

# ***The Dilemma and Improvement of the International Trade and Investment Settlement Mechanism***

## ***--Take the WTO Appellate Body and China's Belt and Road***

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**Abstract:** The suspension of the WTO's Appellate Body is directly related to the integrity and stability of the dispute settlement mechanism. Based on the analysis of Dispute Settlement Understanding's 90-day mandatory regulation on the appeal period and the judge system involved, this paper puts forward suggestions on the trial period, the working mechanism, and the selection mechanism of relevant judges, hoping that the Appellate Body can resume operation soon and survive the crisis. The Investor-to-State Dispute Settlement (ISDS) mechanism is a common dispute settlement method in the field of international investment. However, with the development of the global economy and the increase in the scale of international investment, the ISDS mechanism has also faced some challenges and controversies. Chinese investors are also actively exploring the reform of the ISDS mechanism to improve fairness, transparency, and predictability in the face of ISDS difficulties in the BRI. This article will take the WTO appeal mechanism as a reference to explore the reform path of China's ISDS.

**Keywords:** WTO Appellate Body, Trial Period, ISDS, Belt and Road

## **1. Introduction**

The mechanism for resolving disputes has established a new appellate review system in international legal proceedings. The Appellate Body, as a permanent entity responsible for implementing this system, comprises three out of seven judges who examine the legal issues and related legal interpretations presented in the expert panel's report submitted by the parties to the dispute, and subsequently prepare the Appellate Body report [1]. Since its inception, the Appellate Body, with its professional membership and independent trial mechanism, has guaranteed the quality of every decision.

But the once glorious Appellate Body is now in a dilemma. A flagrant violation of DSU17.5 calls into question the "authority" and "efficiency" of the dispute settlement system. Even if this violation is due to both the DSU's own reasons and the Appellate Body's own shortcomings, it shows that many of the Appellate Body's systems need to be improved to enhance its predictability and help the

appellate hearing process to resume operation from paralysis, continue to resolve disputes between parties effectively, and ensure the stability of international trade [1].

Taking the appellate mechanism of the WTO as a reference, this paper aims to help analyze the reform of the ISDS mechanism in China's BRI. By analyzing the characteristics and advantages of the WTO appellate mechanism, this paper puts forward some suggestions to improve the efficiency and fairness of the ISDS of the BRI. Further steps China can take in the Belt and Road ISDS reform are also discussed. These include establishing an independent appellate body, enhancing professionalism and independence, and enhancing transparency and predictability. This paper introduces some ISDS reform measures China has taken, including promoting multilateral investment agreements and strengthening investment protection clauses. These measures have a positive impact on improving the effectiveness of investment protection and dispute settlement mechanisms.

## **2. Completing the Trial Tasks on Time is Hard for Appellate Body**

### **2.1. The WTO Appellate Body's "90-day" Dilemma**

In 1994, Marrakesh, Morocco, saw the establishment of the DSU, which, in Article 17.5, sets out an inflexible time limit for appeal review. It should not exceed 60 days and 90 days in exceptional cases.

Statistics show that of the 139 decision reports issued by the Appellate Body, the average time between the party's appeal and the final decision of the Appellate Body was 118 days, with 70 of the reports exceeding the hearing period set by the DSU [2]. Objectively, the DSU, which was formed 30 years ago, could not impose reasonable restrictions and guidelines on how the Appellate Body should settle international trade disputes and even provided evidence accusing the Appellate Body of not following the statutory procedures.

With the multilateral trading system's development, the number of cases referred to as the dispute settlement mechanism has increased, and the number of appeals against panel reports has increased accordingly. As of December 31, 2022, 183 of the 283 disputes resulting from the panel's report have been appealed. This represents an appeal in 65% of all cases where the Panel's report was circulated in the original proceedings [3]. With the increasing complexity of cases and the application of the law, it is difficult to ask Appellate Body judges to continue to complete cases under the provisions of 1994.

### **2.2. Paradox between the Judge's Setup and the Principle of "Speedy Settlement of Disputes"**

In the increasing number of cases, "four members outside the appellate court need to participate in the handling of appeals cases", which shows that judges of a particular case must participate in the same cases while considering their own cases and giving their own opinion [4]. In addition, the part-time work of the permanent judges forced them to leave their original posts as soon as a case was brought before the Court of Appeal and immediately went to the Appellate Body to prepare new cases.

The departure of the last permanent judge, Zhao Hong, on November 30, 2020, has put the appellate review process into a dormant state, and the core procedure of the dispute settlement mechanism has ceased to operate. As of December 2022, the parties engaged in a dispute were still presenting the Panel's report to the Appellate Body, and it had 25 appeals waiting to be heard [3].

### **3. Improvement**

#### **3.1. Increasing Flexibility in the Rules about the Duration of Trials**

As mentioned earlier, the "90-day" rule is a thing of the past in today's form of international trade. In order to give the Appellate Body sufficient time so that the judges can report to the satisfaction of the disputing State, the hearing period can be redetermined, or the Appellate Body can be given flexibility in deciding the hearing period. For example, the Appellate Body, based on the case and the past trial experience, determines the time required for a specific case through consultation with the parties and changes the immutable legal period stipulated by the DSU into a variable specified period. However, this method may, to some extent, overrule the trial period system. So that the trial period can not form an effective restriction on the Appellate Body.

In addition, the 90-day appellate review period includes rest days, holidays, and the time needed to translate the report into the official language of the WTO, meaning the Appellate Body has only two months of actual working time to hear the case [5].

However, if the 90-day trial period must be followed, 90 days can be precise as "90 working days for the Appellate Body to hear the case." Honduras, for example, suggested that the calculation of the 90-day limit could consider the exclusion of weekends and holidays, as well as the translation of reports [6]. The 90 days it would take for three judges to hear a case would be reduced to 90 days after deducting time needed for holidays, days off, and parties to present evidence. It can not only extend the urgent situation of hearing cases today but also form an effective restriction on appellate judges to a certain extent so that the Appellate Body's hearing of cases is both urgent and orderly.

#### **3.2. Improving the Selection Mechanism for Judges**

The pressing duty of reviving the Appellate Body is to elect judges who satisfy the minimum number of judges needed to preside over the Appellate Body, and the extended emptiness in the Appellate Body's standing bench since November 2020 can mostly be ascribed to the "consensus principle" of the WTO-making mechanism [1]. This means that a judge must be unanimously approved by 164 members before being elected to office. This means that member states could easily block the selection of judges and undermine the appellate hearing mechanism on their own. If DSU can be appropriately changed and improved, the application of the "reverse consensus" principle in the selection of judges can be canceled, and the voting mechanism for the election of judges of the International Court of Justice can be referred to, the special majority of member states can serve as permanent judges. The selection process can be safeguarded from improper interference to some extent by electing permanent judges. It even addressed the understaffing of members of the Appellate Body.

This measure not only can lengthen the pressing situation of hearing cases today but also can put an effective check on appellate judges to a certain extent, resulting in the Appellate Body's hearing of cases being both speedy and methodical.

### **4. The Challenges and Requirements of the ISDS Mechanism in the Belt and Road Initiative**

With the rapid development of economic globalization, China, at the crossroads of world economic change, has put forward the BRI, which mainly builds the concept of a community of human destiny, aiming to unite other countries in the world to jointly deal with the complicated international economic crisis in a peaceful and mutual assistance way, which has positive significance in many aspects to promote the deep cooperation between China and other countries in the world, achieve multilateral win-win development, and promote the progress of human society [7]. BRI has emerged

as a significant global development strategy. As part of this initiative, China has been actively involved in attracting foreign investment and fostering partnerships with participating nations. From Figure 1 and Figure 2, we can see that China's outbound investment is growing year by year, which is enough to show that China's contribution to the construction of the BRI is huge.

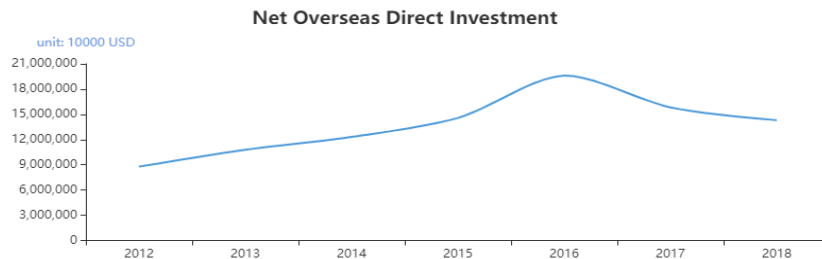


Figure 1: Net Overseas Direct Investment

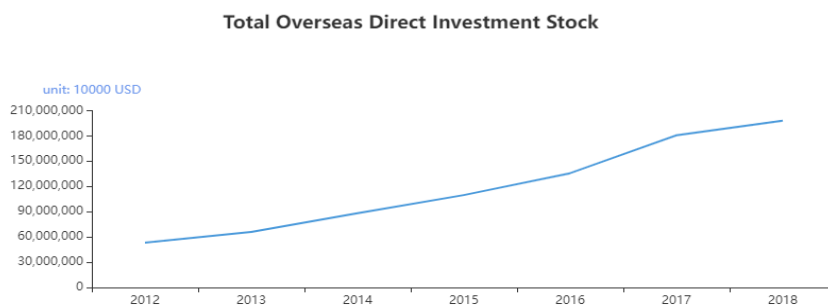


Figure 2: Total Overseas Direct Investment Stock

China has signed at least 128 bilateral investment treaties (BITS) with other countries, including many on infrastructure investment and construction with states along the BRI [8]. However, the BRI involves a large number of countries, and there are great differences in the economy, politics, culture, and rule of law of each country. The following investment disputes and disputes may arise in Belt and Road projects: Contract performance issues between investors and contractors or governments may cause disputes. For example, if the project is delayed or substandard, the investor may demand compensation for breach of contract or rescission of the contract. Policy risks should be considered: The countries involved in Belt and Road projects have different legal and policy environments, and policy changes may adversely affect investors, such as the dispute over the East Coast Rail Link investment in Malaysia. In 2016, Malaysia Rail Link and China Communications Construction Group Limited (hereinafter referred to as "CCCC") signed the "Financing Framework and Project Construction Agreement" worth US \$13.1 billion [9]. Later, the new Prime Minister, Mahathir Mohamad, came to power for the first time. He announced that the East Rail project would be "reviewed", and in July 2018, he sent a document to the Chinese government to terminate the project [10]. At the same time, two Chinese oil and gas pipeline projects were stopped, and these three projects and the total investment is \$22 billion, about 151.8 billion yuan, made Chinese enterprises suffer huge risks and losses. Around the "East Rail" project, Malaysia's political party struggle, economic growth, and Chinese investment intertwined, and Malaysia's political turmoil has seriously affected the implementation of the project [11]. In April 2019, China and Malaysia finally reached an agreement on the East Rail project and restarted the project [12]. In fact, in the face of the Malaysian government, CCCC did not choose to safeguard its investment interests through arbitration, although there are provisions on investment disputes in the BIT agreement signed between China and Malaysia.

Some relevant scholars have conducted investigation and analysis, and investment laws established in the states along the BRI do not set fair and equitable treatment as a clear written provision [13]. There are already relevant data showing that at least 63 BRI countries are facing foreign debt crises, which means that they are highly likely to be unable to repay their loans due to economic collapse. Due to the imperfection of the ISDS mechanism and the lack of procedures, Chinese investors fail to effectively and timely protect their rights and interests in the face of the unilateral default of the host country in the BRI. After consideration, The risk of ISD emerged, and existing legal provisions with arbitration mechanisms have limited protection for investors (which is different from other international ISDS mechanisms that focus on investor protection). Therefore, we need to find a more effective way to deal with potential risks so as to protect the interests of investors from the harm of the host states.

## **5. Specific Measures of China's BRI ISDS Reform**

### **5.1. The Practical Application of ISDS Arbitration Institutions in China**

CIETAC (China International Economic and Trade Arbitration Commission) is an important platform for China to deal with foreign investment and domestic commercial disputes and an important "window" for investment arbitration in China. After decades of development and institutional reform, CIETAC has become one of the world's major permanent arbitration institutions. The CIETAC's headquarters and its Sub-Commissions together form one institution. In 2022, The arbitrations handled by ICETA involve 32 countries along the Belt and Road, covering all 10 ASEAN countries. The main causes of disputes include construction projects: PPP, BOT, EPC, infrastructure, mine drilling, civil and commercial buildings, decoration design, and other disputes [14]. According to the research of scholars, at least more than half of the disputes between investors and countries in the world are related to infrastructure construction and real estate construction of national public safety and environmental health protection [13]. Therefore, the cases accepted by CIETAC and the ISDS disputes involved in the Belt and Road have a high degree of overlap in content, which also shows that the investment disputes encountered by Chinese investors in the Belt and Road are not only diplomatic but also involve such large-scale infrastructure construction, which consumes huge time and money costs.

However, CIETAC is not as influential as ICSID. Because ICSID, as one of the most well-known international investment arbitration institutions in the world, has an influence that cannot be ignored and is widely adopted in the BRI, which is dominated by developing countries, China and the BRI members have referred to ICSID as an appropriate body to resolve ISD and have written it into bilateral treaties [15]. However, the average arbitration time for a case was 3.6 years [16]. This clearly does not fit the complexity and diversity of BRI's ISDS investments.

### **5.2. Improve and Extensively Sign Multilateral Investment Agreements**

It is difficult to recover and compensate investors for their losses only through mediation diplomacy. Because in the Appellate Body sense of the arbitration committee's intervention and conduct determination, once the host country is on the grounds of "endangering national public health and security", investors will be at a great disadvantage. Just like the East Rail project, CCCC had to suspend work for a year while it waited for diplomatic action.

On 30 December 2020, China and the EU completed the negotiation process of the EU-China Comprehensive Investment Agreement on schedule after seven years and 35 rounds of negotiations. In 2009, China and ASEAN signed the Agreement on Investment in the China-Asean Free Trade Area. The agreement covers investment treatment, collection, transparency, dispute settlement mechanism, and other contents, providing adequate legal protection for international investment

activities between China and ASEAN. While the objectives of IIAs may differ from treaty to treaty, the primary goal is usually to encourage economic cooperation between states [17].

## **6. The Implications of the Wto Appeal Mechanism for the Reform of ISDS in the BRI**

### **6.1. Appeal Mechanism of ISDS**

From a geopolitical point of view, most of the current BRI countries are developing countries in urgent need of the introduction of foreign investment to inject vitality into national economic development. But while they hope to attract foreign direct investment, they also fear that the settlement of disputes will undermine their already fragile right to development. This feature illustrates the inherent contradiction of ISDS in the BRI, as attracting investment requires protection to focus on the interests of investors while safeguarding the right to development requires protection to focus on the sovereignty of the host country [18].

In order to solve the contradiction between the investor and the host country, this paper believes that it is worth exploring to establish an appeal mechanism to balance the interests of the two. In practice, many developing countries complain that ICSID tribunals often issue rulings in favor of investors and that since the rulings are made, they are final and enforceable. Developing countries cannot appeal or seek other arbitration, and their national sovereignty and public interests cannot be effectively protected. Thus, the ICSID Secretariat has considered the need to balance investment with the host country if a two-way appeal mechanism can be established to provide relief to the host country. However, according to the Convention, "the award shall be binding on the parties and no appeal or remedy shall be granted other than that provided for in this Convention". In other words, the ICSID convention itself limits the way it can develop for the benefit of host countries. As an efficient and convenient arbitration mechanism, the final award should not be easily abandoned. However, unlike traditional commercial arbitration, the mixed nature of public and private investment arbitration determines that its arbitration award may involve the host country's public interests, such as environmental protection and labor protection. Under this premise, for the consideration of a balance of interests, the arbitration award should not be easily abandoned. Yet the establishment of an appeal mechanism to ensure the legitimacy and flexibility of the ISDS mechanism seems more important than the preservation of the interests of the final decision. After all, the mission of an arbitration body is to "solve problems", not to "complete arbitration" [19]. We can refer to the appellate mechanism in the WTO and try to introduce the appellate mechanism into the ISDS in the Belt and Road.

### **6.2. The Concrete Path to Establish the Appeal Mechanism**

The idea of establishing a permanent appellate body was mainly to establish an appellate body within the ICSID, and the ICSID itself announced in 2004 that it would consider the establishment of an appellate body and solicit views from all parties, but ultimately this path was shelved. However, there is less resistance to establishing an appellate mechanism at CIETAC than there is at ICSID, which is limited by its already internationally accepted conventions, where major changes are subject to resistance. CIETAC generally provides a faster and more efficient arbitration process. Its large team of arbitrators, with rich experience and expertise, can quickly form an arbitral tribunal and handle cases. In addition, CIETAC has adopted a number of simplified procedures to improve the efficiency of arbitration. Therefore, it is theoretically feasible to set up a permanent appellate body similar to the WTO in ICETAC.

### 6.2.1. Consultation

Consultation is the first method to be adopted when a dispute arises between the disputing parties. Consultation is a preliminary procedure. In the consultation stage, the two parties deal with the dispute in a calm and friendly way, which not only enables the contradiction between the disputing parties to be dealt with in a timely manner but also ensures the continuation of good trade relations in the future.

### 6.2.2. The Panel in the Appellate Body

In the appellate body of arbitration, if the panel of experts at the level of second instance is specially set up for the case, it has a provisional nature, and different panels may make different determinations on the same legal issue. The establishment of a permanent Appellate Body would help to solve this problem: on the one hand, as a permanent body, the appellate body's determination of the same issue is usually more consistent. On the other hand, the decision of the appellate body plays the role of a "precedent", and the expert group following the "precedent" of the appellate body can achieve the effect of "the same case and the same judgment" when dealing with the same issue.

### 6.2.3. Appellate Body Candidates

The Dispute Settlement Body (DSB), as the core body of the WTO, requires the candidates of the panel and the Appellate Body to have certain professional qualifications, and the candidates and panel members of the reformed arbitration appellate body should also be selected according to this provision, Article 8 states that panel members should be fully qualified government or non-government individuals obtained from various sources and not citizens of parties to the dispute or third parties [1]. By prohibiting panelists from being nationals of a party to the dispute, the dispute settlement body mitigated the possibility or perception of bias. But at the same time, it is also a challenge for arbitration appellate bodies with relatively few arbitration talents. Based on this provision, we can find arbitrators from non-party countries from ICSID to act as the appellate tribunal, and ICEBAT also has foreign arbitrators. "A total of 87 foreign arbitrators participate in 83 cases" [14].

## 7. Conclusion

The Appellate Body, as a permanent body, awards remedies to the parties to a dispute, is an indispensable step in maintaining the seriousness and authority of WTO. The key to restoring the Appellate Body's operations is to select judges who meet the requirements and can reasonably share the burden of hearing cases and to determine new trial deadlines and operational rules appropriate for the Appellate Body considering the current state of the multilateral trading system. The resumption of the Appellate Body requires the concerted efforts of all WTO member states. We believe that the Appellate Body will bring new vitality to the international trading system soon. China's BRI ISDS reform is of great significance and influence. By reforming the ISDS appeal mechanism, China can improve investor confidence, promote the improvement of the investment environment, enhance international cooperation, promote global governance reform, and break the deadlock of the existing ISDS unilaterally favoring investors. Introducing the WTO appeal mechanism into ISDS will provide strong support for the successful implementation of the BRI and will also inject new vitality into global economic cooperation and development.

## Acknowledgement

Yanan Fang and Yunsong Lu contributed equally to this work and should be considered co-first authors.

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