The Local Remedies Rule
Is there a Principled Basis for Distinguishing between Application to Judicial Expropriation Claims versus Denial of Justice Claims?

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Abbreviations

BIT      Bilateral Investment Treaty
ICC      International Chamber of Commerce (in reference to its Arbitration Institute)
ICSID    International Centre for Settlement of Investment Disputes
VCLT     Vienna Convention on the Law of Treaties
1 Introduction

Judicial expropriation, being a direct or indirect taking of property, represents the most severe form of interference with it.¹ A confusion has emerged² as to the way in which a State’s judiciary can breach this investment protection standard, and, in particular, whether judicial expropriation is to be equated with denial of justice. The practical importance of the question whether the two concepts can be equated becomes apparent when one considers that, save for the established exceptions, exhaustion of local remedies is a prerequisite in denial of justice claims. Thus, if there is no principled basis to distinguish the two concepts, the local remedies rule should, as a matter of principle, also be applied in judicial expropriation cases. Such a result would significantly raise the jurisdictional threshold to be met by investors when attempting to bring a judicial expropriation claim or would mean that a finding of a breach of the standard would require a due process violation of a certain magnitude.³ This is why the thesis question is a very interesting and relevant one for both investors and States.

In attempting to identify a principled basis to distinguish between judicial expropriation and denial of justice claims, this thesis starts with looking briefly at the origins of the local remedies rule. This is to gain a better understanding of its purpose, both when first developed and as understood today. Next, the thesis examines the position of the local remedies rule in denial of justice cases, and the rationale for it. Then, the determination turns to judicial expropriation claims. This focuses on the applicability of the rule in this context and outlines the confusion which exists in the area. Then, a comparison of the two standards follows in order to conclude whether the rationale would make sense in judicial expropriation context. Finally, the thesis provides a practical guide by applying the findings of the previous chapters to the facts of Saipem v Bangladesh⁴ and proposes the right way to proceed in arguably borderline cases.

¹ Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law (2nd edn, Oxford University Press 2012) 98.
³ Jan Paulsson, Denial of Justice in International Law (Cambridge University Press 2005) 98.
⁴ Saipem SpA v People’s Republic of Bangladesh, ICSID Case No ARB/05/07 Award (9 September 2009) (Saipem).
1.1 Limitations

There are a number of contentious questions in relation to the local remedies rule. This thesis deals solely with the question whether there is a basis on which judicial expropriation claims can in a principled manner be distinguished from denial of justice cases, for the purpose of determining whether judicial expropriation claims should require a prior exhaustion of local remedies by the claimant. The question posed does not distinguish between the two facets of the local remedies rule, i.e. the rule as a procedural requirement (a jurisdictional hurdle) and the rule as a substantive requirement (often referred to as the “finality rule”). The correctness of the two approaches to the local remedies rule is outside the scope of this thesis and does not impact the findings in it.

The thesis solely addresses investment treaties which are silent on the requirement of exhaustion of local remedies, i.e. treaties which do not include an express requirement to exhaust local remedies prior to a claim of judicial expropriation.

1.2 Disposition

Chapter 2 briefly explains the origins of the local remedies rule, as well as its rationale, both as understood at the time of its introduction and nowadays.

Chapter 3 addresses the orthodox position on the applicability of local remedies rule in denial of justice cases and the rationale for applying local remedies rule in this context.

Chapter 4 addresses the current state of the law on local remedies rule in judicial expropriation cases, and identifies the existent confusion. This is done by examining three different views on the relationship between the thresholds for judicial expropriation and denial of justice.

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5 If the local remedies rule is a procedural requirement, non-exhaustion means that the tribunal cannot hear the case. Where, on the other hand, the rule is seen as a substantive requirement, the tribunal can hear the case but it might nevertheless fail on the merits, because the rights are not sufficiently violated.
Importantly, chapter 5 provides a critical comparison of the two concepts, in order to examine whether the rationale for the application of the rule in denial of justice cases makes sense in judicial expropriation cases.

Chapter 6 applies the findings of all the previous chapters to the fact pattern of *Saipem v Bangladesh*\(^6\), in order to provide a practical guide for how practitioners can proceed when operating in the area of judicial misconduct.

In the final chapter, I discuss all the findings of the previous chapters and reach a conclusion on the posed question.

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\(^6\) *Saipem* (n 4).
2 Origins of and Rationale for the Local Remedies Rule

The local remedies rule has its origins in the law of diplomatic protection, and so is a rule of customary international law. It states that where there has been a breach of international law in the treatment of an alien by a State, before the national State of the alien can bring the claim on the international plain, local remedies must be exhausted by the alien.\(^7\)

The rule was formulated in order to ensure respect for sovereignty of host States in international dispute settlement.\(^8\) This rationale remains unchanged today in all the areas where the rule is still relevant. Thus, it can be said that the rationale of the rule survived the development of more sophisticated dispute resolution mechanisms.\(^9\) The modern *raison d'être* is therefore “recognition given by members of the international community to the interest of the host State, flowing from its sovereignty, in settling international disputes of a certain kind by its own means before international mechanisms are invoked”\(^10\).

The rationale of respecting sovereignty of the host State is therefore the starting point in the examination of its suitability in the judicial expropriation context, as compared to that of denial of justice.

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\(^7\) Chittharanjan F Amerasinghe, *Diplomatic Protection* (1st edn, Oxford University Press 2008) 142.

\(^8\) Amerasinghe (n 6).

\(^9\) Amerasinghe (n 6).

\(^10\) Amerasinghe (n 6).
3 The Correct Rationale for the Local Remedies Rule in Denial of Justice Cases is Safeguarding State Sovereignty

The following paragraphs address briefly the nature of denial of justice claims and explore and evaluate several possible reasons for why the local remedies rule applies in this context. The preferred view is that the rationale underpinning the application of the rule is in fact the nature of the State’s international obligation, and its interplay with State’s sovereignty. Thus the rationale for the application of the rule in this context is protection of State’s sovereignty.

There is no uniform definition of what constitutes a denial of justice under international law. On one end of the spectrum is a broad definition encompassing the general notion of an international wrong. Some definitions, however, delimit the scope of denial of justice solely to cases of refusal of access to court, such as the one espoused by the Spanish Government in the *Barcelona Traction Co Case*. Recently, the practice of arbitral tribunals suggests that denial of justice in fact encompasses more than a refusal of access to courts, and rather includes manifestly unjust decisions.

Arguably, the vague nature of the concept is in fact necessary, i.e. the concept must be expressed as an “abstraction”. Otherwise, formalism would prevail and the avoidance of international responsibility would become easy for states. While it is, therefore, true that some controversy remains over the exact meaning of the concept, there is authority to the effect that denial of justice denotes “every failure on the part of the State to provide an adequate judicial protection for the rights of aliens”.

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11 See, for example: AO Adede, ‘A Fresh Look At The Meaning Of The Doctrine Of Denial Of Justice Under International Law’ (1977) 14 Canadian Yearbook of International Law.
12 4 ICJ Pleadings 463.
14 Paulsson (n 3), p.59.
15 Paulsson (n 3) 60.
16 Alwyn V. Freeman, *The International Responsibility of States for Denial of Justice* (Longman 1938) (as cited in Paulsson (n 3) 60).
It is generally accepted that the local remedies rule applies in the denial of justice context, i.e. that there can be no denial without exhaustion. Put simply, for a claimant to prevail on a denial of justice claim, he needs to have gone through all the “effective and adequate” appeals available in that legal system.

Turning now to the possible rationale behind the rule, legal scholars such as Alwyn Freeman posit several such reasons. For example, the outcome of national appeals may make international action unnecessary. This is so as the alien might obtain the remedy he is seeking through an instance of the national appeal mechanism. Also, solving the dispute in national courts rather than by bringing a claim against the State on the international plain would lessen inter-state friction. Furthermore, respect for the gravity of international responsibility by only allowing claims “really worthy of consideration” speaks in favor of the local remedies rule. However, as Jan Paulsson notes, these reasons could work to militate in favor of application of the local remedies rule for all international wrongs and not only denial of justice. Thus a more specific rationale, one that distinguishes denial of justice from other international wrongs, is needed.

A distinction between breaches of municipal law versus international law is not a helpful rationale in this context either. This rationale has been formulated to say that it is “an essential condition of a State being held responsible for a judicial decision in breach of municipal law that the decision must be a decision of a court of last resort, all remedies having been exhausted”. This reasoning makes sense: if the relevant national legislation is itself a breach of international law, there is no need to bring a denial of justice claim. Rather, a claim can be brought for the breach of the specific duty under international law. If on the other hand, the complaint is one for a mere misapplication of that legislation by a national court, this can hardly be considered as a breach of the obligation to provide a “minimally adequate legal system”.

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17 Paulsson (n 3).
18 Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3 (Loewen).
19 Freeman (n 15) 416–417.
20 Paulsson (n 3) 102.
21 Eduardo Jiménez de Aréchaga, ‘International Law in the Past Third of a Century’ (1978) 159 Recueil des cours (as cited in Paulsson (n 3) 104).
22 Paulsson (n 3) 104.
of justice will include an allegation that the trial immediately violated international law.\(^\text{23}\) If so, it becomes less clear why an exhaustion of local remedies should be required.

The argument based on the special nature of adjudication is unpersuasive, in that it rightfully qualifies adjudication as burdened with rationality but fails to explain how that is fundamentally different from the legislative and executive powers. These special characteristics of adjudication have been extensively covered by Fuller, who refers to adjudication as “a device which gives formal and institutional expression to the influence of reasoned argument in human affairs”.\(^\text{24}\) The argument continues that it is this “burden” of rationality that sets adjudication apart from other forms of social ordering.\(^\text{25}\) This is not convincing since it does not explain how the executive and legislative organs of the State are not burdened with that same rationality, or even why that burden is a sufficient reason to make judicial acts or omissions less susceptible to international review. A slightly more elaborate argument is put forward by Zachary Douglas, who argues both in terms of the special attributes of adjudication and in terms of the time at which damage occurs in adjudication cases.\(^\text{26}\) The argument is that the damage in these cases occurs only once the investor’s substantive rights are finally denied. That this is also not convincing is demonstrated in Chapter 5, when looking closely at whether this is true in judicial expropriation cases.

The better rationale behind the local remedies rule in the denial of justice context is based on the State’s duty to provide an effective system of justice; such a duty cannot be breached in the first place unless the whole system as such has been tried and failed.\(^\text{27}\) When officials lower in the hierarchy breach such systemic obligations of the State, and where those breaches can be rectified at a higher level, there is no unlawful act.\(^\text{28}\) Therefore, this rationale is closely linked to that of respect for the host State’s sovereignty: the sovereign State should not be responsible in

\(^{23}\) Paulsson (n 3) 105.
\(^{26}\) Douglas (n 24).
\(^{27}\) Sattorova (n 12).
international law for a breach of a duty it has never undertaken. Rather, implied or express State’s consent is the way to understand how a sovereign State finds itself bound by international obligations. Legal positivism explains States’ international obligations through the concept of consent. The starting point expressed in the seminal *Lotus* case is that States are allowed to do anything unless a rule prohibits it. *The SS Wimbledon* explains that an assumption of these limitations to what a State can do is the ultimate expression if its sovereignty. If the duty of the State is a systemic one, as it is in this case to provide an effective system of justice, individual instances of judicial misconduct, which are still appealable, cannot attract the State’s international responsibility.

Therefore, the local remedies rule is easily understandable in the denial of justice context given the nature of the sovereign State’s international obligation. Furthermore, another facet of the rationale of protecting State sovereignty is applicable in the denial of justice context: the State here is acting as sovereign in its dealings with the individuals alleging the judicial misconduct in question.

In sum, the only satisfactory rationale for the application of the local remedies rule in the denial of justice context is closely connected to the State’s sovereignty. State’s implied or express consent is the only way a State can become bound by international obligations. Since in this case the obligation imposed is a systemic one, no breach can occur and no international responsibility arise until the whole system has been tried.

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29 *The Case of the S.S. Lotus* [1927] PCIJ, 9 (PCIJ).
30 *The SS ‘Wimbledon’* [1923] PCIJ.
4 Confused Application of Local Remedies Rule in Judicial Expropriation Cases

Ever since the first arbitral cases dealing with judicial expropriation, its nature and the threshold to be applied have been subject to a degree of confusion.

This thesis will explore three different positions on the threshold to be applied in judicial expropriation cases, which also result in different consequences for the application of the local remedies rule. All three approaches have some backing in the existing arbitral case law, and have attracted some academic support. They will be briefly set out in this section and then critically evaluated in order to decide on the right approach.

4.1 Proposition: Judicial Expropriation as Denial of Justice in Disguise

*Robert Azinian and Others v United Mexican States*31 was one of the first cases dealing with the threshold to be applied in judicial expropriation cases. The ICSID arbitral tribunal dismissed this claim, stating that “the Claimants must show either a denial of justice, or a pretense of form to achieve an internationally unlawful end”32. The Tribunal in *Aktau Petrol Ticaret AS v Kazakhstan*33 then relied on this case in order to suggest that the only international wrong for which a State can be held liable based on the acts or omissions of its judiciary is precisely denial of justice.

*Robert Azinian* can be construed in other ways. Nowhere in the award did the tribunal make such a categorical statement.34 To the contrary, members of the tribunal cited a former President of the International Court of Justice for the proposition that State’s responsibility for a judiciary’s conduct may result from three different types of judicial decision, only one of which was denial of justice.35 Furthermore, this reading is consistent with Jan Paulsson’s views expressed in

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31 *Robert Azinian and others v United Mexican States*, ICSID Case No ARB(AF)/97/2, Award (1 November 1999) (Azinian)
32 *Azinian* (n 28) para 99.
34 Gharavi (n 2).
35 *Azinian* (n 28) para 98.
scholarly works on denial of justice that “a national court's breach of other non-procedural rules of international law, or of treaties, is not a denial of justice, but a direct violation of the relevant obligation imputable to the state like any acts or omissions by its agents”.

Furthermore, a distinction between the thresholds for judicial expropriation and other forms of expropriation would cause practical problems, which are also clear from the facts of *Aktau*. Namely, some treaty breaches in that case were perpetrated by the court bailiffs. This ultimately led to a debate in the case as to whether court bailiffs form part of the judiciary or the executive of the State, as this can vary from State to State. While the parties in the case ultimately reached an agreement to the extent that bailiffs constitute part of the executive, this shows the absurdity that would arise if a higher threshold was required to be met in cases where a bailiff administratively forms part of the judiciary than if he were to form part of the executive. This would mean that, if the bailiff forms part of the host State’s judiciary, the claimant alleging mistreatment would need to exhaust all local remedies before bringing his claim on the international plane. On the other hand, that same alleged mistreatment could immediately be brought to an international tribunal where bailiffs form part of the host State’s executive.

This position, as well as the resultant confusion, has been strengthened by academics as well. While admitting that his view is novel, Douglas writes that denial of justice is “the sole form of international delictual responsibility towards foreign nationals for acts or omissions within an adjudicative procedure”. However, this proposition is not only novel but also “not substantiated by any legal authority”. A more subtle, though no less problematic, position is that, while not every judicial expropriation will amount to a denial of justice, and although not every denial of justice is in the form of judicial expropriation, every arbitrary, unjustified and expropriatory act by the judiciary will necessarily also constitute a denial of

36 Paulsson (n 3) (as cited in Gharavi (n 2)).
37 Gharavi (n 2).
38 Douglas (n 24).
39 Gharavi (n 2).
justice.\textsuperscript{40} Equally, both standards protect from a certain form of judicial misconduct and both occur in the context of administration of justice.\textsuperscript{41}

If this is the case, distinguishing between thresholds for expropriation by the judiciary and denial of justice would open the door for investors to use ‘skillful labelling’\textsuperscript{42} in order to avoid the application of the local remedies rule by invoking an investment protection standard rather than a denial of justice one.\textsuperscript{43} On this view, investors would be encouraged to present their claims as judicial expropriation and in that way circumvent the application of the local remedies rule. Such an avoidance by investors of a procedural requirement can be said to be meddling with the rules on international review of the judicial conduct. The main rule is that the special nature of adjudication, combined with the nature of the State’s obligation, requires exhaustion of local remedies. If investors are then allowed to “cherry-pick”\textsuperscript{44}, this rule is clearly undermined. The whole argument is, however, based on the flawed idea that there is something special about the nature of adjudication as compared to legislative and executive powers and that, furthermore, that special nature should be enough to justify treating adjudication differently.

While both judicial expropriation and denial of justice represent standards that are in place to protect from judicial misconduct, the mere fact they apply to the same of overlapping subject matter should not suffice to show that the same thresholds should be applied. It is true that cases of unlawful expropriation are also often going to amount to a denial of justice, but the logical conclusion stemming from this overlap is not that the threshold to be applied in judicial expropriation cases is that of denial of justice. The threshold to be applied to establish breach of an investment protection standard needs necessarily to be derived from the text of the Treaty which forms the basis of the Parties’ consent and the scope of the tribunal’s mandate.\textsuperscript{45} Most Model Bilateral Investment Treaties (BITs) contain language to the effect that ‘Neither Party may expropriate or nationalize a covered

\begin{footnotesize}
\textsuperscript{40} Mavluda Sattorova, 'Judicial Expropriation or Denial of Justice? A Note on Saipem v Bangladesh' (2010) 13(2) International Arbitration Law Review.
\textsuperscript{41} Sattorova (n 12).
\textsuperscript{42} Sattorova (n 12).
\textsuperscript{43} Sattorova (n 12).
\textsuperscript{44} Sattorova (n 12).
\textsuperscript{45} Natasa Novakovic, Memo: Should an exhaustion of local remedies be required prior to arbitration of claims of judicial expropriation?
\end{footnotesize}
investment”. Thus most Model BITs do not expressly distinguish between different types of expropriation.

Turning then to the question of the threshold to be applied, one needs to refer to the canons of interpretation as contained in the Vienna Convention on the Law of Treaties (VCLT). Article 32, which provides for an interpretation that does not have a result that is “manifestly absurd or unreasonable” would stand in the way of having a different threshold for cases of judicial expropriation as compared to expropriation by other organs of the State. Firstly, this is so as such an interpretation would provide an incentive to States to reorganize takings to be via the judiciary, which would on that interpretation result in a higher threshold and consequently also an application of local remedies rule. Furthermore, it would lead to a very arbitrary result in that the outcome of a case would depend on a distinction between the judiciary and the other two organs of the State that can sometimes be a very fine one. That this is so can be demonstrated by cases such as Aktau, which expose an investor deprived of his investment to a rather unprincipled chance of success.

For all the reasons above, the idea that denial of justice is the only form of judicial international delict is unpersuasive. Furthermore, there are also practical reasons why the equating of the thresholds, while keeping the threshold for other forms of expropriation lower, would be problematic. As explained above, this would raise issues where the separation of powers varies in different States, and equally where acts or omissions of more than one State organ contribute to the act of expropriation. Overall, the view that judicial expropriation is merely a form of denial of justice in disguise should be rejected.

4.2 Proposition: The Thresholds are Similar

The tribunal in *Eli Lilly* did not completely equate the thresholds for the two standards but rather reasoned that a threshold falling just short of denial of justice in disguise should be rejected. 

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47 *Aktau Petrol Ticaret AS v Republic of Kazakhstan*, ICSID Case No ARB/15/8, Final Award (13 November 2017) (*Aktau*).
would also suffice in cases where there is “conduct that may...be sufficiently egregious and shocking, such as manifest arbitrariness or blatant unfairness”. Therefore, when the tribunal in this case was expressly deciding the question whether denial of justice is the only threshold of international liability for judicial misconduct, it answered that question in the negative.

Although the *Eli Lilly* tribunal, when dealing expressly with the liability threshold issue, suggested a “manifest arbitrariness” threshold, it provided no persuasive authority to this effect. Absent any further explanation and given the above analysis whereby the threshold is to be based on the consent of the parties, it is safe to say that the threshold to be applied is no higher than that in all other expropriation cases.

### 4.3 Proposition: Judicial Expropriation and Denial of Justice have Different Thresholds

There is also, however, much support in arbitral awards for the proposition that the thresholds to be applied in denial of justice and judicial expropriation cases are in fact different: there have been numerous findings of judicial expropriation on a stand-alone basis. When addressing the question of whether a judicial expropriation occurred on the facts of the *Rumeli Telekom* case, for example, the tribunal said nothing to suggest that, for the claim to succeed, the measures by the Presidium of the Supreme Court of Kazakhstan need to have amounted to a denial of justice. In that case, the Court’s valuation of the claimant’s shares, as opposed to that of the Claimant’s Kazakh partner, amounted to a judicial expropriation. While the tribunal did refer to the measure undertaken as being “manifestly and grossly inadequate”, this was only done in the part of the award applying the relevant

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49 *Eli Lilly* (n 32) paras 222–23.
50 Gharavi (no 4).
51 See, for example: *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v Republic of Kazakhstan, ICSID Case No ARB/05/16, Award (29 July 2008) (Rumeli)* paras 702–704; *Saipem SpA v People’s Republic of Bangladesh, ICSID Case No ARB/05/07 Award (9 September 2009) (Saipem)* para 181.
52 *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v Republic of Kazakhstan, ICSID Case No ARB/05/16, Award (29 July 2008) (Rumeli).*
53 *Rumeli* (n 15).
legal principles to the specific facts of that case and in order to finally conclude unlawfulness in the specific context.

The correct view is that the thresholds to be applied are in fact different. That this is so becomes clear following the examination of how the two standards relate in Chapter 5.

4.4 Conclusion on Exhaustion of Local Remedies Rule in Judicial Expropriation Cases

As demonstrated above, there is no clear answer to whether a judicial expropriation claim requires a prior exhaustion of local remedies. This confusion has come into focus since a number of defendant States have recently attempted to rely on the high denial of justice threshold in this context. While the view has been expressed here that the thresholds for judicial expropriation and denial of justice should not be equated, this does not conclusively answer the question whether the standards are the same or similar enough so that a principled distinction cannot be drawn for the purpose of local remedies rule. Thus, in order to decide whether such a requirement should apply, the distinction between judicial expropriation and denial of justice, where it does apply, becomes critical.

54 Aktau (n 8) para 287; Franck Charles Arif v Republic of Moldova, ICSID Case No ARB/11/23, Award (8 April 2013) (Arif) para 307 as quoted in Douglas (n 24).
5 Judicial Expropriation vs. Denial of Justice Claims

It has now been established that the orthodox position is that an exhaustion of local remedies is a requirement in denial of justice cases, but that its application in judicial expropriation cases has been subject to confusion. Since this is the case, the comparison between the two standards becomes central to answering whether the local remedies rule should apply in judicial expropriation cases.

The question whether there is a principled basis to distinguish between judicial expropriation and denial of justice claims depends on the correct rationale for the application of local remedies rule in the denial of justice context. If this rationale is in fact the special nature of adjudication, it would appear that the rule should equally apply in the judicial expropriation context, since the latter is also concerned with the mistreatment of an alien by the judiciary. The argument goes that what is shared by all forms of international delict against aliens is damage to that alien. When it comes to delictual responsibility for acts and omissions relating to the exercise of enforcement powers, “the damage occurs simultaneously with the misfeasance or nonfeasance in question”. Arguably, this is different from the damage caused in the context of an adjudicative procedure. The damage to the alien is only caused once the substantive rights of that individual are finally denied. This argument has been used to argue that there is no principled basis to distinguish between denial of justice and judicial expropriation. However, it has already been explained in Chapter 3 that the better rationale is that of the nature of obligations undertaken by sovereign States. Even if this is not the case, the argument is flawed in so far as it suggests that the damage to the investor in judicial expropriation cases occurs only once his substantive rights are finally denied.

That this is not the case becomes obvious when one looks at the nature of the right of the investor as well as at the nature of the expropriation standard. The standard protects investors from both direct and indirect takings of their property. Thus, at the point when judicial expropriation occurs, the investor will already have been either deprived of his title to a property or that property will have been substantially damaged.

55 Douglas (n 24).
56 Douglas (n 24).
57 Douglas (n 24).
deprived of its value. Clearly, this is when the damage to the investor occurs, rather than when he is potentially denied damages by the court of final instance in the host State, or otherwise mistreated. The obligations in question are different: an obligation not to expropriate on the one hand and an obligation to provide a just legal system on the other hand. This can be quite clearly seen from bankruptcy and liquidation cases, in which the harm to the investor quite clearly occurs once his property is liquidated. For example, in the Yukos case, the Respondent State’s courts imposed bankruptcy and then ordered a liquidation of all of the Claimant’s remaining assets through a number of auctions.\footnote{Yukos Universal Limited (Isle of Man) v. The Russian Federation, UNCITRAL, PCA Case No. AA 227, Award (18 July 2014).} Finally, Yukos was struck off the register of companies and its shares were legally extinguished. It is clear that the true damage to the investor occurred at this point. Thus the wrong in judicial expropriation cases crystallizes when the taking is complete, rather than when the domestic system is proven to be unjust.

Thus, the better rationale is that of protection of State sovereignty. While this rationale has been explained above in denial of justice context, it is hard to apply in judicial expropriation cases. Legal instruments do not distinguish between judicial expropriation and expropriation by the other two organs of the State.\footnote{Gharavi (no 2).} Since these investment protection standards are imposed on sovereign States by virtue of them exercising that sovereign power by agreeing to the terms of a treaty and signing it, it is hard to see how arbitral tribunals could then alter such investment protection provisions or read into them a higher standard than that agreed between the parties. In fact, such an intrusion by an arbitral tribunal arguably constitutes an excess of the powers or the mandate of the tribunal.\footnote{Gharavi (no 2).}

Even if one considers Jiménez de Aréchaga’s proposition (that for a State to be held responsible for a judicial decision in breach of municipal law, this must be a decision of a court of last resort)\footnote{see above: page 7.} to be a strong enough rationale to support the application of the local remedies rule in denial of justice context, it would still not justify the same rule being applied in judicial expropriation cases. Namely, although it is correct that the State should only be held responsible for breaches of municipal
law by the judiciary if they are breaches by the court of last resort (unless an exception to the local remedies rule applies\textsuperscript{62}), a judicial expropriation constitutes a breach of international law itself, no matter how low in the hierarchy the court is. This point is connected to that of the time when damage is suffered by an investor: when the property of an investor is taken or rendered worthless, this is in itself a breach of international law, regardless of the court whose decision led to such an outcome. Thus, an application of local remedies rule in judicial expropriation cases is not well supported by this line of reasoning either.

It would be hard to find a rationale to support the application of local remedies rule in judicial expropriation cases but not in the case of expropriation by other State organs. Such a distinction seems arbitrary since there are also instances of review of other State decisions, such as a State’s Constitutional Court where the measure alleged to be in breach of the standard is taken by the legislature, or for example a Supervising Ministry in cases of measures by the executive.\textsuperscript{63} Furthermore, judicial review of both legislative and executive actions is quite common in some jurisdictions. While one could argue against this by pointing to the special nature of adjudication, it has already been said that this arguments rests on the premise that the damage to the alien only occurs once he is finally denied his substantive rights. As explained earlier, this is clearly not the case in judicial expropriation cases.

Another unpersuasive argument for imposition of the local remedies rule in judicial expropriation cases is based on an analogy with the US Supreme Court’s jurisprudence on the Fifth Amendment Takings Clauses of the US Constitution. Namely, Foster proposes that exhaustion of local remedies can be imposed as a substantive requirement in cases of alleged breach of investment protection standards other than denial of justice. By comparing judicial expropriation to the US cases, he suggests that while uncompensated takings are not allowed, a claim cannot succeed unless compensation has been sought and denied.\textsuperscript{64} This, he

\textsuperscript{62} See, for example: Dan Cake S.A. v. Hungary, ICSID Case No. ARB/12/9, Award (24 August 2015) (Dan Cake).
\textsuperscript{63} Gharavi (no 2).
explains, would reduce the need for federal intervention and protect State sovereignty.

This comparison to the US legal system is a very weak one from the outset. The system of investor-State arbitration was introduced specifically to allow an efficient and direct legal protection of aliens. Furthermore, even if the analogy was a well-grounded one, to suggest that the requirement of exhaustion would somehow protect State sovereignty is flawed. As already noted, the signing of an investment treaty by a State is in itself an expression of sovereignty: the State is sovereign enough to bind itself to international obligations.

Furthermore, the local remedies rule does not sit well within the system of bilateral investment treaties. The imposition of the local remedies rule in judicial expropriation cases would amount to a deprivation of the investors of their substantive and procedural rights under international law. BITs normally provide investors with a jurisdictional right to resort to arbitration, which at the same time constitutes a direct and efficient way to protect all the substantive rights granted under the treaty. Given that this is the case, it is hard to argue that a foreign investor should be required to undertake the time and the expenses of arguing his case in front of a local court first. What is more, investment treaty arbitration is a hybrid dispute settlement mechanism, whereas the local remedies rule is a rule of customary international law. It is, thus, crucial to look at the State’s consent as expressly provided in the text of a treaty, rather than look to the other sources of international law.

When one is interpreting the text of a Treaty which is the source of a State’s obligations, it is important that such interpretation should not “lead to a result which is manifestly absurd or unreasonable”, as provided for in Article 32 of the VCLT. It is arguable that equating the thresholds for judicial expropriation and denial of justice, while at the same time allowing for the threshold for unlawfulness of other types of expropriation to be governed by the terms of the Treaty (i.e. normally requiring discrimination, no compensation and a lack of due process), would provide an incentive to reorganize takings so as to be done by the judiciary.

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65 Gharavi (no 2).
66 Gharavi (no 2).
The standards are also different from a more formalistic point: judicial expropriation is one of the types of expropriation while denial of justice falls under the fair and equitable treatment standard. The acts of the judiciary can constitute a breach of the FET standard without amounting to a denial of justice and it would be absurd if this would be otherwise in cases of expropriation. It would not make sense to use the special nature of adjudication to justify treating judicial expropriation and denial of justice in the same manner, although other judicial acts can violate stand-alone components of the FET standard.

Thus, the correct rationale for the application of local remedies rule in denial of justice context is that of respecting the sovereignty of the host State. The State can only be held liable when the whole judicial system fails, since this is the only duty imposed on the State in international law. This rationale is, however, unable to support the application of the same rule in judicial expropriation cases. There is in this context nothing that State sovereignty needs protecting from since it is the exercise of that sovereignty that allows the State to bind itself to the terms of a treaty which provides for arbitration of judicial expropriation claims. This is the main principled distinction to be drawn between denial of justice and judicial expropriation cases.

Furthermore, the context in which the claims arise is also crucial. While judicial expropriation claims are grounded in investment treaty provisions, and thus come about through express consent of the parties, exhaustion of local remedies, and its application in denial of justice cases, is rooted in customary international law.

Apart from this, the context provided by investment treaty arbitration is crucial since the whole idea behind it is to allow efficient and direct protection of the foreign investor. To impose a requirement of exhaustion of local remedies would sit uneasily in this context.

To conclude, the rationale of protecting State sovereignty which was identified for the local remedies rule in denial of justice cases is not applicable in judicial expropriation cases. This is so as judicial expropriation claims are based on express consent of the parties, which does not normally distinguish between different

67 Gharavi (no 2).
expropriation claims. Also, the obligations in question can be distinguished based on when the wrong crystalizes/when the damage occurs: when the State’s duty is not to expropriate, the damage to the investor occurs as soon as his property is expropriated. Where, on the other hand, the State’s duty is to provide a fair system of justice, the damage to the alien occurs only once his substantive rights are finally denied. Furthermore, these treaties are in place to facilitate access to dispute resolution for the foreign investor. Thus, the principles basis to distinguish between denial of justice and judicial expropriation is the need to protect State sovereignty.
The findings of previous chapters will now be applied to the fact-pattern of *Saipem v Bangladesh*[^68]. This case was chosen as it represents a good example of a borderline case, and has been criticized as a disguised case of denial of justice.[^69]

### 6.1 Facts of *Saipem v Bangladesh*

The ICSID arbitration concerned a contract to jointly build a pipeline concluded between the claimant investor, an Italian company, and Petrobangla, a Bangladeshi state entity. This contract contained an arbitration clause providing for ICC arbitration.

Once a dispute arose between the parties to the contract, Saipem commenced an ICC arbitration. Petrobangla filed a number of jurisdictional objections, all of which were dismissed by the ICC tribunal. Subsequently, the tribunal rejected a number of procedural objections raised by Petrobangla.

Petrobangla then turned to the local courts. Initially, it sought the revocation of the authority of the ICC tribunal in the First Court of the Subordinate Judge of Dhaka. It later also sought a stay of proceedings in front of the High Court Division of the Supreme Court of Bangladesh. A week later, the Supreme Court of Bangladesh issued an injunction to restrain Saipem from proceeding with the ICC arbitration.

Saipem then filed an objection to Petrobangla’s action seeking the revocation of the ICC tribunal’s authority. A few weeks later, the First Court of the Subordinate Judge of Dhaka came to a decision to revoke the authority of the ICC tribunal (the Revocation Decision).

There were two available instances of appeal of the Revocation Decision. Saipem decided not to pursue them, however.

In the meantime, the ICC tribunal decided to continue with the arbitral proceedings and eventually (after a number of other injunctions being granted by the local courts) rendered an award.

[^68]: *Saipem* (n 4).
[^69]: Sattorova (n 37).
Petrobangla then commenced the setting aside proceedings. The High Court Division of the Supreme Court of Bangladesh denied such application, on the ground that it was “misconceived and incompetent inasmuch as there is no Award in the eye of the law, which can be set aside”.\(^{70}\)

Saipem did not appeal this decision. Rather, it commenced an ICSID arbitration based on the BIT between Italy and Bangladesh. It claimed that Saipem’s right to arbitrate is a contractual right which had been expropriated without compensation by the judiciary of Bangladesh.

6.2 Findings of the ICSID tribunal

The ICSID tribunal found in favor of Saipem. It considered the expropriated property to be “Saipem’s residual contractual rights under the investment as crystallized in the ICC Award”.\(^{71}\) The tribunal found that the decision which rendered the ICC Award a nullity “is tantamount to a taking of the residual contractual rights arising from the investments as crystallized in the ICC Award”.\(^{72}\) Thus, the taking in question was found to be a judicial expropriation. This was so even though Saipem did not exhaust local remedies available for both the Revocation Decision and the decision rendering the ICC Award a nullity. The ICSID tribunal held that exhaustion of local remedies is not a requirement in judicial expropriation cases, as opposed to denial of justice cases.

6.3 Practical Guidance on Proceedings in Borderline Cases

The case in question has been criticized for being based on a mistaken and unpersuasive distinction between judicial expropriation and denial of justice.\(^{73}\) Even the claimants in the case explained that the only reason why they decided to pursue the claim as a judicial expropriation claim and not denial of justice was because the BIT did not confer jurisdiction to the arbitral tribunal in the latter case.\(^{74}\)

\(^{70}\) Saipem (n 4), emphasis added.
\(^{71}\) Saipem (n 4).
\(^{72}\) Saipem (n 4).
\(^{73}\) Saipem (n 4).
\(^{74}\) Saipem (n 4).
Thus the question arises whether the tribunal was right in basing its decision on a breach of the expropriation standard. Furthermore, a confusion exists as to how practitioners can proceed not only in similar cases of judicial intervention in arbitral proceedings but also, more generally, in cases of judicial misconduct.

Firstly, in so far as it distinguishes judicial expropriation from denial of justice, the case was decided correctly. In coming to its conclusion, the tribunal agreed with Saipem’s analysis based on the dicta in *Generation Ukraine*75. There, the tribunal explained that judicial expropriation and denial of justice are clearly not the same illegality. Denial of justice cases relate “as much to the process by which a certain result is reached as to the actual outcome”.76 Judicial expropriation is “completely different”.77 There, the only issue is the final outcome, i.e. whether the investor was illegally deprived of his property. It is true, however, that the *Generation Ukraine* tribunal, and therefore also the *Saipem* tribunal, submit that in expropriation cases the way the outcome is achieved does not matter, but then at the same time qualify the taking as having to be “illegal”. The *Saipem* tribunal notes that the “sole effects doctrine” postulates that the only criterion to determine whether there is an indirect expropriation is the impact of the measure, but it goes on to say that in this particular case illegality also has to be proven. This is so because of the “very peculiar circumstances” of the case.78

The more persuasive argument is the one based on a strict upholding of the “sole effects doctrine”. A finding of expropriation is based solely on the effects of the measure on the investor’s property. Even if one accepts that illegality is also necessary to prove expropriation in exceptional cases, the *Saipem* tribunal did not suggest that that proof of illegality equals proof of denial of justice. Rather, the requirements for illegality of expropriation are those that are found in the BIT: in this case those were no public purpose or national interest, no full and effective compensation, discrimination and non-conformity with all legal provisions and procedures.79 This is different to a proof of denial of justice, which tribunals have

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75 *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (16 September 2003) (*Generation Ukraine*).
76 *Generation Ukraine* (n 72).
77 *Generation Ukraine* (n 72).
78 *Generation Ukraine* (n 72).
79 Italian-Bangladeshi BIT, Article 5.
described as “manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety”\textsuperscript{80} and the International Court of Justice as “a willful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial propriety”.\textsuperscript{81}

It is true, however, that the circumstances of the case were peculiar and that the tribunal needed a way to limit its finding that a judicial interference in a claimant’s right to enjoy an arbitral award can amount to expropriation. As the tribunal noted, it would otherwise be possible to claim that any setting aside of an award amounts to expropriation. However, the better view is that the Saipem tribunal should have focused on delimiting the definition of “investment” instead. Its finding that a contractual right to arbitrate represents an investment under the treaty is a broad and questionable one. That this is so is clear if one considers the time at which damage normally occurs in expropriation cases, i.e. the moment the investor is deprived of his investment or that investment is rendered worthless. On the facts of this case, however, it is less clear that the courts’ interference with the claimant’s right to arbitrate is when the damage actually occurred. In fact, the real damage in this case would occur once the right to arbitrate is finally denied. Nonetheless, the claimants in this case did attempt all the reasonably available remedies by opposing several local courts’ decisions, so that the case would have been more properly decided on the basis of an exception to the local remedies rule.

Moving on to how claims based on judicial misconduct can be brought in practice, the better view is that no exhaustion of local remedies is needed prior to commencing a judicial expropriation claim in front of an international tribunal. Judicial expropriation and denial of justice are two different standards. Not only is this the case, but the illegality aspect of judicial expropriation (whether it is relevant to show expropriation itself or merely quantum) also does not require a proof of denial of justice. Thus, practitioners should be able to pursue judicial expropriation claims where there is no exhaustion of local remedies and without having to prove an injustice which shocks or offends.

\textsuperscript{80} Loewen (n 17).
\textsuperscript{81} Elettronica Sicula SpA (ELSI) [1989] ICJ, 15 (ICJ).
Even in cases where a tribunal considers that exhaustion of local remedies does in fact constitute an element of a judicial expropriation claim, it is still likely that such a requirement would be interpreted loosely, i.e. so as not to require the investor to go through all the instances of appeal. Several exceptions to the local remedies rule have been developed in customary international law. Although the Saipem tribunal held that there was no requirement to exhaust local remedies, it nonetheless went on to say that even if such a requirement did apply, the claimant would be found to have exhausted all reasonably available remedies. This was so as Saipem attempted to defend its right to arbitrate in front of several national courts. Thus it is safe to say that even if a tribunal would decide differently to what this thesis proposed as to the difference between judicial expropriation and denial of justice, it is unlikely that in practice an attempt at all of the instances of appeal would be necessary, but rather only those which are reasonably available.

To sum up, the Saipem tribunal was correct to distinguish between judicial expropriation and denial of justice claims, at least from a theoretical point of view. What is more questionable is the tribunal’s finding of “investment” on the facts of the case, and it is arguable that the tribunal’s conclusion that the contractual right to arbitrate constitutes an investment is too broad. Thus, this claim would have been better decided as a denial of justice claim to which an exception to the exhaustion of local remedies rule applied. Finally, it was also suggested that where the council can establish all the elements of judicial expropriation, no exhaustion of local remedies is required. Even in cases where the tribunal finds differently (i.e. does not draw a distinction between judicial expropriation and denial of justice), it is argued that the rule is not a strictly formalistic one, but rather that the tribunal will look for reasonable attempts at exhaustion.
7 Conclusion

This thesis demonstrated that the principled distinction to be drawn between judicial expropriation and denial of justice claims consists in the applicability of protection of State sovereignty rationale. While this rationale is understandable in the context of denial of justice given the nature of the international obligation imposed on the State, judicial expropriation cases are grounded in investment treaties which are themselves products of State sovereignty.

The question was explored by first looking at the rationale for the application of the local remedies rule in general. This section concluded that the rationale is the protection of the State’s interest, flowing from its sovereignty, in having disputes resolved by its own means, before they are referred to international tribunals.

Then, the thesis looked at the rationale behind the application of the local remedies rule in the denial of justice context. This section rejected the special nature of adjudication as the correct rationale. Namely, the argument does not explain how this nature is any different to that of executive and legislative power, or why that nature should result in a degree of deferral to a State’s judiciary. Rather, this chapter concluded that the correct rationale is to be found in the nature of the State’s obligation and its interplay with State sovereignty. Sovereign States should, based on the consent theory, only be bound by impliedly or expressly assumed international obligations. In case of systemic obligations, then, no international responsibility exists until the whole system has been tried and failed.

Next, I turned to exploring the confusion which exists in the area of judicial expropriation, with regard to the correct threshold to be applied. It was concluded that judicial expropriation and denial of justice do not in fact have the same threshold. The correct threshold for a treaty-based protection standard is to be found in the text of the relevant treaty. Most investment treaties do not distinguish between judicial expropriation and other forms of expropriation.

When looking closely at how judicial expropriation and denial of justice relate to each other, this thesis showed that the standards can be distinguished in a principled manner. First, it was explained that it is wrong to suggest that the two standards crystallize at the same time: the damage in judicial expropriation cases occurs the
moment the investor is deprived of his investment. It was also shown that judicial expropriation should not be treated differently to other forms of expropriation: the text of the treaty does not so require and there are also instances of review for State’s legislative and executive acts. The context of investment treaty arbitration is also crucial, in that its development has been towards a direct and effective form of international dispute settlement.

The final chapter explored the fact-pattern of *Saipem v Bangladesh*, as an example of a borderline case. The finding in the case that judicial expropriation does not require an exhaustion of local remedies is correct. Furthermore, the tribunal applied the correct illegality test, in that it looked at the treaty requirements rather than at denial of justice. The particular facts of the case should have, however, fallen under a denial of justice claim to which an exception to the local remedies rule should have then been applied. It was suggested that in practice a judicial expropriation claim can be brought without a prior exhaustion of local remedies and with no need to show denial of justice in form of an “act which shocks, or at least surprises”. 82

Thus, for all the reasons stated above, exhaustion of local remedies is not a requirement of a successful judicial expropriation claim.

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82 *ELSI* (n 78).
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