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The Construction of the RCEP Investment Dispute Settlement Mechanism: Currentcy, Dilemmas and Solutions

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Abstract

The signing of RCEP signifies the official launch of the world's largest and most promising free trade area in terms of population, playing a positive role in promoting regional trade, investment, and economic growth. Currently, based on the resurgence of neo-Calvinism, legitimacy crises in ISDS mechanisms, and the absence of ISDS mechanisms in RCEP, member countries are beginning to reexamine the RCEP investment dispute settlement mechanism. Overall, the RCEP investment dispute settlement mechanism fails to effectively balance the interests of host countries and investors. Therefore, based on comparative analysis of existing investment dispute settlement mechanisms, it may be advisable to explore establishing a new ISDS mechanism for RCEP that integrates both preventive measures and back-end mechanisms.

Keywords

RCEP, ISDS, Investment Dispute Settlement Mechanism, Mechanism Construction

1. Introduction

The Regional Comprehensive Economic Partnership (RCEP) comprises China, South Korea, Japan, New Zealand, Australia, and the ten ASEAN countries. As the world's largest and most promising free trade area, the RCEP countries are closely interconnected, having concluded numerous bilateral or multilateral investment treaties that have deepened two-way investment. However, this development has also led to numerous investment disputes, presenting unprecedented opportunities and challenges for member countries. Traditionally, disputes between host countries and foreign investors are resolved by submitting the disputes to international investment arbitration institutions through the Investor-State Dispute Settlement (ISDS) mechanism. However, due to the legitimacy crisis of the ISDS mechanism, the resurgence of Calvo Doctrine, and the absence of an RCEP-specific investment dispute settlement

mechanism, member countries have begun to reassess the investment dispute settlement mechanisms under RCEP. Some scholars believe that the absence of the ISDS mechanism seems to have little impact on investment flows between member countries (Shiro & Luke, 2022, pp. 315-364), but it is clearly detrimental to the protection of foreign investment. The lack of an effective investment protection mechanism makes investors' property rights vulnerable to infringement, greatly reducing their confidence and thus affecting the establishment of a high-quality, reciprocal economic partnership under RCEP, and hindering the realization of regional investment goals (Wang, 2022, pp. 86-96). Therefore, exploring the challenges in constructing an investment dispute settlement mechanism under the RCEP framework and proposing targeted Chinese solutions is of great significance for promoting new cooperation and development in the investment fields of RCEP member countries.

2. Currentcy and Dilemmas of RCEP Investment Dispute Settlement Mechanisms

RCEP has temporarily shelved the ISDS provisions and only included interstate dispute resolution provisions in Chapter 19. According to Article 19.3 of the RCEP, the RCEP investment dispute settlement mechanism operates in parallel with the dispute settlement mechanisms in bilateral or multilateral investment treaties between member countries. This means that disputing parties can resolve investment disputes either through the RCEP interstate dispute settlement mechanism or through bilateral or multilateral investment treaties. Although there appear to be multiple remedies available to host countries or investors, this fragmentation of dispute settlement leads to confusion and makes it difficult to effectively protect the legitimate rights and interests of both parties.

2.1 RCEP Dispute Settlement Mechanism

Chapter 19 of the RCEP establishes a broad dispute settlement mechanism, including consultation, mediation, conciliation, and expert panels, similar to the WTO dispute settlement mechanism, but it is only applicable between member countries and has certain limitations: firstly, it can only resolve interstate disputes, and only member states can initiate the RCEP investment dispute settlement mechanism, which is clearly politically motivated (Ma & Tang, 2023, pp. 54-67). Investors cannot use the RCEP to seek remedies, making the mechanism unfavorable for protecting investors' legitimate rights and interests in terms of initiation, operation, and outcome. Secondly, even for interstate investment disputes, the RCEP dispute settlement mechanism mainly adopts remedies that require the defaulting party to perform the agreement, rather than monetary compensation, which greatly limits its role in protecting investors. Thirdly, the RCEP strictly limits the scope of the dispute settlement mechanism, excluding provisions such as national treatment, most-favored-nation treatment, performance requirements, and investment facilitation, which further hampers the protection of investors' legitimate rights and interests.

2.2 International Investment Arbitration Mechanism

Although the RCEP does not include ISDS provisions, investment or trade treaties between member countries typically contain ISDS clauses. Despite providing a relatively mature mechanism for resolving investment disputes, international investment arbitration still faces issues such as lack of democracy, high costs, and inconsistent arbitral awards. Currently, the exposure of inherent flaws in the international investment arbitration mechanism has led to a serious legitimacy crisis. The resurgence of Calvo Doctrine, coupled with the absence of public law controls in international investment arbitration, generally favors capital-exporting and legally advanced countries (Shan & Wang, 2019, pp. 20-28). The RCEP member countries vary greatly in their levels of development, including both developed and numerous developing countries. Given the advantages of the ISDS mechanism for developed countries, most RCEP members are cautious about this mechanism. For example, ICSID, as a permanent institution for resolving investment disputes between host countries and investors, has not been signed by Laos, Myanmar, and Vietnam among the 15 RCEP member countries to date. The utilization rate of ICSID is also low among the other 12 member countries, possibly because RCEP members believe that ICSID's inherent bias towards investors may undermine the integrity and effectiveness of host country regulations.

2.3 Local Remedies and Diplomatic Protection

Local remedies in the host country, also known as Calvo Doctrine, originated in Latin America and are a traditional means of resolving investment disputes between host countries and investors. In the 1980s, due to the need to attract foreign investment for domestic economic development and the rise of international investment arbitration mechanisms, Calvo Doctrine showed a declining trend. However, in recent years, there have been signs of a "resurgence". Since the RCEP dispute settlement mechanism only applies to interstate disputes, if a host country refuses to accept international investment arbitration, investors can seemingly only seek diplomatic protection from their home country or accept the territorial jurisdiction of the host country after exhausting local remedies. The development levels between China and other RCEP member countries vary significantly, and their domestic legal systems differ. Additionally, the influence of interest groups in some countries may result in issues such as unfairness, lack of transparency and independence, making it difficult for host countries to overcome the drawbacks of "territorial protectionism". Furthermore, since diplomatic protection is a right of the investor's home country rather than an obligation, the home country may not necessarily exercise this right when the investor's legitimate rights and interests are violated. The main reason is that the home country must consider multiple factors when exercising diplomatic protection. Compared to the property interests of investors, factors such as national interests and diplomatic relations are more important, which could lead to greater interstate conflicts.

3. China's Proposal for Constructing the RCEP Investment Dispute Settlement Mechanism

3.1 ISDS Reform Models and Incompatibility with RCEP

The resurgence of the Calvo Doctrine in some countries, especially developing ones, has intensified the strong resistance of other countries to the international investment arbitration mechanism. Nevertheless, the unique advantages of international investment arbitration make it the most recognized mechanism for resolving investment disputes by the international community. On the one hand, completely abandoning the international investment arbitration mechanism would deprive investors of the opportunity to directly sue the host country, leaving them only with traditional local remedies and diplomatic protection from their home country to safeguard their legitimate rights and interests. On the other hand, without guarantees similar to the Washington Convention for the enforcement of arbitral awards, mechanisms like mediation, consultation, or conciliation lack effectiveness and recognition, which is a significant reason why international investment arbitration remains an irreplaceable means of resolving investment disputes.

In international investment arbitration practice, the ISDS mechanism poses severe challenges to the national sovereignty and public interests of host countries. Issues such as inconsistent arbitral awards, lack of transparency, and erosion of regulatory authority have led to a "crisis of confidence" in the ISDS mechanism (Qi, 2018, pp. 79-87). Against this backdrop, more and more countries have started to reform dispute resolution clauses in investment treaties and attempt to establish new mechanisms for resolving investment disputes. Latin American countries have adopted an "abandonment" attitude towards the ISDS mechanism, with some countries withdrawing from ICSID. The United States insists on a partial improvement model, making incremental reforms to the details of the ISDS clauses without changing them entirely. For example, in the USMCA, the scope of disputes eligible for arbitration is narrowed, and strict limits are placed on arbitration applications. The European Union has established an investment court system with a two-tier appeal process and optimized appeal mechanisms, attempting to judicialize the ISDS mechanism and establish a new ISDS framework (Xiao, 2021, pp. 84-97).

However, none of these three models can serve as a reference template for the investment dispute resolution mechanism under the RCEP framework: Firstly, the inherent advantages of the ISDS mechanism make the abandonment model of Latin American countries incompatible with the core interests of RCEP member states. Secondly, the RCEP member countries include the ten ASEAN nations, some of which have a defensive attitude towards the ISDS mechanism. The partial improvement model of the United States does not meet the interests of these countries. Finally, the judicial reform model of the European Union essentially reflects an avoidance of arbitration, which is also a response to the resurgence of the Calvo Doctrine. The investment court system originated in the EU, which consists mainly of developed countries, while the RCEP member countries include developed, developing, and underdeveloped nations. Establishing a unified investment court involves issues of national judicial sovereignty, and the rule of law development levels among RCEP member

countries are uneven, making it unsuitable to establish a unified court. Additionally, countries like China and Japan do not support the establishment of an investment court. Therefore, it is difficult for the RCEP to establish an investment court by referring to the judicial reform model of the European Union.

3.2 Constructing Multi-level RCEP Investment Dispute Resolution Mechanism

3.2.1 Design of the RCEP Investment Dispute Prevention Mechanism

The construction of an investment dispute settlement mechanism should follow the principle of maximizing common ground (Ma & Tang, 2023, pp. 54-67). Investment dispute prevention measures refer to mechanisms aimed at reducing the actual occurrence of disputes and preventing their escalation (Wang, 2018, pp. 13-23), applicable to investor-host country disputes under the RCEP framework. Unlike traditional investment dispute settlement mechanisms that intervene after disputes arise, this mechanism intervenes before disputes occur, aiming to reduce the likelihood of disputes and prevent their escalation through prevention measures. Compared to international investment arbitration, this mechanism is not only efficient, convenient, and low-cost but also crucial for breaking the "regulatory chill" phenomenon and maintaining the regulatory authority of the host country. In the field of international investment, the regulatory authority of the host country refers to its power to safeguard national economic sovereignty and interests. The investment dispute prevention mechanism not only avoids the application of international investment arbitration, protecting the regulatory authority from challenges, but also tests and improves regulatory measures, strengthening the management of investors and their investments, thereby responding to the Calvo Doctrine (Wang, 2020).

An effective investment dispute prevention mechanism should include two aspects: "enhancing the host country's capacity to serve investments to eliminate potential disputes" and "establishing a response mechanism to prevent dispute escalation". Enhancing the host country's capacity to serve investments requires increasing the transparency and stability of investment policies, promoting the disclosure of relevant government affairs, and appointing officers to notify policy changes. On the one hand, consideration should be given to establishing information sharing and review agencies responsible for building various investment policies and information sharing platforms and reviewing policy applications. These agencies can also create coordination platforms to eliminate differences in policy understanding and promote the healthy development of investment policies. The new generation of investment treaties shows great interest in establishing similar platforms. According to a UNCTAD report, over 30% of the new generation of international investment treaties include commitments from states to engage stakeholders, including the establishment of an investment-related coordination center (Investment Facilitation in International Investment Agreements: Trends and Policy Options, n.d.).

On the other hand, the exploration of setting up foreign investment facilitation windows is recommended, with various departments responsible for business approvals, investor appeals, and administrative supervision, to protect investor interests and improve administrative efficiency. The investment dispute response mechanism should include an early warning system and an investment

ombudsman system. There are already practical examples of early warning systems, such as Peru's "Coordination and Response System for Investment Disputes" established in 2006. The early warning system should be integrated across all levels of government agencies, responsible for tracking key enterprises and industries, monitoring investment activities, and issuing risk warnings to all parties, including investors, regarding measures that may cause investment disputes. The effective operation of this system relies on the joint efforts of government agencies, coordination departments, and other relevant entities. In international practice, there are many reference examples of the investment ombudsman system, such as the ombudsman offices in the United States and Japan, and the Foreign Investment Ombudsman in South Korea. Consideration should be given to establishing functional departments for information collection, regular meetings, and coordination. The information collection department is mainly responsible for gathering warnings from the early warning system and investors' appeals. Regular meetings handle issues, respond to disputes, and provide solutions to administrative agencies. The coordination department is responsible for collaboration between this institution and other administrative departments. Establishing the above institutions and procedures helps achieve comprehensive investment dispute prevention, addressing investor grievances in the "pre-dispute" stage, eliminating potential investment disputes, and attracting more sustainable foreign investments through balanced public-private relationships (Bi & Zhan, 2023, pp. 64-74).

3.2.2 Design of the Back-end Mechanism for RCEP Investment Disputes

Given the widespread acceptance of the ISDS mechanism and its substantial contributions to resolving investment disputes, it is not advisable for Latin American countries to completely abandon the ISDS mechanism; instead, they should proactively reform it to align with the trends in investment development. Considering the developmental levels of RCEP member countries and their attitudes towards the ISDS mechanism, a model similar to the ISDS provisions in the "Agreement among China, Japan, and Korea for the Promotion, Facilitation and Protection of Investment" could be adopted. This includes establishing "friendly consultations" as a preliminary step in the ISDS process and integrating mediation with arbitration to develop a novel ISDS mechanism. This not only reflects the cultural value of "peace as a priority" in East Asian countries but also helps maintain the sovereignty of host countries, addressing the erosion of regulatory rights by traditional ISDS mechanisms. Furthermore, actively promoting the integrated development of arbitration and mediation mechanisms also contributes to meeting the diverse needs of dispute resolution and enhancing efficiency in resolving disputes Introducing mediation into arbitration procedures and integrating the development of investment arbitration with mediation can fully leverage the advantages of both approaches, avoiding procedural delays, shortening the duration of disputes, saving costs, and resolving disputes quickly and professionally.

Addressing the inherent deficiencies of international investment arbitration mechanisms can also be considered from the perspectives of arbitrator appointment and regulatory bodies. On the one hand, the appointment of arbitrators can draw insights from the "Code of Conduct for Arbitrators in International

Investment Dispute Resolution" issued by the International Law Commission. This code primarily stipulates provisions on its applicability, arbitrators' independence and impartiality, and assistant roles. Overall, there should be enhanced independence and impartiality among tribunal members, who must operate independently from the parties and arbitration institutions to ensure fairness and transparency in arbitration processes. On the other hand, establishing independent regulatory bodies comprising members from each RCEP member state can oversee and assess the operations of arbitration institutions. These bodies can publicly disclose the functioning of arbitration institutions to enhance the contracting parties' trust in the arbitration mechanism. Regulatory mechanisms may include regular evaluations and audits of arbitration institutions, along with procedures for handling complaints. It is noteworthy that in the practice of international investment arbitration, most disputes are related to the interpretation of terms. Some scholars argue that the legitimacy crisis in international investment arbitration arises when arbitral tribunals fail to adhere to norms and continuously blur the boundaries between interpretation and legislation during the decision-making process. Inappropriate interpretations of relevant terms by investment arbitral tribunals may lead to inconsistent arbitration outcomes (Maximilian, 2017). Therefore, to address the issue of inconsistent interpretations, it is crucial to regulate the application of interpretation rules by arbitral tribunals. Guidance should be provided to strengthen the application of unified interpretation rules for investment arbitration tribunals. Tribunals should respect host country sovereignty and adopt restrictive interpretation principles when terms cannot be clearly defined even after exhausting relevant interpretation rules. Furthermore, the interpretation of international investment treaty texts should not be solely left to investment arbitral tribunals. Member states also need to guide arbitral tribunals in accurately interpreting texts and correcting tribunal errors through appropriate means. Specifically, member states should provide guidance for the interpretation of terms, potentially using joint interpretation to clarify the meanings of core provisions in international investment treaties and limit the scope of arbitrary interpretation clauses.

4. Conclusion

Overall, the existing investment dispute settlement mechanism in the RCEP cannot effectively balance the interests of investors and host countries. Therefore, it is necessary to establish a diversified and unified investment dispute settlement mechanism in the RCEP, taking into account the development situation of each party. Attempts can be made to combine the dispute prevention mechanism with the back-end mechanism, establish a pre-dispute prevention mechanism for investment disputes including the strengthening of the host country's investment service capacity and the investment dispute response mechanism, and reform the ISDS mechanism in accordance with the "Agreement among China, Japan, and Korea for the Promotion, Facilitation and Protection of Investment" to establish a new type of ISDS mechanism combining the development of mediation and arbitration. This will not only help to efficiently resolve investment disputes among RCEP parties, but will also enhance the international

competitiveness of the RCEP agreement.

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