingdom and Cyprus for that matter, would be an exercise in futility."[222] The Claimants continued to illustrate that "the tax authorities to review the entire file -- written submissions, relevant correspondence, expert reports, witness statements, hearing transcripts and over 8,000 exhibits -- and to comment on it, would amount to a

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[221] The Energy Charter Treaty, December 1994, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2427/download (last visited July 19, 2021).
[222] The *Yukos* case*, supra* note 170, at 450.

'useless exercise'."[223] The Claimants also said that "the Russian Ministry of Finance would effectively be asked to 'be a judge in its own cause' "[224].

The Respondent replied that according to Article 26(3)(b)(i) and Annex ID of the ECT，the Tribunal does not have the jurisdiction. The claimants were not allowed an investor to resubmit the same dispute to International Arbitration.[225]

The *Yukos* Tribunal accepted the Claimants' arguments on the futility and stated that the Claimants' "referral to the tax authorities would be an 'exercise in futility' ".[226] The Tribunal also elaborated on the "obvious futility" grounded on the good faith interpretation of the provision,

> The requirement for an investor to make a referral under Article 21(5)(b)(i), first sentence (and, a fortiori, the requirement for the Tribunal to make a referral under Article 21(5)(b)(i), second sentence) cannot, in the Tribunals' view, apply in cases where such a referral would obviously be futile. Like any provision in an international treaty, Article 21(5)(b)(i) of the ECT must be interpreted in good faith. A good faith interpretation of the provision leads to the conclusion that a referral cannot be required if following the referral procedure would clearly be futile under the circumstances of a specific case.[227]

The Tribunal reckoned that the relevant authorities cannot produce "timely and meaningful conclusion about the dispute or make any timely determinations that could potentially serve to assist the Tribunal's decision-making" so that the referral is "clearly futile" and the referral is not required. Based on these reasons, the Tribunal dismissed the Respondents' objections to jurisdiction.[228]

Despite applying the strict standard, the Tribunal finally reached an absolutely different conclusion from the one of the *ICS* Tribunal and affirmed that the claims of futility exception in *Yukos* were established. From the decisions of two Tribunals, it seems that both of them

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[223] *Id.*, at 450, 451.
[224] *Id.*, at 450.
[225] *Id.*, at 403.
[226] *Id.*, at 451.
[227] *Id.*, at 452.
[228] *Id.*, at 578.

adopted the same strict futility standard using similar keywords -- "obviously" "clearly", but the application is totally different. The *ICS* Tribunal examined whether the local remedies were available mainly according to the "local law" and "prevailing circumstances", while the *Yukos* Tribunal reckoned that the relevant authorities cannot produce "timely and meaningful conclusions" ground on the procedures of domestic remedies was too complicated. One is an objective method, and the other is a rather subject approach without a real try on the remedies. It could be noticed that the keywords with subjective overtones -- obvious, patently, manifestly, clearly, etc., are not the keys to solving the futility issue because they could be misused to interpreted whether the local remedies are obvious futile or not.

VI. *Abaclat and Others v. The Argentina Republic*

In the *Abaclat v. Argentina* case, the parties disputed over whether the eighteen-month local remedies prerequisite provided by Article 8 of BIT was a mandatory one? Whether it had a consequence on the admissibility of the proceeding or jurisdiction on the Tribunal?[229] Regarding the eighteen-month period, Article 8 of the Italy-Argentina BIT provides as below,

> 1. Any dispute regarding an investment between an investor of one of the Contracting Parties and the other Party, arising out of or relating to this Agreement, shall, to the extent possible, be settled through friendly consultation between the parties to the dispute.
> 2. If the dispute cannot be settled amicably, it may be submitted to the competent judicial or administrative courts of the Party in whose territory the investment is made.
> 3. Where, after eighteen months from the date of notice of commencement of proceedings before the courts mentioned in paragraph 2 above, the dispute between an investor and one of the Contracting Parties has not been resolved, it may be referred to international arbitration.[230]

The Respondent contended that Article 8 of BIT eighteen-month local remedies prerequisite "articulates a multi-layered, sequential dispute resolution system setting forth a

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[229] *Abaclat and Others v. The Argentina Republic* (hereinafter the *Abaclat* case), ICSID CASE NO. ARB/07/5, Decision on Jurisdiction and Admissibility, 223 (August 4, 2011), https://www.italaw.com/cases/documents/340. (last visited July 19, 2021).
[230] Argentina-Italy BIT (1990), *supra* note 131, Article 8.

three-step mandatory process".[231] Additionally, the provisions of Article 8 of BIT were a jurisdictional issue. The Claimant's non-compliance with it constituted a jurisdictional hurdle.[232] To support its contentions, the Respondent further explained that, "(i) The mere argument that resort to domestic courts would involve time or money may not render such litigation futile. (ii) The Emergency Law does not prevent Claimants from submitting a dispute before the Argentine courts under the BIT."[233]

The Claimant rebutted that the three solutions offered by Article 8 of BIT do not constitute "a compulsory multi-layered, sequential dispute resolution system", while they were different options of dispute solutions. That is to say, the eighteen-month prior local remedies prerequisite is not a mandatory precondition before recourse to international arbitration. Furthermore, the Claimant contended that even if it was a mandatory prerequisite, it had sufficient reasons to relieve from it. On the one hand, the local remedies in Argentina would have been futile; on the other hand, the requirement has contravened "the very object and purpose" of the BIT.[234]

The Tribunal first ascertained the merits relating to the eighteen-month prior prerequisite that the Claimant did not initiate proceedings before Argentine courts.

Then the Tribunal supported the Respondent's view that the dispute solutions provide by Article 8 was "a multi-layered, sequential dispute resolution system".[235] It was not a "pick and choose" system, but a system with "a certain hierarchy of three interconnected means of dispute solutions", which conducted as " the failure of one of them that would trigger the next one".[236]

Next, besides the wording of Article 8 context, the Tribunal stated that concern should be given to the aim and purpose, which was to "provide the disputing parties with a fair and

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[231] The *Abaclat* case, *supra* note, at 229.
[232] *Id.,* at 224.
[233] *Id*., at 225.
[234] *Id.*, at 225, 226.
[235] *Id.*, at 218.
[236] *Id.*, at 226.

efficient dispute settlement mechanism".[237] The Tribunal summarized that the real question under the object and purpose of BIT was that "whether this disregard, based on its circumstances, can be considered compatible with the object and purpose of the system put in place by Article 8, or whether it goes against it", instead of that whether the non-compliance with eighteen months litigation prerequisite could preclude Claimants from resorting to arbitration[238].

Then a so-called "a general balancing approach" was adopted.[239] The Tribunal distribute fairness and efficiency respectively to the Respondent and the Claimant, expounding that the interests behind the Respondent were to "put in place to give the Host State the opportunity to address the allegedly wrongful acts within the framework of its own domestic legal system and to provide a chance to resolve the dispute in a potentially shorter period than international arbitration"[240]. So the provisions aimed to show respect for state sovereignty. While for the Claimant, the main concern was whether it could be provided with an efficient solution.

The Tribunal analyzed that the solution through litigation before Argentine courts "only theoretical and/or could not have led to an effective resolution of the dispute within the 18-month time frame"[241]. Nevertheless, the Tribunal did not continue to elaborate on futility, but focused on the competing interests between parties, stating that "this conclusion derives more from a weighting of the specific interests at stake rather than from the application of the general principle of futility".[242] It returned to the "general balancing approach"[243]. And the Tribunal found the local remedies that Argentina provided were not "effectively"[244] to solve the dispute, as the Emergency Law and other relevant laws and decrees prohibited the Argentine government from paying any compensations. So Argentina was not "in a position to adequately address the present dispute within the framework of its domestic legal

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237 *Id*., at 227.
238 *Id*., at 228.
239 Mollengarden, *supra* note 15, at 451.
240 The *Abaclat* case, *supra* note 229, at 192.
241 *Id*., at 229.
242 The *Abaclat* case, *supra* note 229, at 229.
243 Mollengarden, *supra* note 15, at 451.
244 The *Abaclat* case, *supra* note 229, at 230.

system"[245]. At last, the Tribunal confirmed that Argentina's interests to solve the dispute through its own domestic legal system cannot "justify depriving Claimants of their right to resort to arbitration".[246] The Tribunal finally decided that the case is admissible though without compliance with the domestic litigation requirements in Article 8 of the BIT.[247]

In my opinion, although the Tribunal stated "the conclusions derive more from a weighting of the specific interests at stake rather than from the application of the general principle of futility"[248], but as all the reasons provided above, it could be seen that the futility analysis and a weighting of different interests on parties were cross-applied. When applying the futility, the Tribunal used the word not "effectively"[249] and not "adequately"[250] to describe the local remedies under the circumstances. Though not explicitly expressed, these words show that the Tribunal adopted an intermediate standard. If the local remedies within eighteen-month time frame were available, the prior litigation prerequisite cannot be circumvented. On the other hand, the Tribunal concentrated on the "general balancing approach"[251] to relieve the Claimant from eighteen months of local litigation. But this approach was too simple to be convincing. Firstly, this non-legal approach could only be a supplementary method to give rulings in an adjudication; Secondly, there is no hierarchy of the two interests -- fairness and efficiency. It is hard to say that the efficiency for the investors weighs heavier than the fairness for the host state. The Respondent wanted to solve the dispute in an efficient way and the Claimant also wanted to get fair rulings. These rigid rules to distribute interests are not desirable, making it rather dangerous to apply when the tribunal arbitrarily exercises discretion.

Another distinction that made this case different from others is that the Tribunal clearly stated that the waiting period was a bar to admissibility to the international tribunal instead of

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245 *Id.,* at 231.
246 *Id*., at 230-231.
247 *Id*., at 280-282.
248 *Id*., at 229.
249 *Id*., at 230.
250 *Id*., at 231.
251 Mollengarden, *supra* note 15, at 451.

a hurdle to jurisdiction. It shows that the nature of the precondition directly decides the conclusion of the decision.

In summary, I have two other comments to add. Firstly, when the Tribunal stated that the establishment of futility should be examined under the prevailing circumstances and analyzed that the local remedies were not available because the Emergency Law and other relevant laws and decrees prohibited the Argentine government from paying any compensations. Accordingly, it is enough to illustrate that there was no need to comply with the eighteen-month period. Secondly, at this time, the improper application of weighing interests will only impair the authority of the decision.

VII. *ICS Inspection and Control Services Ltd. v. Argentina*

The cause of dispute between ICS and Argentina was due to an Inspection Programme launched by the Argentine government. The Claimant contended that the Respondent did not pay enough money according to the Contract and violated "basic and fundamental standards of protection" by BIT.[252] In accordance with the facts, the Claimant argued that the litigation before Argentine courts was a futile exercise, as the dispute could not be solved within 18 months by local remedies, but would only postpone the remedies.[253]

In the *ICS v. Argentina* case, the United Kingdom-Argentina BIT provides that the eighteen-month local remedies are a mandatory precondition to resort to international arbitration, which is set out below:

> ARTICLE 8
> Settlement of Disputes Between an Investor and the Host State
> (1) Disputes with regard to an investment which arise within the terms of this Agreement between an investor of one Contracting Party and the other Contracting Party, which have not been amicably settled shall be submitted, at the request of one of the Parties to the dispute, to the decision of the competent tribunal of the Contracting Party in whose territory the investment was made.

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[252] *ICS Inspection and Control Services Limited v. The Argentina Republic* (hereinafter the *ICS* case), PCA Case No. 2010-9, Award on Jurisdiction, 8-10, (February 10, 2012), https://www.italaw.com/cases/documents/553 (last visited July 19, 2021).

[253] *Id*., at 52.

> The aforementioned disputes shall be submitted to international arbitration in the following cases:
> if one of the Parties so requests, in any of the following circumstances:
> (i) where, after a period of eighteen months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision;
> (ii) where the final decision of the aforementioned tribunal has been made but the Parties are still in dispute;
> (b) where the Contracting Party and the investor of the other Contracting Party have so agreed.[254]

To object to the jurisdiction, the Respondent replied that the Argentine courts got the jurisdiction instead of the International Tribunal grounded on the Claimant's non-compliance with the prior 18-month period before recourse to International arbitration.[255]

Before applying futility to the case, the *ICS* Tribunal invoked the rulings of the *Abaclat* Tribunal and gave some comments. The main thoughts of the comments are the overuse of teleological interpretation was rather dangerous and there was no basis in "either the treaty text or in any supplementary interpretative source".[256] Then the Tribunal invoked rules of treaty interpretation to affirm that compliance with the provisions of prior 18-month prerequisite is legitimate under Article 31 and 32 of VCLT, stating that,

> The Tribunal cannot therefore create exceptions to treaty rules where these are merely based upon an assessment of the wisdom of the policy in question, having no basis in either the treaty text or in any supplementary interpretive source, however desirable such policy considerations might be seen to be in the abstract.[257]

After analyzing that the precondition cannot be circumvented, the tribunal applied theory of futility to this case and didn't see any futility in this case although the report of the claimant "suggested that a resolution of the dispute within 18 months was unlikely...".[258] Then the tribunal invoked the commentaries on *ILC 2006 Draft Articles on Diplomatic Protection* to reiterate the standard of the establishment of futility, commenting as below,

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[254] Agreement for Promotion and Protection of Investment, Argentina-U.K. BIT, December 11, 1990, Article 8, UNCTAD, Investment Policy Hub.
[255] The *ICS* case*, supra* note 252, at 33-35.
[256] *Id.*, at 87-88.
[257] *Id.*, at 88.
[258] *Id.*

> In order to meet the requirements of paragraph (a) it is not sufficient for the injured person to show that the possibility of success is low or that further appeals are difficult or costly. The test is not whether a successful outcome is likely or possible but whether the municipal system of the respondent State is reasonably capable of providing effective relief. This must be determined in the context of the local law and the prevailing circumstances. This is a question to be decided by the competent international tribunal charged with the task of examining the question whether local remedies have been exhausted.[259]

According to the commentaries, the establishment of futility should not be determined by the subject claims, it should base on the object circumstances, including the local law, local legal system, and other conditions.

Last but not the least, the tribunal referred to the "obvious futility" to further state that the non-compliance with 18-month local remedies precondition cannot bring about the direct recourse to international arbitration, stating that,

> Even if the Tribunal were to accept Mr. Bianchi's report insofar as it suggests that a resolution of the dispute within 18 months is unlikely, this would not be sufficient to establish futility. This is not a case of obvious futility, where the relief sought is patently unavailable within the Argentine legal system. There is an open and legitimate debate between the Parties' experts as to availability of remedies within the Argentine legal system which may have resolved the dispute within 18 months. Therefore, in the absence of even a cursory attempt by the Claimant, the Tribunal simply cannot conclude that recourse to the Argentine courts would have been completely ineffective at resolving the dispute.[260]

Without even a "cursory attempt" by the Claimant, the Tribunal reckoned that there was no compelling reason to justify for the non-compliance with the prior 18-month litigation before Argentine courts. Finally, the Tribunal declined the jurisdictional claims on the basis of futility.[261]

This is a so-called "typical case" that the tribunal clearly applied the strict standard of futility.[262] Finally, as the attempts of claimants did not meet the standard of futility, the

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[259] ILC, *Draft Articles on Diplomatic Protection with commentaries*, Article 15, comment (4), 48, (2006).
[260] The *ICS* case*, supra* note 252, at 88-89.
[261] *Id.*, at 90.
[262] Mollengarden, *supra* note15, at 446.

invocation of the futility of local remedies failed. However, I contend that the reason that this case was put into the "obvious futile" category is because the Tribunal used the keywords -- "obvious" "patently" "completely", and then rejected the jurisdiction over the claims. But the more important is that the approach based on local law and the prevailing circumstances from commentaries on *ILC 2006 Draft Articles on Diplomatic Protection*, "whether the municipal system of the respondent State is reasonably capable of providing effective relief. This must be determined in the context of the local law and the prevailing circumstances." Which is more objective and accurate than adopting words with subjective emotional overtones.

VIII. *Urbaser v. Argentina*

This dispute dates back to 2001-02 Argentine crisis and the cause of the dispute arose from the Emergency Law of Argentina.[263] The main claims of the case are based on tariff issues and other allegations regarding the Concession on the provision of drinking water and sewage services.[264] The first objection of the Respondent to the Jurisdiction is that the Claimant did not comply with the prior local remedies requirement provided in 1991 Argentina-Spain BIT.[265] The Claimant contended that it was impossible for the dispute to be solved within 18 months as provided in the BIT concerned.[266] Such an exercise was "merely hypothetical and of no practical".[267] And then the Respondent provided the opinions of an expert to confirm that such remedies in local administrative organs or courts could not produce any decisions within an eighteen-month period.[268] It was "senseless and futile" for the investor to resort to local courts.[269]

Referring to the futility claims, the Tribunal first analyzed the purpose and relevance of the prior requirement. The Tribunal stated that the prior requirement gave the host state a "fair

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[263] *Summary of Urbaser v. Argentina case*, https://investmentpolicy.unctad.org/investment-dispute-settlement (last visited July 19, 2021).
[264] *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic* (hereinafter the *Urbaser* case), ICSID Case No. ARB/07/26, Decision on Jurisdiction, 7 (December 19, 2012), https://www.italaw.com/cases/documents/1794 (last visited July 19, 2021).
[265] *Id.*, at 16-22.
[266] *Id.*, at 22.
[267] *Id*., at 23.
[268] *Id.*, at 24.
[269] *Id*., at 20.

opportunity" to solve the dispute in its courts, while the Claimant also deserved the efficient remedies.[270] The Tribunal made it clear that it could not agree with the standard of "obvious futility" invoked by the *ICS* Tribunal, and proposed that the Host State should "place the threshold above the floor requirement".[271] Then the Tribunal referred to dispute settlement provisions in other BITs to further confirm that "such rule was considered useless or even futile" as there was no similar requirement in other BITs.[272] The requirement does not give the investor "benefit" but only operates as an "obvious compromise".[273] Different from the merits in the *ICS* case, the "expert-witness testimony" in this case could help to prove the futility of local remedies.[274] It is notable that the Tribunal analyze the effects of Emergency Law and concluded that the related legislation "prohibited the Argentine government from entering into any juridical, extra-juridical or private transaction",[275] which assessed futility under the prevailing circumstances and domestic law. Another ground which the Tribunal based to favour the futility exception claim is "decision on the substance"[276], which is regarded as the purpose of the requirement. In the opinion of the Tribunal, a requirement which could not reach such an aim is "useless and unfair to the investors".[277] Based on the foregoing analysis, the Tribunal finally states that the Claimant was not required to comply with the prior litigation before Argentine courts.[278]

IX. *Ambiente Ufficio S.p.A. and Others v. The Argentine Republic*

The background of this case is similar to that of the *Abaclat* case. The Claimants contended that there was an exception to the eighteen months prior litigation requirement when the local remedies were futile according to Article 8 of BIT. Hence, the Respondent accepted the view that futility exceptions existed under Article 8 of BIT, but the

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[270] *Id*., at 40-41.
[271] *Id*., at 41.
[272] *Id*., at 42.
[273] *Id*., at 45.
[274] *Id*., at 48.
[275] *Id*., at 50.
[276] *Id*., at 66-70.
[277] *Id*., at 68.
[278] *Id.*

circumstances of the case did not constitute futility as " the relevant threshold is very high".[279] The main issue here was whether the futility exceptions were established according to the provisions of Article 8 of BIT and the facts provided by the parties in this case.

First, the Tribunal stated that the futility exception to the exhaustion of local remedies in the context of diplomatic protection could also be applied in the disputing case in light of Article 8 of BIT. The Tribunal further invoked the interpretation clauses in VCLT, included in Article 31 of General rule of interpretation, providing that,

> 3. There shall be taken into account, together with the context: (c) any relevant rules of international law applicable in the relations between the parties.[280]

Based on this rule, the Tribunal expounded that the futility exception to local remedies in the context of diplomatic protection had already been a customary International Law recognized by a lot of cases and academia. Hence, it could also be applied to the eighteen months prior litigation requirement. Then the Tribunal referred to the threshold of the futility which was also the main bone of the contentions.

Next, the Tribunal made it clear that it firmly supported the threshold provided by Article 15(a) of the *2006 ILC Draft Articles on Diplomatic Protection*, providing as follows: "Local remedies do not need to be exhausted where…there are no reasonably available local remedies to provide effective redress, or the local remedies provide no reasonable possibility of such redress".[281] After making clear of accepting the intermediate standard of futility in this case, the Tribunal compared the futility threshold in this case with the one in the context of exhaustion of local remedies, reckoning that "the threshold to be met for the futility exception to be realized in the present case cannot possibly be considered higher than in the context of diplomatic protection; on the contrary, it is arguably rather lower."[282]

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[279] *Ambiente Ufficio S.p.A. and others v. Argentine Republic* (hereinafter the *Ambiente* case), ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, 202 (February 8, 2013), https://www.italaw.com/cases/documents/1751 (last visited July 19, 2021).
[280] VCLT, *supra* note 172.
[281] ILC, *supra* note 77.
[282] The *Ambiente* case*, supra* note 279, at 208.

When applying the futility exception, the Tribunal gave its decisions on the debate between the Respondent and the Claimant. The Tribunal accepted the Claimant's arguments and stated that the domestic *Galli* case also applied "in principle, with equal force to non-domestic bondholders" as BIT was inferior to the Constitution of Argentina.[283] Hence, in terms of the domestic case, local laws, and the circumstances prevailing, the Tribunal gave conclusions that the local litigation proceedings, even to the Argentine domestic courts "would not have offered Claimants a reasonable possibility to obtain effective redress from the local courts and would have accordingly been futile".[284]

Finally, the Tribunal decided that it had the jurisdiction to decide this case and the claims of the Claimants were admissible.[285]

This case could be regarded as a typical case adopting the intermediate standard of futility, not only from a clear invocation of Article15(a) of the *2006 ILC Draft Articles on Diplomatic Protection* but also from the application of the standard which gave conclusions that the local remedies were not available under the domestic case, local laws, and the circumstances prevailing. Based on a reasonable standard, how to make the intermediate standard more applicable is what we expect. We will discuss it in the last part of this Chapter.

3.3.3 Summary

To clearly present the overviews and key points of the futility cases analyzed in the foregoing part, I put them in the following table in chronological order.

Cases	Arbitration Tribunal	Types of Local Remedies Provisions	Standard of Futility	Decision
Loewen v. U.S. [286](2001)	ICSID	No-U-Turn	Intermediate	Rejected the jurisdiction
Link-Trading v.	UNCITRAL	Waiting period	Lenient	Retained the jurisdiction

[283] *Id.*, at 211.
[284] *Id.*, at 212.
[285] *Id.*, at 217.
[286] *See the Loewen* case*, supra* note 93.

Moldova[287] (2001)				
Ronald v. Czech[288] (2001)	UNCITRAL	Waiting period	Lenient	Retained the jurisdiction
Siemens v. Argentina[289] (2004)	ICSID	Waiting period	Not based on futility, but on the function of the prior requirement (subjective approach)	Retained the jurisdiction
Yukos v. Russia[290] (2009)	UNCITRAL	Mandatory local remedies provisions	Obvious	Retained the jurisdiction
Abaclat v. Argentina[291] (2011)	ICSID	Waiting period	Intermediate	Retained the jurisdiction
ICS v. Argentina[292] (2012)	UNCITRAL	Waiting period	Obvious	Rejected the jurisdiction
Urbaser v. Argentina[293] (2012)	ICSID	Waiting period	Lenient but in some objective circumstance approach	Retained the jurisdiction
Ambiente v. Argentina[294] *(2013)*	ICSID	Waiting period	Intermediate	Retained the jurisdiction

From the table above, some preliminary conclusions could be reached. Firstly, as long as the futility exception was invoked by the Claimant to evade the local remedies, it is highly probable that the international Tribunal will retain the jurisdiction. Secondly, different Tribunals may adopt a different standards of futility without inconsistent practice. No standard acquire extremely high favour ratings. Thirdly, no matter which standard the Tribunal has adopted, there is lot of room for interpretation.

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287 *See* the *Link-Trading case*, supra note 194.
288 *See* the *Ronald* case*, supra* note 205.
289 *See* the *Siemens* case, *supra* note 133.
290 *See* the *Yukos* case, *supra* note 170.
291 *See* the *Abaclat* case, *supra* note 229.
292 *See* the *ICS* case*, supra* note 252.
293 *See* the *Urbaser* case*, supra* note 264.
294 *See* the *Ambiente* case*, supra* note 279.

I argue that if an exception has been frequently used as a general rule and achieves success, it could be regarded as misuse. In this vein, I could provide a preliminary conclusion that the hypothesis that futility has been misused holds true.

3.4 Violations of Rules of International Law

As rules of International Law, the most important issue is compliance with International Law which demonstrates the legitimacy of the rulings. The *ICS* Tribunal expressed a similar view,

> As much as any given rule of interpretation is liable to produce results in certain cases that some regard as undesirable, the need for a rule, and for that rule to be respected, is unavoidable for the establishment of the rule of law.[295]

In terms of the futility exception cases analyzed above, some tribunals have not given decisions based on the rules and jurisprudence of International Law, hence, these decisions were not in accordance with the rules of International Law. By exerting discretion, some international tribunals give rulings arbitrarily on their own interpretations or are motivated by other incentives.[296] However, sometimes the rulings neglect legitimacy which is the baseline we really should hold on to. The reasons that we should comply with the local remedies provisions under normal circumstances have their legal basis, that will be analyzed in the following sections.

3.4.1 Non-compliance with *Pacta Sunt Servanda*

Pacta Sunt Servanda is a general principle of International Law with the principle of non-intervention by one state in the affairs of another and the principle of the legal equality of states.[297] Some scholars like Tim Hiller, pointed that it could also be validly claimed to

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[295] The *ICS* case*, supra* note 252, at 88.

[296] *See e.g.,* Orley Ashenfelter*, Arbitrator Behavior*, AMERICAN ECONOMIC REVIEW VOL.77 NO.2, 342-43 (1987);
See also Robert B. Kovacs, *Efficiency in International Arbitration: An Economic Approach*, 23 AM. REV. INT'L ARB.155, 160 (2012); Anne van Aaken & Tomer Broude, *Arbitration from a Law and Economics Perspective*, in THE OXFORD HANDBOOK OF INTERNATIONAL ARBITRATION (Thomas Schultz & Federico Ortino eds., forthcoming 2019).

[297] MURPHY, *supra* note 147, at 91.

constitute a rule of *jus cogens*.[298] Professor James R. Crawford explained *Pacta Sunt Servanda* as, "The principle that agreements are binding and are to be implemented in good faith".[299]

Pacta Sunt Servanda is included in Article 26 of 1969 Vienna Convention on the Law of Treaty, providing that, "Every treaty in force is binding upon the parties to it and must be performed by them in good faith".[300] Then Article 27 provides that "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[301]

Explained in detail, *Pacta Sunt Servanda* has three meanings, the first one is that the treaty is binding on the parties, the second one is every party should perform obligations in good faith, the third one is the party cannot invoke the national law for not performing the obligations.[302]

There are mainly two types of provisions relating to local remedies.[303] No matter which type, as long as the treaty enters into force, the local remedy clauses should be complied with to the letter, which reflects the parties' consent to the jurisdiction of the host state. The consent to the local remedies provisions incorporated in the IIAs shows that the parties are voluntary to be bound by the clauses which have entered into force, conversely, treaties arise from the consent of states.[304] Consent is the basis of treaties, which almost every procedure in treaty law is based on the State's consent. Without consent, no treaties could be signed or enter into force.[305] *Pacta Sunt Servanda* is a corollary of the State's consent to the treaty and also an obligation of the contracting parties to observe the provisions in good faith.[306]

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298 TIM HILLER, SOURCEBOOK ON PUBLIC INTERNATIONAL LAW, 138 (Cavendish Publishing Ltd., 1st ed. 1998).
299 CRAWFORD, *Supra* note 145, at 186, 303.
300 VCLT, *supra* note 172.
301 *Id.*
302 *Id.*
303 *See* YAMASHITA, *supra* note 121.
304 MURPHY, *supra* note 147, at, 38.
305 VCLT, *supra* note 172, for example, Article 3,7,9,11,12,13,14,17,18, etc.
306 SHABTAI ROSENNE, ESSAYS ON INTERNATIONAL LAW AND PRACTICE, 520 (Martinus Nijhoff publisher, LEIDEN • BOSTON 2007).

The principle of *Pacta Sunt Servanda* was also invoked by the *ICS* Tribunal, expounded as follows,

> The standard of consent is firmly established in international law and does not vary according to the context in which it is considered. BITs are treaties and as such are instruments belonging to the international legal order and deriving their force from the *Pacta Sunt Servanda* rule of that order.[307]

I reckon that if doubting the reasonableness of the local remedies provisions, the parties should negotiate or make reservations on it, instead of applying other ways to deteriorate the legitimacy of the treaty provisions. With respect to futility claims, what we should make clear is that observance of the local remedies provisions is the general rule,[308] while futility is merely an exception which only could be invoked under extraordinary conditions.[309] Ignoring the exceptional characteristic, the claimants wanted to make use of the exception and discretion of the arbitration tribunals to fight against the terms written in White and Black and justify the non-compliance with local remedies provisions in IIAs.

Here again, we take the *Ronald* case which we are already familiar with for example to see how the case has violated the principle of *Pacta Sunt Servanda*. The Czech-U.S. BIT provides that there was a six-month negotiation period before commencing international arbitration if any investment dispute arises and the parties consented to the provisions.[310] According to the principle of *Pacta Sunt Servanda,* as far as the dispute arose, the parties shall observe the six-month negotiation period. Only when the dispute has not been resolved within the six months, could the parties refer to other solutions they consented to in advance. The Claimant contended that after sending a letter to the local remedies for 17 days, the Respondent did not "react at all", so the six-month period was futile to solve the dispute.

I will analyze it from the following three aspects. First, the six-month period was consented to by the parties in BIT which both of them should observe in good faith without

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[307] The *ICS* case*, supra* note 239, at 92.
[308] *See e.g.,* Argentina-U.K. BIT (1990), Argentina-Germany BIT (1991), Argentina-Spain BIT (1991), Czech-U.S. BIT (1991), etc., UNCTAD, Investment Policy Hub.
[309] *See* ILC, *supra* note 77.
[310] Czech-U.S. BIT (1991), *supra* note 204, Article VI.

easily avoiding it. Secondly, the 17-day waiting period was not sufficient to prove the negotiation procedure was futile. Even though waiting a little bit longer, the Respondent's authoritative organs have their own procedures to settle the dispute domestically. The Claimant should comply with instead of evading the requirements in accordance with its own wish. Thirdly, the provisions just prescribe the precondition which the dispute should be resolved through negotiation but does not require any procedural result of the waiting period. The Claimant's contentions that the 17-day period had not achieved any progress through negotiations do not bear much legal basis. The highlight of these provisions is the six-month waiting period instead of negotiation.[311] Therefore, futility is not a reasonable justification for non-compliance with the waiting period, but a violation of the principle of *Pacta Sunt Servanda.*

3.4.2 Overlooking of Textual Interpretation

Textual interpretation is one of the treaty interpretation approaches which are well recognized.[312] Just as Tim Hiller illustrates that,

> There are those who start from the proposition that there must be a presumption that the intention of the parties are reflected in the text of the treaty which they have drawn up, and that the primary aim of interpretation is to ascertain the meaning of this text – generally referred to as the objective or textual approach.[313]

While Professor James R. Crawford states that only textual interpretation has been formally admitted, he writes,

> Various 'rules' for interpreting treaties have been put forward over the years. These include the textual approach, the restrictive approach, the teleological approach, and the effectiveness principle. Of these only the textual approach is recognized in VCLT: Article 31 emphasizes the intention of the parties as expressed in the text, as the best guide to their common intention. The jurisprudence of the International Court likewise supports the textual approach.[314]

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311 *See* the *Ronald* case*, supra* note 205.
312 *See* Odile Ammann, *Chapter 6 The Interpretative Methods of International Law: What Are They, and Why Use Them?* IN DOMESTIC COURTS AND THE INTERPRETATION OF INTERNATIONAL LAW, (Brill | Nijhoff, Odile Ammann, 2020).
313 HILLER, *supra* note 298, at 142.
314 CRAWFORD, *Supra* note 145, at 753.

It can thus be seen that there is no controversy over the approach of textual interpretation when interpreting the treaties. When referring to VCLT, the general rules of interpretation in Article 31 are formulated as,

> 1.A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
> 2.The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
> (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
> (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
> 3.There shall be taken into account, together with the context:
> (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
> (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
> (c) any relevant rules of international law applicable in the relations between the parties.
> 4. A special meaning shall be given to a term if it is established that the parties so intended.[315]

I assert that the sentence "the ordinary meaning to be given to the terms of the treaty in their context"[316] could be conceptualized as textual interpretation.

The words "ordinary meaning" originated from the *Polish Postal Service in Danzig* case.[317] PCIJ observed that "the postal service which Poland was entitled to establish in Danzig by treaty was not limited to working inside the postal building".[318] "Postal service" must be interpreted "in its ordinary sense so as to include the normal functions of a postal

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[315] VCLT, *supra* note 172.
[316] *Id.*
[317] *Polish Postal Service in Danzig* (hereinafter the *Polish Postal Service* case), Advisory Opinion of 16 May 1925, P.C.I.J., Series B: Collection of Advisory Opinions, (1923-1930), https://www.icj-cij.org/en/pcij-series-b (last visited July 19, 2021).
[318] CRAWFORD, *Supra* note 145, at 778.

service".[319] Since then, the principle of ordinary meaning has become the basic guide in the treaty interpretations.[320]

ICJ gave an explanation in the advisory opinion in the Competence of the General Assembly for the Admission of a State to the UN case (1950) in which the Court said that:

> The first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty is to endeavour to give effect to them in their natural and ordinary meaning in the context in which they occur. If the relevant words in their natural and ordinary meaning make sense in their context, that is an end of the matter.[321]

Therefore, the approach of textual interpretation should pay attention to "natural and ordinary meaning", "in the context" in order to give a reasonable interpretation. Here we take Argentina-U.K. BIT for example. Article 8 of the BIT provides "Settlement of Disputes Between an Investor and the Host State" and prescribes a waiting period as follows,

> The aforementioned disputes shall be submitted to international arbitration in the following cases:
> (a) if one of the Parties so requests, in any of the following circumstances:
> (i) where, after a period of eighteen months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision...[322]

This article unambiguously illustrates that only when the eighteen months prior litigation requirements are met, could either of the parties initiates the international arbitration proceedings. One step further, when "shall" is used in the second or third person, it bears the meaning of a command, compulsion, or promise. It has a more forceful effect in nature.[323] The characteristic is also recognized by legal practitioners. Generally speaking, "shall" bears a mandatory nature. Just like a blogger stated in construction contracts, "Parties attempt to use

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[319] The *Polish Postal Service* case, *supra* note 317, at 37.
[320] CRAWFORD, *Supra* note 145, at 778.
[321] *Competence of the General Assembly for the Admission of a State to the United Nations*, Advisory Opinion of March 3, 1950, 8, (ICJ Report, 1950).
[322] Argentina-U.K. BIT, *supra* note 254.
[323] *Differences between shall and may in English grammar,* http://www.differencebetween.net/language/grammar-language/differences-between-shall-and-may-in-english-grammar/. (last visited July 19, 2021).

plain and ordinary words to describe their respective obligations. As an example, when the parties use the word 'shall' in their agreement, they generally understand that the obligation specified is mandatory."[324]

From a textual approach, especially the word "shall" in the article, we could easily tell that the eighteen-month period is not only binding, but also a mandatory requirement. In that the two parties had consented to the eighteen-month period as one manifestation of local remedies rule, they should observe the provisions.[325] If this period could be easily bypassed, why do the parties bother to include it in the BIT? Therefore, I argue that the eighteen-month period could not be easily evaded as it is a provision with very clear and straightforward wording.

Furthermore, BITs are treaties in International Investment Law,[326] in which the parties consented to the provisions showing the assent to be bound by specific clauses.[327] Albeit Article 31 of VCLT also prescribes that "any relevant rules of international law applicable in the relations between the parties" shall be taken into consideration when treaties are interpreted[328] and futility exception has been recognized as customary International Law.[329] Nevertheless, there is no hierarchy between treaties and customary law.[330] Futility exception should not be applied superior to the clearly-provided prior requirements before recourse to international arbitration, nor should these exceptions arbitrarily justify the non-compliance with a waiting period. The customary International Law could apply when there are no explicit provisions to the issue in BITs.[331] If any cause, any reason could be interpreted as a

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[324] *Know the Difference Between "Shall" and "May" in Construction Contracts in Case of Arbitration*, https://www.bestpracticesconstructionlaw.com/. (last visited July 19, 2021).
[325] VCLT, *supra* note 172, Article 26.
[326] *See e.g., International Investment Law Research Guide - Bilateral Investment Treaties (BITs)*, https://guides.ll.georgetown.edu/c.php?g=371540&p=4187393 (last visited July 19, 2021); s*ee also* VCLT, *supra* note 172, Article 2.
[327] *See e.g.,* VCLT, *supra* note 172, Article 11, 12, 13, 14, 15, 17, etc.
[328] VCLT, *supra* note 172.
[329] AMERASINGHE, *supra* note 16, at 193, 194.; *Also* EDWIN M. BORCHARD, DIPLOMATIC PROTECTION OF CITIZENS ABROAD: OR THE LAW OF INTERNATIONAL CLAIMS, 821-25 (New York. The Banks Law Publishing Company, 1915*).*
[330] ANTONIO CASSESE, INTERNATIONAL LAW, 198 (Oxford University Press, 2nd ed. 2004).
[331] PETER MALANCZUK, AKEHURST'S MODERN INTRODUCTION TO INTERNATIONAL LAW, 56 (Seventh edition, Taylor & Francis Group, 1997).

futility exception, it would depart from the consent of the treaties and original intention of the parties.

3.4.3 Misuse of Teleological Interpretation

VCLT 1969 provides teleological interpretation as "treaty shall be interpreted in the light of its object and purpose"[332]. About the application, in the employment of *Women During the Night* case, Judge Anzilotti said:

> I do not see how it is possible to say that an article of a convention is clear until the subject and aim of the convention have been ascertained, for the article only assumes its true import in this convention and in relation thereto. Only when it is known what the contracting parties intended to do and the aim that they had in view is it possible to say either that the natural meaning of terms used in a particular article corresponds with the real intention of the parties, or that the natural meaning of the terms used falls short of or goes further than such intention.[333]

What he expressed was the importance of teleological interpretation, which was the basis for the interpretation of the natural meaning of the terms in the context. It bears some senses to a certain extent. When ascertaining the real intention of the parties, the teleological approach is necessary. However, I argue that it should not be the first step or the only approach in the general rules of interpretation,[334] as the approach is too subject which is "likely to be influenced by the personal views of the judicial decision-maker".[335] We can not accurately examine the real intention at the time that the parties signed the treaties.[336] In most cases, the parties were in a friendly and an amicable relationship when signing an investment treaty. Suppose the "Fork-in-Road" provisions,[337] the investor and the Host State signed an investment contract based on a friendly and cooperative background and were voluntary to

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[332] VCLT, *supra* note 172.
[333] Interpretation of the Convention of 1919 concerning Employment of Women during the Night, Dissenting Opinion by M. Anzilotti, P.C.I.J. Ser A/B, No 50, (1932), https://jusmundi.com/en/document/opinion/en-interpretation-of-the-convention-of-1919-concerning-employment-of-women-during-the-night-dissenting-opinion-by-m-anzilotti-tuesday-15th-november-1932 (last visited July 19, 2021).
[334] Ammann, *supra* note 312, at 209 and 212.
[335] *Id.*, 212.
[336] *Contra Id.*
[337] YAMASHITA, *supra* note 121, at 12-13.

make some concessions.[338] After the dispute arose, the positions of the parties might change. Then they may make arguments in favor of themselves. In the vein, the intention was rather inconsistent and unstable which could seriously affect the decisions.

When it comes to the approach of teleological interpretation, there are some drawbacks criticized by the scholars and practitioners, just like the comments by Professor Crawford,

> According to the teleological approach, any ambiguity in a treaty text should be resolved by preferring the interpretation which gives effect to the object and purpose of the treaty. This may involve a judicial implementation of purposes in a fashion not contemplated by the parties. The teleological approach has many pitfalls, not least its overt 'legislative' character.[339]

Professor Crawford concisely and comprehensively pointed out the problems brought by teleological interpretation, from the characteristics to the disastrous effects of the approach.

I argue that the object and purpose of the treaty are too macroscopical and general to apply in practice. Every article has its specific purpose and function, there may be some sub-purpose in the specific articles. Odile Ammann expressed a similar opinion, "The overall object and purpose of a treaty can be in tension with that of specific provisions. Moreover, a treaty often pursues several goals."[340] Recall the local remedies issues in the agenda of state responsibility in the 1930 Hague Conference[341] and the debate over whether local remedies should be incorporated into Article 26 of the ICSID Convention,[342] it could be seen that the considerations of local remedies have been the respect for state sovereignty. If the teleological interpretation was applied according to a overall object and purpose of the treaty as the only approach, the decisions neglecting other goals and interests must be unfair.

Like the "general balancing approach" in the *Abaclat* case, the Tribunal stated that the regard should be given to the aim and purpose of Article 8.[343] The Tribunal further said: "The

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338 VCLT, *supra* note 172, Article 51, 52, 69.
339 CRAWFORD, *Supra* note 145, at 775.
340 *See* Ammann, *supra* note 312, at 212.
341 Mollengarden, *supra* note 15, at 419-420.
342 ICSID PUBLICATION, *supra* note 63, at 838, 936-937.
343 Argentina-Italy BIT (1990), *supra* note 131, Article 8.

system put in place by Article 8 is a system aimed at providing the disputing parties with a fair and efficient dispute settlement mechanism."[344] Firstly, the Tribunal simply equaled the object and purpose of BIT to that of Article 8.[345] I argued that every clause provided in the BIT has its own functions to achieve different sub-objects. In the Tribunal's opinion, if the object and purpose of the treaty are to promote and protect investment, the whole BIT is to provide rights for investors and obligations for the Host State. In this case, why BIT bothers to incorporate local remedies clauses instead of dispensing with them? The international investment arbitration is established under the partial sovereignty transfer of sovereign states. It could not overly intervene in domestic affairs. International tribunals are the needs of economic globalization, but not established to undermine state sovereignty and independence. Even in an organization with high levels of integration like EU,[346] "Margin of Appreciation" is accorded to balance the protection of human rights and respect for disparate traditions and cultures.[347] I reckon that the Dispute Settlement clause also contains diverse purposes, one of which is aiming to strike a balance between the protection of foreign investment and state sovereignty.[348]

And then the Tribunal simply distributed fairness and efficiency respectively to the Respondent[349] and the Claimant and finally gave a conclusion that efficiency weighed heavier than fairness. But this rulings was too simple to be convincing. On one hand, there is no hierarchy of the two interests -- fairness and efficiency. It is hard to say that the efficiency for the investors weighs heavier than the fairness for the host state. On the other hand, the Respondent also wanted to solve the dispute in an efficient way and the Claimant also wanted to get fair rulings. The interests behind the parties and other policy considerations were rather complicated.[350] In this vein, the misuse of teleological interpretation equals to dig traps for unfair rulings. We should recognize the harm that the teleological interpretations bring,

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344 The *Abaclat* case, *supra* note 229, at 227.
345 *See* Agnone, *supra* note 22.
346 *European Commission - Frequently asked questions on languages in Europe,* https://ec.europa.eu/commission/presscorner/detail/en/MEMO_13_825 (last visited July 19, 2021).
347 ANDREW LEGG, THE MARGIN OF APPRECIATION IN INTERNATIONAL HUMAN RIGHTS LAW, 13 (Oxford University Press, 1st ed. 2012).
348 *See* Wang, *supra* note 40; *also* see Foster, *supra* note 24; Yu, *supra* note 24, etc.
349 Mollengarden, *supra* note 15, at 452.
350 *See Id.*

especially the legitimate issues, and should apply the approach strictly to help realize the "fair and efficient" aim of international arbitration.

The *ICS* Tribunal also objects to the reasoning of *Abaclat* Tribunal which is mainly based on a teleological approach, stating that,

> However, judicially-crafted exceptions must find support in more than a tribunal's personal policy analysis of the provisions at issue. This is especially dangerous in the absence of conclusive evidence adduced to support a tribunal's teleological inferences: the same provision may strike some as 'nonsensical' and others as 'genius'.[351]

A fortiori, the approach of teleological interpretation has a similar problem with the prevailing futility standards, which is too subjective and inaccurate to apply.[352] It gives the tribunals great space to exert discretion. If the international Tribunal holds that the object and purpose of BIT are to promote and protect investment, and the content of BIT usually stipulates the obligation of States parties to protect investors and their investment, then the tribunal is more likely to favour the investors when interpreting and applying the relevant provisions of BIT. Specifically, the tribunal will apply exceptions, extend the connotation and denotation of the contents of some provisions to support the claims of investors. It is this teleological approach that has generated arbitrary interpretations and inconsistent rulings which have sparked great controversies. So, teleological could be applied with "great caution"[353] and with other interpretative methods.[354]

3.4.4 Neglect of Principle of Contemporaneity

The principle of contemporaneity is regarded as an important principle in International Law, as Professor James R. Crawford imported the illustration in *US Nationals in Morocco* case to explain the principle of contemporaneity,[355]

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[351] The *ICS* case*, supra* note 252, at 87.
[352] Agnone, *supra* note 22, at 212.
[353] *Id*., at 208.
[354] *Id.*, at 209.
[355] CRAWFORD, *Supra* note 145, at 1143.

> The language of the treaty must be interpreted in the light of the rules of general international law in force at the time of its conclusion, and also in the light of the contemporaneous meaning of terms.[356]

The provisions should be interpreted with the general rules of treaty interpretation in 1969 VCLT, as well as the principle of contemporaneity. ICJ expressed similar views in Advisory Opinions on the *Nambia* case,

> The silence of a treaty as to the existence of such a right cannot be interpreted as implying the exclusion of a right which has its source outside of the treaty, in general international law, and is dependent on the occurrence of circumstances which are not normally envisaged when a treaty is concluded.[357]

In the *Wintershall* case, Tribunal stated, "it must be construed as at the time it was entered into".[358] By expounding the principle of contemporaneity, the Tribunal finally upheld the objection to the jurisdiction of ICSID in this case, because the Claimants invoke the MFN clauses in the Argentina-Germany BIT to circumvent compliance with the prior local litigation requirement provided in Article 10(2) that Article VII of Argentina-USA BIT. According to the principle of contemporaneity, the MFN clause of Argentina-Germany BIT did not include procedural issues. The interpretations of a treaty must adhere to the prevailing circumstances and also in the light of the contemporaneous meaning of terms instead of expanding interpretations to evade the local remedies.[359]

In the *Ronald* case, Article VII of Czech-U.S. BIT provides that, "the parties to the dispute shall initially seek to resolve the dispute by consultation and negotiation".[360] And then only after six months, could either of the parties initiate international arbitration.[361] In terms of the merits, the Claimant failed to comply with the six-month "waiting period", but

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356 *See Rights of Nationals of the United States of America in Morocco* (France v. United States of America), Judgement, 1952 I.C.J. Reports, 176, 189 (August 27).

357 *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276* (the *Nambia* case), Advisory Opinions, 1971 I.C.J. Report, 35 (June 21).

358 *Wintershall Aktiengesellschaft v. Argentine Republic* (hereinafter the *Wintershall* case), ICSID Case No. ARB/04/14, Award, 107 (December 8, 2008), https://www.italaw.com/cases/documents/1172 (last visited July 19, 2021).

359 ICJ Reports 1952, *supra* note 356.

360 Czech-U.S. BIT (1991), *supra* note 204, Article VI.

361 *Id.*

the Tribunal dismissed the Respondent's objections to jurisdiction based on a rather lenient futility standard.[362] If interpreting the dispute settlement provisions by the principle of contemporaneity, Article VI was the consent of the contracting parties to the six-month waiting period without any ambiguity, so there should not be any other interpretations relating to this clause. Based on the contemporaneous meaning, the "Waiting Period" provisions are restrictions put on the international arbitration. Simultaneously, the prior requirement shall be observed strictly only on the condition that the procedures could be proved reasonably futile.

3.5 Consequences of Misuse of Futility Exception

There are many consequences that misuse of the futility exception has brought about and will bring about.[363] Some of them could be a series of chain reactions, from the direct impacts to the indirect impacts, from a microcosmic level to a macroscopic one.

3.5.1 Expansion of International Tribunal's Jurisdiction

If the claimant has succeeded in evading local remedies, the direct consequence for non-compliance is that the international tribunal gets more chances to have jurisdiction over the dispute. For the investors, the futility exception could be a tactic for them to circumvent local remedies to directly acquire redress from international tribunals.[364] It is widely recognized that international investment arbitration tribunals tend to be more supportive of investors and they are more likely to rule in favour of investors.[365] While for the international tribunals, fewer local remedies mean jurisdiction over more international investment disputes, namely, expansion of international tribunal's jurisdiction.[366]

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362 *See* the *Ronald* case*, supra* note 205, at 38, 39.
363 *See* Mollengarden, *supra* note 15; *See also* Agnone, *supra* note 22.
364 Ye, *supra* note 19, at 6.
365 Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 HARV. INT'L L.J. 435, 436-37 (2009).
366 Agnone, *supra* note 22, at 363.

3.5.2 Undermining of State Sovereignty

One of the aims for investors to use futility exception is to evade local remedies and then directly resort to an international tribunal for redress.[367] However, the incorporation of local remedies provisions in IIAs has its rationales, thereinto, the primary one is respect for state sovereignty. Recall the drafting period of ICSID, Article 26 of the ICSID Convention which provides jurisdiction has triggered lots of disputes. The original version of Article 26 provided an exclusive jurisdiction of ICSID.[368] While what some states were concerned about was the issue of state sovereignty, such as intervention into domestic affairs, jurisdiction over disputes under domestic law, etc.[369] Finally, to strike a balance between the different concerns of different states, the Chairman made a compromise and incorporated local remedies rule in the second sentence of Article 26,[370] but in the precondition of explicit requirements.[371]

According to the principle of territorial principle in International Law, State has jurisdiction over the people, property, behaviors, and activities within its territory.[372] When discussing territorial principle, Professor Tim Hiller elaborated on the territorial principle,

> According to the territorial principle, events occurring within a state's territorial boundaries and persons within that territory, albeit temporarily, are subject to local law and the jurisdiction of the local courts. The principle has practical advantages in terms of availability of witnesses, the territorial principle has received universal recognition.[373]

Professor Sean D. Murphy explained "Territoriality Principle" as,

> A state has absolute (but not exclusive) power to regulate conduct that occurs within its own territory. It may also act to affect interests in a res or the status of persons located within its territory.[374]

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[367] *See* the *Ambiente* case*, supra* note 279; *See also* The *Abaclat* case, *supra* note 229, etc.
[368] *See* ICSID PUBLICATION, *supra* note 63.
[369] *Id*., at 838.
[370] *Id.*, at 936.
[371] ICSID, *supra* note 5, Article 26.
[372] CRAWFORD, *Supra* note 145, at 505-508.
[373] HILLER, *supra* note 298, at 254.
[374] MURPHY, *supra* note 147, at 197.

The basic principle of territorial sovereignty was affirmed by the Permanent Court of International Justice in the case of *Lotus*:

> The first and foremost restriction imposed by international law upon a State is that-failing the existence of a permissive rule to the contrary it may not exercise its power in any form in the territory of another State. In this sense jurisdiction is certainly territorial; it cannot be exercised by a State outside its territory except by virtue of a permissive rule derived from international custom or from a convention.[375]

Speaking in the same case, John Bassett Moore, the United States Judge, said that,

> It is an admitted principle of international law that a nation possesses and exercises within its own territory an absolute and exclusive jurisdiction, and that any exception to this right must be traced to the consent of the nation, either express or implied ...[376]

Similar to territorial principle, domestic jurisdiction is a basic rule of International law which is embodied in Article 2 of the UN Charter, providing that,

> Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matters to settlement under the present Charter.[377]

Domestic jurisdiction derives from state sovereignty, equality among states, and non-intervention in internal affairs of other states, as the respected scholar Malcolm N. Shaw stated, "state sovereignty within its own territorial limits is the undeniable foundation of international law..."[378] Similarly, a judge of the International Court of Justice wrote that "international law rests on the principle of the sovereignty of states and thus originates from their consent."[379]

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375 *Factory at Chorzow* (Germany v. Poland), PCIJ, Series. A, No. 9, Judgement, 18 (1927).
376 *Id.*, at 68.
377 U.N. Charter, June 26, 1945, https://www.un.org/en/about-us/un-charter (last visited July 19, 2021).
378 SHAW, *Supra* note 68, at 486.
379 *Legality of the Threat or Use of Nuclear Weapons*, Advisory Opinion, Separate Opinion of Judge Guillaume, 1996 I.C.J. Report, 291 (July 8).

Foreign investors and their investment-related activities are usually located in the host state.[380] According to the principle of territorial principle, foreign investors and their investment activities must be subject to the jurisdiction of the host state, including legislative, judicial, and administrative jurisdiction.[381] Likewise, investment disputes between foreign investors and the Host State shall be subject to the jurisdiction of the Host State. The Exhaustion of Local Remedies Rule flows from state sovereignty.[382] So The dispute that happened on the territory of one state shall be settled by the local remedies first.[383]

The justifications are also affirmed by many jurists. When talking about the reasons for the rule, Edwin M. Borchard said, "sovereignty and independence warrant the local state demanding freedom from interference, on the assumption that its courts are capable of doing justice".[384] Judge Cordova explained in the *Interhandel* case that,

> The main reason for its 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 the exhaustion of local remedies . . .[385]

Following the *Peace of Westphalia*, there was a focus on the issue of state sovereignty, which implies non-intervention, to secure peace.[386] Local remedies derived from territorial jurisdiction, while the principle of territorial jurisdiction is originated from the notions of equality among states and respect for state sovereignty in the modern International Law.[387] C.F. Amerasinghe also stated that local remedies were a recognition and "perhaps a

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380 Yu, *supra* note 1, at 309.
381 *Id.*
382 AMERASINGHE, *supra* note 16, at 53.
383 *Id.*, at 62.
384 BORCHARD, *supra* note 329, at 817.
385 The *Interhandel* case*, supra* note 68, at 45.
386 *The Peace of Westphalia and Sovereignty*, https://courses.lumenlearning.com/atd-herkimer-westerncivilization/chapter/the-peace-of-westphalia-and-sovereignty/ (last visited July 19, 2021).
387 AMERASINGHE, *supra* note 16, at 15.

concession to the sovereign character of a state".[388] In a word, state sovereignty is the underlying basis for local remedies rule.

In many cases, the damage which the foreign investors suffered is conducted by the lower governmental organs or junior officers. Local remedies are approaches for higher authorities to check the conduct. If illegal, rectifying the conduct or correcting the wrongness through the local legal system to confirm that the injured could get adequate redress and reasonable justice. "The U.S. Supreme Court has observed that benefits of the exhaustion requirement include giving the relevant agency 'an opportunity to correct its own mistakes' ".[389]

In the *Norwegian Loans* case, Judge Read stated that,

> It is important to obtain the rulings of the local courts with regard to the issues of fact and law involved, before the international aspects are dealt with by an international tribunal. It is also important that the respondent State which is being charged with breach of international law should have an opportunity to rectify the position through its own tribunals.[390]

The ICJ expressed a similar ideas in the *Interhandel* case,

> Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.[391]

When succeeding in evading local remedies, the most affected one is the sovereignty of the Host State. The conduct which have happened in its territory cannot be adjudicated through its administrative or judicial system. As scholars of Colombia Center on Sustainable Investment illustrated,

> When investors take their claims directly to arbitration, however, it is the arbitrators, not the courts, that rule on those important issues of contract law and policy and

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388 *Id*., at 61.
389 *McCarthy v. Madigan*, 503 U.S. 140, 145-46 (1992).
390 The *Certain Norwegian Loans* case, *supra* note 42, at 97.
391 The *Interhandel* case*, supra* note 68, at 27.

> may come to dramatically different conclusions than domestic courts regarding the meaning or legitimacy of a given contractual provision. The state thus loses its power to shape and interpret its law.[392]

If the futility exception is misused, the interests which local remedies protect will be harmed to a great extent. That is, the principle of state sovereignty established in modern International Law has been severely stricken by misuse of futility exception.

3.5.3 Restriction of State Regulatory Rights

As a result, not only the domestic jurisdiction over internal affairs has been undermined, but also legislation and government governance have been restricted.[393] Misuse of futility exception directly causes the expansion of the jurisdiction of international investment tribunals, making host states face more risks to bear responsibilities of huge compensation.[394] It is difficult for states to judge how they should act in order to comply with their legal obligations under IIAs. Then they become timorous and over-cautious in carrying out legislative or regulatory activities.[395] This issue is conceptualized as "regulatory chill", bearing the basic meaning of,

> The idea that obligation to pay compensation for regulatory changes may make it difficult for host States to regulate in socially desirable areas.[396]

Firstly, scholars of Colombia Center on Sustainable Investment elaborate the legislative or administrative competence as,

> Policy space enables legislatures to adopt new laws and amend or terminate existing legislation; it enables executive officials to set policies, refine them over time, and exercise discretion as appropriate; and it enables administrative tribunals and judicial courts to perform the roles assigned to them under domestic law in interpreting, applying, and even crafting the law, ruling on the scope of public and private rights and obligations, and invalidating or imposing penalties on illegal or

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392 Johnson, Sachs, Güven and Coleman, *supra* note 169, at 14.
393 *See Id.*
394 For example, Argentina faces the most ISDS cases as a Respondent in the world with 62 cases, available at https://investmentpolicy.unctad.org/investment-dispute-settlement/country/8/argentina (last visited July 19, 2021).
395 *See* Brown, *supra* note 23.
396 *What is Regulatory Chill?,* https://www.igi-global.com/dictionary/regulatory-chill/44758 (last visited July 19, 2021).

> undesirable conduct. This policy space can be especially important for governments whose legal frameworks are still evolving and developing to reflect best international practice.[397]

The government's authority of administration has been greatly curtailed due to the inconsistent outcomes of ISDS, governments are confused about whether their conduct will give rise to a claim. Under the unpredictability and potential pressure of huge compensation, host states are discouraged from taking measures to achieve better economic, social, and environmental goals.[398]

3.5.4 Detriment to Investors

As I have analyzed above, futility has been a tactic for investors to circumvent local remedies and directly initiate international proceedings for remedies.[399] The reason lies in that the investors don't believe that host states could provide effective and adequate remedies. Professor Christoph Schreuer comes straight to the point in *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration,* stating that,

> One of the purposes of investor/State arbitration is to avoid the use of local courts. Litigation in the host State's domestic courts is often seen as lacking the objectivity that the investor desires. In addition, domestic courts are often bound to apply domestic law even if that law falls short of the standards provided by international law.[400]

However, the investors haven't realized that overuse of futility exception could also bring problems to them. First of all, the investors will lose the opportunities to obtain remedies in a high-efficient and low-cost way. Courts are "subsidized by the government", while international "arbitration is self-financed",[401] furthermore, the litigation costs of local remedies are much lower than the huge arbitration costs with an average amount of eight million dollars.[402] And the duration to solve the dispute by arbitration is not short with an

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397 Johnson, Sachs, Güven and Coleman, *supra* note 169, at 11.
398 *Id.*, at 13.
399 Ye *supra* note 19, at 6.
400 Christoph Schreuer, *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration*, 4 LAW & PRAC. INT'L CTS. & TRIBUNALS 1, 1 (2005).
401 Faure and Ma, *supra* note 103, at 4.
402 *See* Pohl, *supra* note 101; also *see* Hodgson and Campbell, *supra* note 101.

average duration of 4.3 years.[403] It is easy to understand because local courts could provide practical convenience and are the best position to apply local laws, just as George K. Foster elaborates on benefits in detail,

> National courts are in the best position (at least as a general rule) to interpret and apply their own laws. They may also be better suited than an international tribunal to make findings of fact if they have greater access to evidence and are able to review documents and examine witnesses in the local language.[404]

That is to say, misuse of futility exception leads to direct resort to international arbitration, while international arbitration may generate much higher financial costs and a longer duration of arbitration.

Secondly, the more publicity of investment arbitration, the more possibilities that the foreign investor might be labeled as a troublemaker that host states might implement stricter reviews of market admission.[405] Then stricter and cautious measures will be taken when the states sign IIAs. In other words, states are more reluctant to sign more IIAs, or even withdraw from the ISDS mechanism like some Latin American states did.[406] In this case, the investors could not enjoy the protection provided in IIAs, detrimental to the paramount interests of foreign investment.

3.5.5 Impact on the ISDS Mechanism[407]

From the ICSID Convention entering into force in 1965, International Investment the Arbitration System centered on ICSID have boomed rapidly,[408] states signed a myriad of IIAs

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403 *Id*., Pohl, at 48-54.
404 Foster, *supra* note 24, at 262.
405 Blaga Thavard, *Why do foreign investors leave Bulgaria as if it were the Titanic?*, https://www.euractiv.com/section/economy-jobs/opinion/why-do-foreign-investors-leave-bulgaria-as-if-it-were-the-titanic/ (last visited July 19, 2021).
406 Peinhardt and Wellhause, *supra* note 17.
407 Agnone, *supra* note 22, at 64.
408 *See Introduction to Investment Arbitration*, https://www.international-arbitration-attorney.com/investment-arbitration/ (last visited July 19, 2021).

which incorporated international investment arbitration system.[409] ISDS mechanism has become one of the most important solutions to settle international investment disputes.[410]

Nevertheless, some problems, such as the futility exception, have triggered a lot of adverse impacts, deteriorating the whole ISDS mechanism.[411] From the case study above, a problem resulted from futility exception cases is arbitrary interpretations. While non-compliance with the rules of treaty interpretation provided in VCLT, some tribunals have arbitrarily exercised discretion and overused teleological interpretation[412]. At the same time, textual interpretation and the principle of contemporaneity have been dispensed with. Huge room for interpretation and arbitrarily use of interpretation rules further made rulings inconsistent, which are presented as different tribunals made opposite decisions on the similar dispute based on the same BIT.[413]

The rulings have been criticized for bias and unfairness.[414] Empirical analysis shows that the majority of the arbitrators are from Western Europe and North America,[415] and there exists an "elite" group of arbitrators who have sat at most of the tribunals.[416] The phenomena produced the result that high-income countries had a higher winning rate with 46% and developing countries won just 27% during the 1998-2010 boom in investment arbitration.[417] Some scholars conclude that the Respondent States are the big losers,[418] while it is concluded

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409 UNCTAD, s*upra* note 9.

410 *See* World Investment Report (2016-2020), UNCTAD, https://unctad.org/topic/investment/world-investment-report (last visited July 19, 2021).

411 Faure and Ma, *supra* note 103, at 2; *see also* David P. Riesenberg, *Fee-Shifting in Investor-State Arbitration: Doctrine and Policy Justifying Application of the English Rule*, 60 DUKE L.J. 987, 986–87 (2011).

412 *See* futility exception cases, e.g.the *Abaclat* case, *supra* note 229, the *Link-Trading* case*, supra* note 194.

413 *See* e.g., the *Abaclat* case, *supra* note 229; and the *ICS* case*, supra* note 252. Under similar merits and legal text, two tribunals give contradictory decisions due to different interpretations and reasoning.

414 Faure and Ma, *supra* note 103, at 3.

415 Pia Eberhardt and Cecilia Olivet, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers Are Fueling an Investment Arbitration Boom,* TRANSNAT'L INST.& CORP. EUR. OBSERVATORY, 36 (NOV. 2012).

416 *Id.*, 38.

417 Emilie M. Hafner-Burton and David G. Victor, *Secrecy in International Investment Arbitration: An Empirical Analysis*, 7 J. OF INT'L DISP. SETTLEMENT 161, 164, 181-82 (2016).

418 Gus Van Harten & Pavel Malysheuski, *Who Has Benefited Financially from Investment Treaty Arbitration? An Evaluation of the Size and Wealth of Claimants*, OSGOODE LEGAL STUD. RES. PAPER SERIES, PAPER NO. 14, 13 (2016).

that at least regarding the jurisdiction issue, the international tribunals are more likely to favour the investors.[419] In a word, some empirical analyses conclude that the ISDS favour the investors from the North.[420]

These drawbacks like arbitrary interpretations, inconsistent rulings, bias, and unfairness and other drawbacks will gradually deteriorate its authority and make the parties to the dispute lose trust in the mechanism, ultimately jeopardizing the whole system. But to figure out the consequences, not only the system itself bears the issue of legitimacy, but the biggest victims are the host states. So far, ISDS mechanism has received lots of criticisms and doubts, not only from academia but also from practitioners. In the past two decades, some Latin American countries like Bolivia, Ecuador, and Venezuela successively withdrew from the ICSID Convention. While some other countries, like Indonesia, South Africa, Italy and Russia withdrew from or terminated IIAs with partner countries.[421] Even the previous initiators and proponents, such as the United States and Western European countries, are now against it.[422] In 2017, 230 Law and Economics professors in United States urged President Trump to remove ISDS from NAFTA and other pacts.[423] Therefore, the whole Investor-State dispute settlement system which aims to protect foreign investors[424] is jeopardized by bias, inconsistency, lack of predictability, and other problems.

3.6 Causes for Misuse of Futility Exception

In this part, I will analyze the main causes why the futility exception has been misused from the characteristics of futility itself, which could provide some implications to mitigate this issue.

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419 *See Id.*
420 Daniel Behn, *Legitimacy, Evolution, and Growth in Investment Treaty Arbitration: Empirically Evaluating the State-of-the-Art*, 46 GEO. J. INT'L L. 363, 369-70 (2014).
421 Peinhardt and Wellhause, *supra* note 17.
422 Melanie Foley, *USTR Says No ISDS in US-UK Free Trade Agreement*, https://citizen.typepad.com/eyesontrade/2020/07/no-isds-in-us-uk-free-trade-agreement.html (last visited July 19, 2021).
423 230 Law and Economics Professors, *supra* note 18.
424 Schreuer, *supra* note 400, at 1.

3.6.1 Lack of Precision

First, I think the three options of futility by Special Rapporteur John R. Dugard should be reviewed here, which are respectively reiterated as,

> Local remedies do not need to be exhausted where:
> (a) The local remedies:
> (i) Are obviously futile (option 1)
> (ii) Offer no reasonable prospect of success (option 2)
> (iii) Provide no reasonable possibility of an effective remedy (option 3)[425]

Finally, option 3 was incorporated into the *2006 ILC Draft Articles on Diplomatic Protection* but with a revised version, provided in Article 15(a) as,

> Local remedies do not need to be exhausted where:
> (a) There are no reasonably available local remedies to provide effective redress, or the local remedies provide no reasonable possibility of such redress[426]

No matter the obvious or lenient standard, or the intermediate formulation which was adopted by ILC, all of them are too subjective and ambiguous to apply. This subjectivity and vagueness provide great room for the Tribunal to interpret. I will analyze them one by one.

With regard to the obvious standard, this standard requires "obvious", "immediately apparent", "clear" or "manifest" futility,[427] nevertheless, there is no accurate rule to evaluate whether the prevailing circumstances in the specific dispute meet the threshold of "obviously futile". The Tribunal could interpret that the prevailing local remedies are futile with repetition of terms of "obviously", "immediately apparent", "clearly", or "manifestly". Here again, I take the *Yukos* case for instance, at first, the Claimant contended that local remedies were futile in light of the logistical burden.[428] While haven't clarified why the local remedies provided by the Respondent State are futile, the *Yukos* Tribunal just simply stated that, "the following procedure would clearly be futile under the circumstances of a specific case".[429] I

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425 Dugard, *supra* note 25, at 56.
426 ILC, *supra* note 77.
427 *See* the *Finnish Ships* case, *supra* note 41; also *see* the *Yukos* case, *supra* note 170.
428 The *Yukos* case, *id*., at 450-451.
429 *Id*., at 452.

argue that such a subjective standard is lack of accurateness and precision, so whether the futility is established or not almost hinges on how the Tribunal interprets the conditions instead of evaluating the prevailing circumstances objectively. Someone might debate that while it is very important to have an objective standard, a tribunal must always evaluate the case on its own merits. I would counter-argue that I do not intend to make the Tribunal dispense with its discretion, but it should be restricted to give a much more neutral and fair decision.

The next one is the lenient standard which is construed as "no reasonable prospect of success".[430] But what situations could be regarded as "no reasonable prospect of success" are not clear. Literally analyzed first, "prospect" is "the possibility that something good might happen in the future".[431] According to this explanation, the lenient standard does not require the existence of futility. Furthermore, the word "reasonable" bears the meaning of "based on or using good judgment and therefore fair and practical"[432], thus once again establishing a subjective standard. I argue that it is not clear that under what situations, could the local remedies be assessed as fair and practical remedies. What could be regarded as good judgement when assessing futility? What kind of standard could be used to evaluate the judgement? These are all questions that need to be answered.

The last one to be analyzed is the standard incorporated in *ILC 2006 Draft Articles*, stipulating that, "There are no reasonably available local remedies to provide effective redress, or the local remedies provide no reasonable possibility of such redress".[433] The key point here is the assessment of the term "effective". Different parties have different opinions. The Respondent state always holds the position that as long as the local remedies are "available" from the "prevailing circumstances", it is effective.[434] While the Claimant contends that

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[430] Dugard, *supra* note 25, at 56.
[431] *Meaning of prospect in English*, https://dictionary.cambridge.org/dictionary/english/prospect (last visited July 19, 2021).
[432] *Meaning of reasonable in English,* https://dictionary.cambridge.org/dictionary/english/reasonable (last visited July 19, 2021).
[433] ILC, *supra* note 77.
[434] *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 28 (January 29, 2004), https://www.italaw.com/cases/documents/1019 (last visited July 19, 2021).

"effective" local remedies mean that the remedies should be "fair and efficient". If not, it could be regarded as "futility".[435]

The *Yukos* Tribunal also adopts the viewpoint that the intermediate standard is "subjective entirely".[436] I argue that the subjective characteristic makes it rather dangerous to apply when the tribunal exercises discretion. The Tribunal could give a narrow interpretation to favour the contentions of the Respondent or give a wide interpretation to support the contentions of the investors, which all depends on their stances.

The *Loewen* case shows the difficulty of applying the prevailing intermediate standard. Sometimes, the tribunal adopts a subject approach, ascertaining facts from the claimant's point of view, such as the Claimant's right to appeal is impractical.[437] Sometimes, the tribunal reached a conclusion under the circumstances which we could call it "objective approach", stating that the appeal to the Mississippi Supreme Court is "an adequate and fully effective appeal".[438] Although more reasonable with the term "available" compared with the lenient threshold, I argue that the intermediate standard with unclear formulation makes it hard to apply.

To sum up, the subjective and ambiguous characteristics of futility standards make it rather difficult to apply. To be exact, it is quite difficult for different Tribunals to give consistent rulings with vague standards.

3.6.2 Absence of Legally Binding Force

Lack of legally binding force is another cause that could contribute to the misuse of futility exception. Although incorporated into *ILC 2006 Draft Articles*[439] and adopted by ILC,[440] as the *ILC 2006 Draft Articles* have not turned into a treaty, the authoritative futility standard has not bore legally binding force based on the international treaties. On the other

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[435] *See* the *Abaclat* case, *supra* note 229.
[436] The *Yukos* case, *supra* note 170, at 452.
[437] The *Loewen* case*, supra* note 93, at 49.
[438] *Id.*, at 48.
[439] ILC, *supra* note 77.
[440] ILC, *supra* note 76.

hand, there is no uniform and consistent practice on this issue, so it is not qualified to say the prevailing standard has become customary International Law.[441] Therefore, even the intermediate standard adopted by ILC is not legally binding, nor the other two standards. In this case, the tribunals are not obliged to apply to any of them.[442] More exactly, most of the tribunals haven't specified which futility standard they adopt.[443] On the contrary, if the standard is legally binding, the Tribunal has to apply it. If the standard is legally binding, even though the standard is subjective or vague, the possibilities of inconsistent rulings will be greatly reduced compared with three or more non-legally binding standards.

3.6.3 The Defects in the ISDS Mechanism

I also argue that some inherent subsystems or characteristics of ISDS mechanism also contribute to the misuse of futility exception, for instance, the arbitrators' fees come from the parties,[444] most of the arbitrators are from western countries,[445] there is no appeal system,[446] etc. In this part, I will analyze them one by one based on the main factors that relate to the issue of futility exception.

I. The Source of arbitrators' fees

The source of arbitrators' fees also contributes to the misuse of futility exception in ISDS. According to rules of arbitral institutions, the fees of arbitrators are not governmentally

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441 HUGH THIRLWAY, SOURCE OF INTERNATIONAL LAW, 88-100 (Oxford University Press 1st ed. 2014).

442 Statute of the International Court of Justice, Article 38, https://www.icj-cij.org/en/statute. (last visited July 19, 2021).

443 *See e.g.,* the *Loewen* case*, supra* note 93; the *Link-Trading* case*, supra* note 194; the *Ronald* case*, supra* note 205; the *Siemens* case, *supra* note 133; the *Abaclat* case, *supra* note 229; the *Urbaser* case*, supra* note 264.

444 *See* the ICSID Convention, *supra* note 5; Arbitration Rules of Arbitration Institute of the Stockholm Chamber of Commerce, (SCC), 2010, https://sccinstitute.com/media/40120/arbitrationrules_eng_webbversion.pdf (last visited July 19, 2021); UNCITRAL, *supra* note 6.

445 *See* Eberhardt and Olivet, *supra* note 402.

446 *See* Jaemin Lee, *Chapter 20 Introduction of an Appellate Review Mechanism for International Investment Disputes: Expected Benefits and Remaining Tasks*, in RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM: JOURNEYS FOR THE 21ST CENTURY, 474 (Brill/Nijhoff, Jean E. Kalicki and Anna Joubin-Bret, 2015).

subsidized, they are covered by the parties.[447] For example, Article 61 of the ICSID Convention provides that,

> (1) In the case of conciliation proceedings the fees and expenses of members of the Commission as well as the charges for the use of the facilities of the Centre, shall be borne equally by the parties. Each party shall bear any other expenses it incurs in connection with the proceedings...[448]

Article of 43 of SCC Arbitration Rules also provides costs of arbitration, stating that,

> (1) The Costs of the Arbitration consist of:
> (i) the Fees of the Arbitral Tribunal;
> (ii) the Administrative Fee; and
> (iii) the expenses of the Arbitral Tribunal and the SCC.
> .....
> (5) Unless otherwise agreed by the parties, the Arbitral Tribunal shall, at the request of a party, apportion the Costs of the Arbitration between the parties, having regard to the outcome of the case and other relevant circumstances.
> (6) The parties are jointly and severally liable to the arbitrator(s) and to the SCC for the Costs of the Arbitration.[449]

From the two provisions of arbitrators' fees above, arbitrators' fees or Tribunal's fees are paid by the parties instead of other sources. Furthermore, an OECD study on investment arbitration gives a conclusion that on average arbitrators' fees account for 16% of the total cost of an arbitration case. While another study concluded that the average arbitration costs which parties faced are $8 million.[450] It is not a small amount when multiplying the two numbers. So it could be calculated that the arbitrators' fees are more than $1 million on average.

Given an economic and empirical analysis of prior literature, gaining and increasing the income is the arbitrators' biggest incentive.[451] In order to increase the income, arbitrators have to pay efforts from the following aspects: The first one is to be competent. In order to

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[447] *ISDS costs - how much and who pays?* http://isdsblog.com/2015/11/19/isds-costs-how-much-and-who-pays/ (last visited July 19, 2021).
[448] The ICSID Convention, *supra* note 5.
[449] SCC, *supra* note 444.
[450] Gaukrodger D., & Gordon K., *Investor-state dispute settlement: A scoping paper for the investment policy community,* OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT, NO. 3, 19 (2012).
[451] Faure and Ma, *supra* note 103, at 7-9.

stand out in the competitive arbitrator market, arbitrators may arm themselves with specialized expertise in investment and Public International Law.[452] The specialization of arbitrators brings benefits, such as making good and efficient decisions, shorter duration, etc. The second one is increasing the number of arbitration cases. In the decisions on jurisdictional issues, arbitrators are more likely to reject the jurisdiction of local remedies and affirm the jurisdiction of the international tribunal without complying with IIA provisions or customary International Law.[453] The more cases there are, the more income arbitrators will gain. The third one is satisfying the parties,[454] which aims to increase the chances to be chosen by parties, the party-appointed arbitrator system leads arbitrators to one side, either propose the investors or the host states. Only in this way could they get more chances to be selected as arbitrators.[455] What can not be ignored is that it may give rise to bias. Another issue is arbitrators sometimes "split the difference" to gain support from parties rather than strictly apply the rules.[456]

In short, the international tribunal may take the initiative to interpret the rules from its own position and apply the rules to achieve its own purposes. In a sense, it is not an absolute neutral adjudication organ to passively apply laws.[457] On the contrary, the governmentally subsidized courts passively apply the rules impartially.[458] The arbitrators are more motivated to expand the jurisdiction of an international tribunal with financial benefits.[459] As a strategy contended by investors, a futility exception could be established with the discretion of the tribunal. The Tribunals and arbitrators are more willing to favour the claims of futility contended by investors.[460]

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[452] Ashenfelter, *supra* note 296, at 342-343.
[453] Harten & Malysheuski, *supra* note 418, at 13.
[454] Faure and Ma, *supra* note 103, at 8.
[455] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, 570 (Wolters Kluwer, 7th ed. 2007).
[456] *Id.*
[457] Faure and Ma, *supra* note 103, at 33.
[458] *See* Lawrence Baum, *What Judges Want: Judges' Goals and Judicial Behavior*, 47 POL. RES. Q. 749, 754-60 (1994).
[459] *See* Aaken & Broude, *supra* note 296.
[460] Faure and Ma, *supra* note 103, at 31.

II. High Concentration of Arbitrators

Among other things, the empirical analysis shows that the majority of the arbitrators are from Western Europe and North America,[461] and there exists an "elite" group of arbitrators who have sat at most of the tribunals.[462] As Guy Sebban, the former Secretary-General of the International Chamber of Commerce (ICC), said, "Everyone knows everyone in the arbitration world."[463] Similarly, an empirical analysis stated that,

> Most of the members of this club are men from a small group of developed countries:
> Proportion of arbitrators from Western Europe and North America: 69% for all cases held at the World Bank's International Centre for Settlement of Investment Disputes (ICSID) and 83% if taking into account arbitrators who have sat in more than 10 cases.[464]

The rulings of international arbitration tribunals have been criticized for bias toward investors.[465] Some scholars conclude that the Respondent States are the big losers,[466] while it is concluded that at least regarding the jurisdiction issue, the International tribunal is more likely to favour the investors.[467] There are some studies claiming that developed countries could get better results than developing countries.[468] The phenomena produced the results that high-income countries had a higher winning rate with 46% and developing countries won just 27% during the 1998-2010 boom in investment arbitration.[469] A study also stated that arbitrators also "enjoy close links with the corporate world and share businesses' viewpoint in relation to the importance of protecting investors' profits."[470] Additionally, some empirical analyses conclude that the ISDS favors the investors from the North.[471] So it could be

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461 Behn, *supra* note 420, at 394-395.
462 Eberhardt and Olivet, *supra* note 402, at 36-38.
463 *Id.*, at 36.
464 *Id.*
465 *See* BRETTON WOODS PROJECT, *ICSID in Crisis: Straight-Jacket or Investment Protection?* (July 10, 2009), https://www.brettonwoodsproject.org/2009/07/art-564878 (last visited July 19, 2021).
466 Harten & Malysheuski, *supra* note 418, at 13.
467 *See* Harten & Malysheuski, *supra* note 418.
468 *See* Rachel L. Wellhausen, *Recent Trends in Investor State Dispute Settlement*, 7 J. INT'L DISP. SETTLEMENT 117, 117–19 (2016).
469 Hafner-Burton and Victor, *supra* note 417, at 181-182.
470 Eberhardt and Olivet, *supra* note 402, at 36-38.
471 Behn, *supra* note 420, at 369-370.

inferred that the party-subsidized system and the concentration of arbitrators may result in the partisan tendency of investors and favour the contentions of the investors with discretion.

III. Absence of Appellate system

Based on the model of commercial arbitration,[472] the decisions of international investment arbitration are final without any appellate procedures.[473] Absence of an appellate system is one of the drawbacks bore by ISDS mechanism which has been strongly criticized. Absence of appellate system further aggravates the arbitrary interpretation, inconsistent rulings, etc. In 2017, 230 Law and Economics professors in the United States urged President Trump to remove ISDS from NAFTA and other pacts.[474] The absence of appeal process was explained in the Letter as,

> There is no appeals process and therefore no way of addressing errors of law or fact made in arbitral decisions; and there is no oversight or accountability of the private lawyers who serve as arbitrators, many of whom rotate between being arbitrators and bringing cases for corporations against governments.[475]

Appellate process is a mechanism to review whether the lower tribunal applies the law correctly[476] and give consistent rules on specific issues to ensure more coherent jurisprudence.[477] In contrast, the absence of an appellate system provides more possibilities for the Tribunal to arbitrarily interpret provisions in IIAs. The Arbitrators do not need to worry about the review or supervision of a superior institution on their rulings. Even though non-compliance with the rules of International Law and the consequences of inconsistent rulings, the Tribunal could make decisions based on their own understandings and stances.

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472 Faure and Ma, *supra* note 103, at 2.
473 *See* ICSID rules, SCC Arbitration Rules, and UNICTRAL Arbitration Rules, *supra* note 444.
474 230 Law and Economics Professors, *supra* note 18.
475 *Id.*
476 *Appellate Courts*, https://www.investopedia.com/terms/a/appellate-courts.asp (last visited July 19, 2021).
477 Lee, *supra* note 446, at 476.

The correctness and legality of the arbitral decisions can not be guaranteed, causing a loss of confidence in ISDS mechanism.[478]

Although futility exception has been misused by some tribunals,[479] some tribunals also adopt narrow interpretations regarding futility exceptions.[480] This phenomenon also reflects the inconsistent rulings in international investment arbitration.[481] Meanwhile, the futility exception itself bears some deficiencies like ambiguousness and non-legally binding force, which leaves more room for wider interpretation. A reasonable appellate system could help to enhance the predictability and consistency of international investment arbitration,[482] as well as play the function of surveillance to restrict the discretion of the Tribunal. Hence, absence of an appellate system in practice is one of the factors contributing to the misuse of futility exception.

3.7 Summary

In Chapter 3, a comprehensive and in-depth analysis was conducted, including case study, legal analysis impacts, and causes of the issue. From the study on the futility exception cases, it could be concluded that the phenomenon of misuse of futility exception really exists. It not only contravenes rules of International Law, but also contravened the purpose of local remedies provisions in IIAs which aim to protect state sovereignty to some extent under the precondition of well balancing between state sovereignty and foreign investment.[483]

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[478] Eun Young Park, *Appellate Review in Investor-State Arbitration*, in RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM: JOURNEYS FOR THE 21ST CENTURY, 443 (Leiden/ Netherlands: Konindlijke Brill, 2015).

[479] *See e.g.,* the *Loewen* case*, supra* note 93; the *Link-Trading* case*, supra* note 194; the *Ronald* case*, supra* note 205; the *Siemens* case, *supra* note 133; the *Abaclat* case, *supra* note 229; the *Urbaser* case*, supra* note 264, etc.

[480] *See e.g.*,the *Loewen* case*, supra* note 93; the *ICS* case*, supra* note 252, etc.

[481] *See* the *ICS* case, *supra* note 252 and the *Abaclat* case, s*upra* note 229.

[482] Lee, *supra* note 446, at 482, 486.

[483] *See* Foster, *supra* note 24.

Chapter 4. Viable Proposals to the Issue

In the previous Chapter, I have fully discussed the issues related to futility exception, including the problems, the impacts, and the causes of the problem. Futility exception is designed to protect the rights and interests of foreign investors under extraordinary situations,[484] while overuse of the exception without a reasonable legal basis constitutes misuse, undermining the sovereignty of the host states.[485] In this chapter, I will first refer to some model BIT texts and say how they deal with the futility exception issues in the model BITs. Then I will offer some proposals on how to mitigate the misuse of futility exception according to the formulation and interpretation of the standard, aiming to strike a better balance between state sovereignty and foreign investment.

4.1 Provisions on Futility Exception in Model BITs

4.1.1 *IISD Model BIT*[486]

Exhaustion of local remedies and the exception are clearly incorporated in Article 45(B)(C) of *2005 International Institute for Sustainable Development (IISD) Model BIT,* providing that,

> (B) A dispute between an investor or investment and a host state may not be commenced until domestic remedies are exhausted in relation to the underlying issues pleaded in relation to a breach of the Agreement.
> (C) Where such remedies are unavailable due to the subject of the dispute or a demonstrable lack of independence or timeliness of the judicial or administrative processes implicated in the matter in the host state, an investor may plead this in an application before a panel as a preliminary matter. The decision of a panel on this issue shall be final. This panel shall be chosen in accordance with Article 40. The Council shall establish procedures for such a pleading at its first meeting.[487]

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[484] *See e.g.*, the *Finnish Ships* case, *supra* note 41; ILC, *supra* note 77, etc.
[485] *See* Johnson, Sachs, Güven and Coleman, *supra* note 169.
[486] HOWARD MANN, KONRAD VON MOLTKE, LUKE ERIC PETERSON, AND AARON COSBEY, IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT: NEGOTIATORS' HANDBOOK, (IISD, 2nd ed. 2006).
[487] *Id.,* at 60.

In paragraph (B), the texts clearly state that exhaustion of domestic remedies is required before resorting to international arbitration. In the commentary to Article 45, it states that the reason that exhaustion of local remedies should return, is that some contract claims are over internationalized due to the multiplications of IIAs in the 1980s and 1990s.[488] But IISD and some observers contend that contract claims should be resolved at a domestic level, at least theoretically.[489]

The paragraph (C) mainly talks about exceptions of exhaustion of local remedies. Three situations are provided in this clause. Firstly, "remedies are unavailable due to the subject of the dispute"[490]; Secondly, "a demonstrable lack of independence"[491]; And thirdly, "timeliness of the judicial or administrative processes implicated in the matter in the host state".[492] Compared with the exceptions to the local remedies rule provided in Article 15 of *ILC 2006 Draft Articles on Diplomatic Protection*,[493] it could be found that the "remedies are unavailable" might be regarded as the "futility exception".

Though these provisions have neither clearly pointed out the term "futility exception", nor provided the threshold of "futility exception", the proposals for the exhaustion of local remedies, and exceptions to it, was nonetheless a big step forward in balancing investors' rights and responsibilities with rights and obligations of host states.[494]

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488 *Id.*
489 *Id.,* at 61, 62.
490 *Id.,* at 61.
491 *Id.*
492 *Id.*
493 ILC, *supra* note 77.
494 IISD, *supra* note 486*,* at xi.行间距

4.1.2 *2012 SADC Model BIT*[495]

The *2012 Southern African Development Community (SADC) Model BIT* could not be reviewed without the terminations of BITs with some EU member states.[496] Under the pressure of claims brought by foreign investors to international arbitration, South Africa decided to "weighs risk and benefits of BITs"[497] and it found the main concern of protection of investors from developed countries was outdated.[498] Moreover, the drafting of the *2012 SADC Model BIT* is guided with the help of the IISD. That is to say, some provisions and the agenda of the BIT may follow the IISD Model BIT.

The local remedies rule and exceptions are provided in Article 29.4 of *2012 SADC Model BIT*, and is formulated as,

> An investor may submit a claim to arbitration pursuant to this Agreement, provided that:
> (a) six months have elapsed since the Notice of Intent was filed with the State Party and no solution has been reached;
> (b) the Investor or Investment, as appropriate,
> (i) has first submitted a claim before the domestic courts of the Host State for the purpose of pursuing local remedies, after the exhaustion of any administrative remedies, relating to the measure underlying the claim under this Agreement, and a resolution has not been reached within a reasonable period of time from its submission to a local court of the Host State; or
> (ii) the Investor demonstrates to a tribunal established under this Agreement that there are no reasonably available legal remedies capable of providing effective remedies of the dispute concerning the underlying measure, or the legal remedies provide no reasonable possibility of such remedies in a reasonable period of time.
> (c) The Investor has provided a clear and unequivocal waiver of any right to pursue and/or to continue any claim relating to the measures underlying the claim made pursuant to this Agreement, on behalf of both the Investor and the Investment, before local courts in the Host State or in any other dispute settlement forum.[499]

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[495] *SADC Model Bilateral Investment Treaty Template with Commentary, Southern African Development Community,* 2012 July, http://www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf (last visited July 19, 2021).
[496] *South Africa begins withdrawing from EU-member BITs*, https://www.iisd.org/itn/en/2012/10/30/news-in-brief-9/ (last visited July 19, 2021).
[497] *Id.*
[498] *Id.*
[499] SADC, *supra* note 495*,* at 57.

Paragraph (a) provides a prior requirement pursuing informal and non-binding resolutions. The paragraph (b) clearly incorporated exhaustion of local remedies but without providing a specific period. The formulation of "futility exception" in paragraph (b) adopts the "intermediate" standard of Article 15 of *ILC 2006 Draft Articles* with almost the same terms and expressions.

4.1.3 *2015 India Model BIT*[500]

In Article 15 of *2015 India Model BIT*, "Conditions"[501] related to futility exception "Precedent to Submission of a Claim to Arbitration"[502] are provided as,

> 15.1 In respect of a claim that the Defending Party has breached an obligation under Chapter II, other than an obligation under Article 9 or 10, a disputing investor must first submit its claim before the relevant domestic courts or administrative bodies of the Defending Party for the purpose of pursuing domestic remedies in respect of the same measure or similar factual matters for which a breach of this Treaty is claimed. Such claim before the relevant domestic courts or administrative bodies of the Defending Party must be submitted within one (1) year from the date on which the investor first acquired, or should have first acquired, knowledge of the measure in question and knowledge that the investment, or the investor with respect to its investment, had incurred loss or damage as a result.
>
> For greater certainty, in demonstrating compliance with the obligation to exhaust local remedies, the investor shall not assert that the obligation to exhaust local remedies does not apply or has been met on the basis that the claim under this Treaty is by a different party or in respect of a different cause of action.
>
> Provided, however, that the requirement to exhaust local remedies shall not be applicable if the investor or the locally established enterprise can demonstrate that there are no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure or similar factual matters for which a breach of this Treaty is claimed by the investor.
>
> 15.2 Where applicable, if, after exhausting all judicial and administrative remedies relating to the measure underlying the claim for at least a period of five years from the date on which the investor first acquired knowledge of the measure in question,

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[500] *Model Text for the Indian Bilateral Investment Treaty* 2015, https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf (last visited July 19, 2021).
[501] *Id.*
[502] *Id.*

no resolution has been reached satisfactory to the investor, the investor may commence a proceeding under this chapter by transmitting a notice of dispute ("notice of dispute") to the Defending Party.

15.3 The notice of dispute shall: specify the name and address of the disputing investor or the enterprise, where applicable; set out the factual basis of the claim, including the measures at issue; specify the provisions of the Treaty alleged to have been breached and any other relevant provisions; demonstrate compliance with Article 15.1 and 15.2, where applicable; specify the relief sought and the approximate amount of damages claimed; and furnish evidence establishing that the disputing investor is an investor of the other Party.

15.4 For no less than six (6) months after receipt of the notice of dispute, the disputing parties shall use their best efforts to try to resolve the dispute amicably through meaningful consultation, negotiation or other third party procedures. In all such cases, the place of such consultation or negotiation or settlement shall be the capital city of the Defending Party.[503]

From the provisions above, it could be seen that before commencing an international arbitration, two prior requirements should be satisfied. Firstly, for a period of six months an amicable resolution, such as consultation, negotiation, or other third-party procedures, should be sought by the parties. After that, it comes to the exhaustion of domestic remedies within "at least a period of five years"[504]. In 15.1, futility exception is formulated as "if the investor or the locally established enterprise can demonstrate that there is no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure or similar factual matters for which a breach of this Treaty is claimed by the investor."[505] The formulation here obviously adopts a similar approach of Article 15(a) of *ILC 2006 Draft Articles on Diplomatic Protection*, with the terms of "available" "reasonably",[506] etc. But the biggest difference is that "any relief"[507] in *2015 India Model BIT* set a higher threshold than Article 15(a) of *ILC 2006 Draft Articles*. Moreover, the specific period of five years of exhaustion of local remedies and the modal verbs "shall"[508] and "must"[509] before the prior requirements make the requirements much more difficult to bypass.

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503 *Id.*
504 *Id.*
505 *Id.*
506 *Id.*
507 *Id.*
508 *Id.*
509 *Id.*

Although not perfect in formulating a futility exception, the *2015 India Modal BIT* lifts the issue to a new level. It aims to reverse the distorted protection of investors and tries to achieve a better balance between investor protection and sovereignty of host states. The standard of futility provided in this legal text may be up for debate, but the approach of clear incorporation of the futility exception could be adopted by other IIAs. Explicit provisions of futility exception to local remedies with an appropriate standard could protect the rights of investors to obtain remedies at the international level when the local remedies are futile,[510] on the other hand, as an exception, it re-establishes the respect for state sovereignty with local remedies provisions.[511]

4.2 Narrow Construction of Futility Exception

As analyzed in section 3.5 above, the prevailing formulation of futility contains some deficiencies that contribute to the misuse of futility exception. So a new standard needs to be formulated to mitigate the problems created by vagueness and excessive subjectivity. To acquire a reasonable and appropriate approach, not only should the technical issues be taken into account, but also the rationales behind the rules require attention.

Futility is one of the exceptions to local remedies which is a justification for non-compliance with local remedies provisions in IIAs.[512] However, utilization of local remedies is the general rule, while the exceptions could be established only under extreme situations. The original purpose of the futility exception in customary International Law is to protect the rights and interests of foreign investors. If the exception is overused, it will go against the established purpose. Just like the exceptions are restrictions placed on local remedies, similarly, exceptions themselves should also be reasonably constricted. Otherwise, it might be used by some individuals who have ulterior motives to achieve specific purposes,

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[510] *See İçkale İnşaat Limited Şirketi v. Turkmenistan*, ICSID Case No. ARB/10/24, Award, 95 (Mar. 8, 2016), https://www.italaw.com/cases/2560 (last visited July 19, 2021). ("The Tribunal stated that the futility exception could not be applied because there was no explicit provisions in BIT.")

[511] AMERASINGHE, *supra* note 16, at 15.

[512] *See e.g.*, the *Loewen* case*, supra* note 93; the *Link-Trading* case*, supra* note 194; the *Ronald* case*, supra* note 205; the *Siemens* case, *supra* note 133; the *Abaclat* case, *supra* note 229; the *Urbaser* case*, supra* note 264; the *Yukos* case, *supra* note 170, etc.

such as evading the local remedies provided in BITs.[513] Based on the grounds of technical and rational considerations, I propose that futility should be narrowly construed.

The next question to discuss is how to formulate a reasonable and appropriate standard technically with a narrow approach. The standard incorporated in *ILC 2006 Draft Articles*,[514] as well as the other two options provided by Special Rapporteur John R. Dugard,[515] are too subject and imprecise to apply. It is hard to assess what kind of situations could meet the threshold of "obvious" or "reasonable" or even "effective". Compared to the three options provided by Special Rapporteur John R. Dugard in *Third Report on Diplomatic Protection*, I partially favour the approach in the *ILC 2006 Draft Articles on Diplomatic Protection* with commentaries, in which the standard is elaborated as follows:

> In order to meet the requirements of paragraph (a), it is not sufficient for the injured person to show that the possibility of success is low or that further appeals are difficult or costly. The test is not whether a successful outcome is likely or possible, but whether the municipal system of the respondent State is reasonably capable of providing effective relief. This must be determined in the context of the local law and the prevailing circumstances. This is a question to be decided by the competent international tribunal charged with the task of examining the question whether local remedies have been exhausted. The decision on this matter must be made on the assumption that the claim is meritorious.[516]

I assert that whether the local remedies required by the relevant provisions in BITs are futile or effective, is not determined by the arbitrators' subject judgement or the contentions by the parties, but by the objective circumstances at that time, i.e., in terms of the nature of the dispute, the content of the domestic law, etc., as well as whether the local authorities could provide workable and feasible local remedies. It should not rest upon the Claimant's position that the recourse to local remedies are difficult[517] and that there is no need to resort to it. If the Tribunal determines whether the futility is established based on the contentions of the Claimant, the Tribunal would be unduly influenced by such contentions and, overlook the objective circumstances. This in turn will lead to an unjust and pro-investor decision. On the

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513 *See Id.*
514 ILC, *supra* note 77.
515 Dugard, *supra* note 25, at 56.
516 ILC, *supra* note 259.
517 *See* the *Loewen* case, *supra* note 93.

contrary, an objective circumstances approach could widely restrict the unconstrained discretion of the Tribunal.

Another question to consider regards the burden of proof. If it is the case, when the Claimant contends the prior requirement of local remedies was futile, it should be the Respondent's burden to prove that under the prevailing circumstances and domestic laws, the remedies provided by the host state are reasonably available. This proposal mainly considers the convenience of the Host State to provide the ascertainment of local laws and other evidences in domestic circumstances.[518] Furthermore, as the narrow approach elucidated above has already restricted the rights of investors, so the burden of proof put on the Respondent State is more equitable under the circumstances. I'd like to call it the "objective circumstance approach" and incorporate the special burden of proof rule into the futility exception clause which is formulated as,

> There are no reasonably available local remedies to provide effective redress, determined in the context of the local law and the prevailing circumstances. If the Respondent could not prove the local remedies are objectively effective, the futility claims are established.

I argue that the incorporation of the "objective circumstance approach" to evaluate a futility exception could promote accuracy and precision of the standard, alleviating the misuse of futility exception to a great extent.

4.3 Refinement of Treaty Interpretation Rules

Another issue which cannot be ignored is the method of treaty interpretation. The approach of the teleological interpretation could be problematic, as the interpretation of the adjudicator may be unconstrained.[519] It is also very dangerous to apply the teleological interpretation, just as Professor Crawford stated, "The teleological approach has many pitfalls,

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[518] *See* Foster, *supra* note 24, at 262.
[519] Ammann, *supra* note 312, at 208.

not least its overt 'legislative' character."[520] Therefore I propose that the teleological interpretation approach should not be the only method to interpret treaty provisions; the misuse of teleological interpretation by the *Abaclat* Tribunal provides us with an opposite example.[521] The method of teleological interpretation should be handle with caution and in conjunction with other methods of treaty interpretations.[522] I assert that a proposal to restrict the teleological interpretation could effectively and efficiently regulate the misuse of arbitral tribunal's discretion. It would encourage them to take on a more neutral standpoint in order to give fair and just rulings and awards.

In the light of the manifestations and consequences caused by unsound futility standards and violations of International Law, we should find some approaches to alleviate the adverse impacts brought on by it. One important way is to strictly limit the extensive and arbitrary interpretation. Furthermore, it could be advised to refine the treaty interpretation rules. As an authoritative research institution of International law, ILC could compile a draft of treaty interpretation based on the treaty interpretation rules of VCLT. In the draft, the first step is to determine which methods can be incorporated into the scope, for example, textual interpretation, interpretation in good faith, restrictive interpretation, teleological interpretation, effective interpretation, and so on. At the same time, the extensive interpretation should be excluded. The second step is to be divided into two subcategories; textual interpretation should have an objective foundation, while interpretation in good faith, restrictive-interpretation, teleological-interpretation, effective-interpretation are placed in the category of "subjective" interpretation. The third step is to establish a hierarchy of these approaches, for instance, the objective interpretation is superior to the subjective interpretation. Additionally, rulings based solely on subjective interpretation standards are to be prohibited, because they are too ambiguous to apply. When applying the rules of subjective interpretation, objective interpretation should be required to form a supplementary function, at minimum. I think that this method could effectively regulate the misuse of arbitral tribunal's discretion and encourage a neutral position in order to give fair and just decisions and awards.

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[520] CRAWFORD, *Supra* note 145, at 775.
[521] *See* the *Abaclat* case, *supra* note 229.
[522] Ammann, *supra* note 312, at 209.

Chapter 5. Conclusions

International Investments Agreements are currently undergoing a transition from the first generation of a conservative approach and the second generation of a liberal approach to the third generation of balanced types.[523] There are two main reasons for the trend of balanced IIAs. One is the changes in capital flows. In the 20th century, the capital mainly flowed one way, from the developed countries to developing countries.[524] Nevertheless, in the recent two decades, investment activities have begun to move back and forth between developed and developing countries, and some countries have become capital exporters and importers at the same time.[525] In this vein, the developed countries have become the Respondents in ISDS,[526] while the developing countries have become the home state of Claimants.[527] Another cause that triggered the development of balanced IIAs is that there are inherent deficiencies in the ISDS mechanism. The problems of inconsistent rulings, arbitrary interpretations, lack of transparency have undermined the rights and interests of sovereign states and greatly challenged the governance, the legislative and judicial power of the host state.[528] The crisis of legitimacy makes states lose confidence and trust in the ISDS mechanism.[529] Against this backdrop, reforms are called for to achieve a balance between state sovereignty and foreign investment protection[530].

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523 *See* Congyan Cai, *Balanced Investment Treaties and the BRICS*, in BRICS APPROACH TO THE INVESTMENT TREATY SYSTEM, (Cambridge University Press, 27 August 2018).

524 Lin Huiling, *The Correction of Treaty Control Mechanism to the Settlement of International Investment Disputes from the Perspective of Rebalancing -- Review on "The Return of the Home State to Investor-State Disputes: Bringing Back Diplomatic Protection?"*, 1 TRIBUNE OF POLITICAL SCIENCE AND LAW 150, 151 (2021).

525 *Id.*

526 In 31 *ISDS* cases, Canada has been the Respondent state; the number for Italy is 13; Spain is 53; U.S. is 20.
Investment Dispute Settlement Navigator,
https://investmentpolicy.unctad.org/investment-dispute-settlement (last visited June 30, 2021).

527 In 14 cases, Ukraine has been the home state of claimant; Mauritius is 9, India is 9 and China is 8, etc., Investment Dispute Settlement Navigator,
https://investmentpolicy.unctad.org/investment-dispute-settlement (last visited June 30, 2021).

528 Cai, *supra* note 523.

529 Park,*supra* note 478.

530 *See* Li, Fenghua, *The Divergence and Convergence of ICSID and Non-ICSID Arbitration*, PhD thesis, http://theses.gla.ac.uk/6292/ (last visited July 19, 2021); *see also* Yu, *supra* note 24; and Foster, *supra* note 24, etc.

To strike a balance, some countries and organizations have already made proposals to the issue of futility exception to local remedies. For instance, the *2005 IISD Model BIT for Sustainable Development* proposes that exhaustion of local remedies and their exceptions should be provided in the texts.[531] *2012 SADC Model BIT* not only incorporates exhaustion of the local remedies and its futility exception, but also a six-month period for the solutions.[532] Moreover, the *2015 India Model BIT* provides a five-year pursuit of local remedies prior to International arbitration for the purpose of exhausting local remedies, as well as clearly incorporates "futility" exception to the prior local remedies requirements.[533] All the measures are taken to respond to the theme of respecting national sovereignty in the current era.

In the contemporary era, the economic power is shifting, the world economic environment is being restructured, and types of investment are also diversifying. The previous mechanism and jurisprudence in International Investment Law are no longer suitable for the new circumstances. Misuse of futility exception to local remedies is only a tip of the iceberg. The objects and interests of the legal protection of international investment are often multiple, so it is impossible to promote the development of International Investment Law simply from the perspective of a single capital-importing country or capital-exporting country as in the past. The situation of distorted protection of investors should be reversed,[534] and this change could be started from a reasonable formulation and interpretation of futility exception to local remedies. The decision on futility exception should be based on equality, mutual respect, and mutual benefit, aiming to achieve the balance among investment interests of various parties.[535] Only in this way, could the maximum benefits for all parties be achieved, as well as equity and justice be ensured in the investment field against the backdrop of the process of international economic integration.

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[531] IISD, *supra* note 486, at 60.
[532] SADC, *supra* note 495, at 57.
[533] Indian Model BIT (2015), *supra* note 500, Article 15.
[534] IISD, *supra* note 486, at x.
[535] *Id.*, at xi.

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국문초록

경제의 세계화와 더불어 국제 투자의 발전이 가속화되는 동시에 이와 관련된 투자분쟁도 증가되는 추세를 보이고 있다. 이는 투자자들과 국가 간의 분쟁으로서, 일반적으로 ICSID, UNCITRAL 등 투자자-국가 간 분쟁해결 제도에 의하여 해결되는바, 이러한 국제중재에 앞서 국내적 구제수단이 먼저 개시되는 것이 일반적이다. 그러나 근년래, 일부 사안에서는 무용화 예외(futility exception)에 따라 국내 구제절차를 뛰어넘어 분쟁을 1직접 국제중재에 회부하는 것이 인정되었는바, 이는 많은 논의를 불러일으켰다. 일반 원칙으로서의 무용화 예외는 구체적인 목적을 실현하기 위하여 사용되었으며, 이에 대한 남용은 국가주권을 크게 약화시키는 결과를 초래할 수 있다. 본 논문은 이론적 및 실천적 견지에서 국내 구제절차에 대한 무용화 예외에 대한 탐구를 통하여, 이러한 문제를 해결할 수 있는 실행가능한 방법을 모색함으로써, 안정된 국제투자협정의 배경 하에서의 국가 주권과 외국인 투자 간의 균형점을 확보하고자 한다.

키워드: ISDS, 국내 구제절차, 무용화 원칙, 조약해석, 국가주권, 균형점
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