

# China's Exploration of Responses in the Context of the Reform of the Investor-State Settlement of Investment Disputes (ISDS) Mechanism

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**Abstract:** *In the context of the reform of the Investor-State Settlement of Investment Disputes (ICSID) mechanism, China should actively participate in the reform of the ICSID and contribute to its better development based on the development of its national situation and the development trend of the international community, i.e., China's investments with foreign countries are becoming more and more frequent and close. But at the same time, due to the limitations of ICSID, China should not rely too much on ICSID's mediation of international investment disputes, and China should take the initiative to seek countermeasures. China can sign bilateral or multilateral agreements with other countries to mediate investment disputes, and internally China should develop public interest litigation to mediate investment disputes, invite non-disputing third-party countries to participate in mediation, and also introduce corresponding legal systems for adjustment.*

**Keywords:** *ICSID, International investment disputes, Multilateral agreements, Public interest litigation*

## 1. Introduction

With the widespread development of international investment activities and the rapid growth of international investment agreements (IIAs), investor - State disputes (ISDS) have become one of the most active types of disputes in the field of international trade and economic cooperation. Investor-State disputes often involve areas of public policy or significant public interests of the host country, such as human rights, the environment, etc., and thus attract a great deal of public attention. In this process, the ISDS mechanism has gradually exposed a series of shortcomings such as the lack of independence and impartiality of arbitrators, the lack of transparency of the procedure, the excessive room for arbitral tribunal's discretion, the high cost of arbitration procedure in terms of time and money, the lack of fairness, consistency and predictability of awards, and the damage to the host country's public interests, etc. The objections to ISDS have increased significantly, which has evolved into the legitimacy crisis (Legitimation Crisis) of the ICDS mechanism, which is the most serious problem in the international economic and trade field. This has led to a Legitimacy Crisis (also known as "legitimacy crisis") of the ICSID mechanism, which has triggered the international community's rethinking of the mechanism. In response to external criticism, the international community has pushed for reform of the ISDS mechanism at several levels.

At present, there is no unified body with compulsory jurisdiction in the field of international investment law such as the Dispute Settlement Body (DSB) under the World Trade Organization (WTO) law. The main problem with the current ISDS regime is that ISDS is based on the commercial arbitration model. While investor-State disputes may involve public law policies, ISDS relies on ad hoc arbitral tribunals and party-appointed arbitrators to resolve one-off disputes.

As a typical representative of the improvementists, the current revision of the ICSID rules does not have a subversive effect, but it has its own characteristics, which reflect the direction of the development of the ISDS mechanism from an important side. Although there are still Paradigm Shifters, Systemic Reformers and Incrementalists in the international arena, it is undeniable that most countries agree on the importance of improving the ICSID mechanism rather than abandoning the ICSID and "setting up a new stove".<sup>[1]</sup> However, it is undeniable that most countries agree on the importance of improving the ICSID mechanism rather than completely abandoning it and "starting a new one".

As the most important international organization in this field with the largest number of cases before it, the ICSID has opened an important chapter in the modernization of the ISDS Rules by completing the revision of the Rules after a six-year consultation process. The revised rules, which will be applicable

from July 1, 2022, have taken into account the experience accumulated by the ICSID Secretariat in applying the 2006 Regulations and Rules and a large number of past cases, and have listened to a wide range of opinions from various sectors, comprehensively responding to the various problems of the previous ICSID dispute resolution mechanism, and also taking into account the current international environment and the new issues arising from the global new crown epidemic.

Therefore, the main highlights of the current round of ICSID rule revisions can be summarized as the overall improvement of procedural efficiency, the reduction of costs and fees, the further enhancement of the transparency of the arbitration process, the further regulation of third-party funding, the new independent fact-finding and conciliation rules, and the expansion of the scope of application of the Additional Facility Rules.<sup>[2]</sup> In response to the current round of ICSID rule revisions, China should also consider what countermeasures to take against the backdrop of its increasingly frequent business dealings in the international community.

The revision of the ICSID rules is related to the future development of China's overseas investment. Since China's reform and opening up, many Chinese investments have been betting abroad, which not only boosts China's domestic economy and enhances China's international economic status, but also injects economic impetus for many countries. However, the friction and disputes between international investments need to be resolved by the cooperation of each country, and the revision of ICSID rules is for the smooth resolution of disputes arising from international investments. China should adopt a prudent and rational attitude towards this issue, and strive to cooperate and actively solve the problems arising from international investment. But at the same time, as a sovereign state, China should also have a different response plan, and should not rely too much on external forces to maintain the interests of a country. Therefore, in response to the revision of the ICSID rules, China can take both internal and external measures to help Chinese investments develop smoothly overseas. Therefore, against the backdrop of the ICSID rule revision, China's countermeasures should be analyzed in detail.

## **2. China's external response**

The current round of revisions to the ICSID Rules has contributed to an overall increase in procedural efficiency, notably through the establishment of new rules on step-by-step arbitration, which are set out in Article 41(4) of the 2006 Arbitration Rules, which provides that the arbitral tribunal may deal with jurisdictional objections as preliminary issues or together with substantive issues; and that the arbitral tribunal may, on its own initiative, decide whether or not to proceed with step-by-step proceedings as well as on the procedure and timing of such decisions. Step-by-step arbitration is one of the factors that has the greatest impact on the length of proceedings. Investors often do not want cases to be stepped because it means a more lengthy and costly process. The opposite is true for host states, and in practice most host states will require the tribunal to deal with jurisdictional issues first and then proceed to a step-by-step process.<sup>[2]</sup>

The issue of national jurisdiction has been the subject of much controversy in China. As a result, the Law of the People's Republic of China on State Immunity of Foreign Countries was adopted at the Fifth Session of the Standing Committee of the Fourteenth National People's Congress of the People's Republic of China on September 1, 2023, and came into force on January 1, 2024, after many considerations and discussions of the interests of the country. This law responds to China's long-standing problem of state sovereign immunity. China has shifted from the principle of absolute immunity to that of relative immunity, a choice it has made in light of its increasing participation in international trade in the international community.

The change in China's state immunity policy is conducive to China's better participation in international investment activities, but it can be seen from the ICSID rules revision activities, the current international investment dispute settlement needs more countries to participate in and efforts, China in the process of how to solve the problems encountered should be analyzed and discussed.

### **2.1. Active participation in ICSID reform**

Among the many challenges faced by mediation in international investment dispute settlement, the conflict between voluntary and mandatory investment mediation stands out. This stems mainly from the different interests of the parties to an investment dispute and the lack of consensus on the rules of conciliation. The question of how to make the outcome of conciliation acceptable to both parties to an investment dispute, and how to increase the voluntariness and credibility of the implementation of the

outcome, is a real issue.

Different countries have different legal systems because of different regions, cultures, traditions and other factors, such as whether a certain behavior constitutes a crime, if it constitutes a crime should be sentenced to what kind of punishment, etc., there are also different perceptions between countries. In the case of litigation in which a State is the subject and the *lex fori* of a State is used as the basis for the litigation, whether the judgement rendered by the State can be recognized by the other State and does not negatively affect the diplomatic relations between the two States, in reality, some States will take more diplomatic factors into consideration when rendering a judgement in the course of the litigation.

In view of this situation, it is necessary for China to actively resolve disputes through the ICSID, which, as an international dispute resolution body, can utilize its resources and manpower to resolve disputes in a fair manner within its scope of adjustment, bypassing the courts of any country. Although its reform has a gradual process and its development is not yet perfect, the recent reform regulation has effectively improved several outstanding problems. As a big country, China can not only promote the accumulation of experience and development of ICSID, but also show the image of China as a big country.

More importantly, the use of ICSID to resolve international investment disputes can avoid a series of diplomatic contradictions and disputes arising from the difference of the two countries' *lex fori*. The credibility of dispute resolution can be improved through the intervention of a third party.

## ***2.2. China should actively exercise its rights and interests***

The condition for China's participation in ICSID is to accept the mediation results together with other countries or foreign investors under the premise of limiting the national immunity policy, but in this process, analyzing China's limiting immunity policy as an example, it is related to the dignity and sovereignty of China.

The essence of China's current qualified immunity policy is to safeguard its transnational economic interests, which also reflects the fact that China will face more and more foreign litigation. In dealing with such litigation, it is necessary to safeguard not only national interests, but also national dignity and sovereignty.

In the early stages of its economic development, China faced an economic blockade by capitalism, and now that its economic development has been successful, it is facing economic sanctions imposed by foreign countries. In the past, China's policy of absolute immunity was also intended to deal with unreasonable lawsuits from abroad. It is only with economic development, the growing strength of China's comprehensive national power, China's increased foreign cooperation, and the growth of China's overseas interests that the urgency of protecting them has become more and more acute, hence the implementation of the policy of limited immunity.

China's policy of limiting immunity is aimed at effectively safeguarding its interests abroad. While it is inevitable that it will accept the mediation and judgment of the local courts of other countries in this process, China should be careful not to place its national interests at the mercy of other countries and suffer serious damage.

## ***2.3. Promotion of bilateral or multilateral agreements***

The current ICSID's mediation efficiency needs to be further improved and costs further reduced, which is one of the main focuses of its reform. It would be unrealistic for China to expect all international investment disputes to be resolved perfectly by the ICSID. China needs to turn proactive into reactive and sign relevant agreements with other countries on investment issues to prevent or mediate conflicts.

In particular, China has been advocating the "One Belt, One Road" since modern times, and investment transactions with neighboring countries are only increasing, so it can negotiate with the relevant countries of the "One Belt, One Road" and sign multilateral agreements in line with the interests of the country, especially for investment disputes, and set up dispute resolution measures or mechanisms in order to resolve the disputes. We can negotiate with the relevant countries of the "Belt and Road" and sign multilateral agreements in line with national interests, especially set up dispute settlement measures or mechanisms for investment disputes, so as to resolve disputes quickly, facilitate the smooth operation and development of the "Belt and Road", not to impede economic and trade exchanges between countries, and to minimize the number of investment disputes and trade frictions between China and the countries related to the "Belt and Road", and promote the better economic development of each The "Belt and

Road” will help the smooth operation and development of the “Belt and Road” without hindering the economic and trade exchanges between countries.

This type of agreement focuses on matters related to investment disputes, such as provisions on disclosable matters in investment and provisions on fact-finding procedures and formalities, with the primary objective of improving the efficiency of dispute resolution and reducing related expenses. China can refer to the ICSID's experience and mechanism in this agreement, but since this agreement is for a few individual countries, its operation and efficiency will be better than the ICSID's interim measures and institutions. Temporariness is also one of the shortcomings of ICSID, whose function is to resolve one-time disputes, but whether it is necessary to develop it into a permanent institution similar to WTO to improve its professionalism and efficiency remains to be answered by the times.

### **3. China's internal response**

Compared with traditional international law, the development of international investment law is still at a relatively early stage, and the reform of ISDS has a long way to go due to the lack of consensus among countries. In other words, the adjusting and binding effect of ISDS reform is limited, so what kind of response and measures should our country take to properly deal with the disputes and conflicts arising from international investment beyond the scope of ISDS adjustment is an issue we should study and explore.

These changes in the field of international investment law are now the joint and concerted actions taken by countries based on the parties to the treaty and sovereign states, which adjust the conflict between the private rights of investors and the public interest. In other words, it is the conflict between the public interest of the investor and that of the home country, so why not develop public interest litigation to adapt to the change in the situation and background of the conflict between foreign investors and the public interest within China.

Based on the current domestic situation in China, civil public interest litigation in China needs to rely more on the procuratorate.

#### ***3.1. Positioning and Role of the Procuratorate in Public Interest Litigation***

The origins of public interest litigation can be traced back to a product of social welfare that was created in developed countries at a certain stage of economic development. The essence of public interest litigation for a kind of charity, is the development of society to a certain stage, the economic wealth of society is rich enough to allocate a portion of the money to support social welfare organizations to protect the interests of the public. From which can be extracted two key points, public interest litigation in a country to get the perfect development of the prerequisites must be: one, the social development of the rich, abundant funds; two, the development of social welfare organizations, its institutions have human and material resources to support the function of the operation.

However, looking at the current situation of China's development, both the economic level of society, or the development of social welfare organizations are not enough to carry out public interest litigation on their own. Therefore, the number of public interest litigation in China's procuratorial organs to occupy an absolute advantage has its own reason, is China's national conditions and the level of economic development of many decisions.

On the one hand, the inspection authority to undertake public interest litigation can be borne by the state financial expenditure, reducing the pressure of public property expenditure; on the other hand, the inspection authority for the litigation more professional ability and experience, to promote the public interest litigation is more efficient, and China's social public interest organizations lack of legal manpower support, or China's lawyers' associations and other social legal organizations have not yet been fully developed. Public welfare or charitable function, relying on social welfare organizations to bring civil public interest litigation, not only lack of funds, but also lack of relevant human resources support. Therefore, China's procuratorial organs have naturally assumed the important responsibility of filing public interest litigation. This is not an organization or any individual decision, but the national conditions and social development of our country decided.

However, although the positioning of the procuratorate in civil public interest litigation is biased by our national conditions, we should gradually correct its positioning in the process of social development.

China's social economy is developing rapidly, and the accumulation of social wealth is accelerating,

and China should also introduce policies and other regulations to support the development of social welfare organizations, which can help the independent management of social affairs and reduce the pressure on the Government to manage them. At the same time, with the gradual accumulation of social wealth, social welfare organizations have more funds available, should gradually train professionals to support the social welfare organizations of the practice and the operation of the system. Similarly, for public interest litigation, social public interest organizations should also seize the trend of social development, actively develop themselves, and accumulate sufficient financial and human resources and experience in public interest litigation, in order to rectify the dominant position of the procuratorate in public interest litigation, and to facilitate the procuratorate to use more resources for their own duties.

In addition, in practice, the collection and fixing of evidence for public interest litigation is the most difficult. Therefore, the procuratorate, as a judicial institution with rich experience and many professionals, should provide legal assistance to public interest organizations, such as providing legal support, teaching experience in evidence collection and fixation, and carrying out all kinds of knowledge exchange activities to help the growth of public interest organizations. In the aforementioned legal provisions, the procuratorial organs have the meaning of “complementary” public interest litigation, then for the smooth progress of public interest litigation organization should also try to cooperate with the activities of social welfare organizations.

In short, the current procuratorial organs in public interest litigation are in a dominant position, but with the development of society, their “dominant” position should be transformed into an “auxiliary”, position to promote the social public interest organizations in public interest litigation to achieve a dominant role, but also the due meaning of the procuratorial organs. Procuratorate's due sense.

### ***3.2. Enhancing the transparency of the arbitral process***

In China's domestic investment dispute settlement adjudication process, it is necessary to refer to the requirements of the ICSID rules to improve procedural transparency. For example, it should take the initiative to invite non-disputing third-party countries to participate in the arbitration, and stipulate the type of third-party countries to be invited, the specific participation procedures, and whether relevant professionals can intervene in the discussion and participate in the fact-finding process.

For example, at the beginning of the fact-finding process, the third-party countries can be actively invited to participate in the process, witness the investigation procedures and means, and accept the questioning of their professionals, so as to improve the authenticity of the basis of arbitration. And set up new rules of regulation, such as in the pre-procedure of arbitration, the third-party countries can act as an intermediary to participate in the mediation and dispute settlement between the two parties, also can be proposed to suspend the mediation when the arbitration is in a tense stage, and also can be carried out in the final stage of the arbitration to supplement the extra-procedural dispute settlement. This kind of third-party mechanism is to alleviate the two countries in the process of resolving conflicts of interest in the investment dispute to produce additional diplomatic disputes. The two countries have a long-term impact on the impact of commercial, trade and further development of the two countries to become a trigger for the deterioration of diplomatic relations, and its third-party mechanism of the intervention of a buffer zone in the conflict of interest between the two countries to establish a buffer barrier. At the same time, it is also a response to address the suspicion and discrimination that may be brought about by having a country's national institutions to conduct investment conflict resolution. It is unavoidable to question whether a country's forum law, in regulating international investment conflicts, will favor the national interests of the home country to the detriment of the investment interests of other countries. In the scope of ISDS can not control international investment conflicts and want to use a country's court of the law of the land to regulate, then you must improve the transparency of the arbitration process. Inviting non-disputing third-party countries to intervene in the arbitration can not only improve the transparency of the arbitration but also improve the credibility of the arbitration.

Special attention should be paid to the fact that the third-party States to be invited must be carefully chosen, as they have the role and utility of “notaries public” in this procedure, and must therefore be disinterested third-party States. In fact, based on their roles and functions, under certain circumstances and conditions, international institutions or organizations may also be invited to bear witness, without being bound by sovereign States, as long as they can play their roles effectively.

In addition, China needs to introduce appropriate domestic legal provisions to regulate international investment disputes, and specialized legal provisions are conducive to the better resolution of investment disputes in China.

#### 4. Conclusion

In the process of reform and opening up, China's economic and trade exchanges with the international community have become more and more close, especially the growing demand for investment liquidity makes China pay more attention to the development and operation of the ICSID, for the reform of the ICSID, China is happy to see, China's investment overseas is growing, but its dispute resolution has become a problem, international investment disputes is a complex issue, especially the ICSID, as a third-party institution specializing in mediating international investment disputes, is a force that China needs. Therefore, China needs to actively participate in its reform and promote its development, and at the same time strengthen its domestic legal support to help China resolve its investment disputes.

However, ICSID solves more one-off disputes, relies on temporary arbitration institutions, and needs to formulate arbitration personnel, and its procedures, efficiency, and funding have yet to be further improved. China cannot and cannot rely on ICSID for all international investment disputes, and it needs to seek more measures to solve the disputes, especially in the context of China's promotion of "One Belt, One Road" and the increase of economic trade with other countries. China needs to seek more measures to resolve international investment disputes, especially in the context of China's promotion of the "One Belt, One Road" and the increase in economic trade with other countries, which cannot wait for the maturity of the ICSID. Therefore, China needs to sign bilateral or multilateral agreements on international investment externally, while internally it should look for dispute resolution measures that are adapted to China's national conditions. Based on the fact that general investment disputes are mostly conflicts between foreign investors and the public interest of the home country, it is more appropriate to leave the resolution of such conflicts to public interest litigation. Therefore, it is appropriate to develop public interest litigation in China. Based on China's domestic conditions, the procuratorial authorities play an important role in public interest litigation, but with reference to the experience of foreign countries in the development of public interest litigation, it is appropriate to adjust the position of the procuratorial authorities in the future, so that public interest litigation will be initiated by public interest organizations more often. In addition, in order to enhance the transparency of the process and the credibility of the results of mediation in investment disputes under China's domestic forum law, non-disputing third-party countries may be invited to intervene, and China may introduce a more specific and specialized legal system to make adjustments in the future.

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