Identifying Problems of International Investment Law (IIL) and Evaluating the Focus of Reform Initiatives

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The normative structure of international investment law is highly asymmetrical. Generally, current IIAs grant investors significant substantive and procedural rights, while States and affected communities often lack equivalent safeguard. In recent years, scholars have criticised and identified many problems including human rights concerns ingrained in the international investment law framework. The States and other stakeholders also raised many concerns regarding international investment agreements and investor-State dispute settlement. Moreover, there's agreement on the need for comprehensive reform of IIL to make ISDS effective. Yet, issues with ISDS go beyond systemic flaws, also entrenched in substantive deficiencies in existing IIAs. Furthermore, the current legitimacy crisis provides a unique chance to amend the international IIAs comprehensively. However, the WGIII and ICSID reform initiative primarily focuses on procedural aspects of ISDS, avoiding substantive issues raised by various stakeholders. While procedural reforms are essential, resolving substantive issues is equally necessary.

Keywords: international investment law, investor-State dispute settlement, reform, UNCITRAL, WGIII, ICSID

Introduction

In recent years, there has been a significant increase in scholarly interest towards the investment treaty system. This surge in interest has led to the adoption of a broader range of theories and methodologies, pushing the frontiers of knowledge in multiple aspects of the investment treaty system. They have criticised and identified many problems ingrained in the international investment law (hereinafter IIL) framework. The States and other stakeholders also raised many concerns regarding international investment agreements (hereinafter IIAs) and investor-States dispute settlement (hereinafter ISDS).

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The United Nations Commission on International Trade Law (hereinafter UNCITRAL) tasked Working Group III (hereinafter WGIII) to explore potential reform of ISDS. The process is government-led and consensus-based. The process recognises concerns about the democratic accountability and legitimacy of the investment law regime. Criticisms of ISDS include both substantive and procedural aspects. Questions also arise whether the advantages of investment treaties with ISDS provisions outweigh their costs. These concerns highlight the need for UNCITRAL to take a comprehensive view of the system’s effectiveness in realising its goals when considering ISDS reform.

Reform initiatives at the International Centre for Settlement of Investment Disputes (hereinafter ICSID) and UNCITRAL’s WGIII are focusing on reforming the ISDS which involves procedural aspects. On the other hand, the United Nations Conference on Trade and Development (hereinafter UNCTAD) is offering amendment guidelines to States.

In this paper, in section 2, the author identifies the problems in IIL by evaluating perspectives of scholars and stakeholders. In section 3, the author, then, identifies the focus of reform initiatives concerning IIL and provides evaluation. In section 4, the author provides the conclusions of this paper.

Identifying the problems in IIL

Foreign investors anticipated and also encountered risks while investing in a host country. Therefore, the target of the capital-exporting States is to establish protective system for the investment, while goal of the capital-receiving States is to protect their regulatory power. It is claimed that initially the international investment law was shaped by unequal military power and later influenced by the US hegemony. After that it has consolidated through investment treaties and contracts. Despite encountering dissent, ongoing efforts seek to adjust its outer features while maintaining the core. Comprehending the strategies utilised to maintain this prevailing system is essential.

One of the oft repeated claims is that international standard of treatment for foreign investors is a customary international law principle. However, Sornarajah opposes this view. In his view, claiming that there existed customary international law concerning the international minimal standard is incorrect as the international community was divided on accepting the international minimum standard...
as guaranteed under customary international law. Moreover, Latin American States initially resisted the system based on external minimum standards of treatment, followed by African and Asian States. In addition, he dismissed the assertion of existence of customary international law on this issue as a creation of Western international lawyers’ imagination. He also emphasises that as the power dynamics shifted, so did the system.

The formal beginning of the existing system can be traced back to the 1959 Germany–Pakistan BIT. However, an alternative view suggests its roots in the United States’ Freedom, Commerce, and Navigation Treaties. So far, over 2,800 BITs have been concluded. Under the current international investment law system, foreign investors are empowered with the right to sue governments. While Simmons highlights that the foreign investors’ right to sue a government for damages by choosing a forum constitutes the most revolutionary aspect of international law, Professor Gus Van Harten counters by highlighting the institutional biases embedded within ISDS. He asserts that the system favours wealthy claimants, leaving resource-constrained States struggling to put up even a basic defence. He argues further that this imbalance undermines the development of an international rule of law, a concept that remains problematic in itself. Furthermore, Choudhury argues that the IIL can be regarded as a global public good, offering a comprehensive legal framework and creating a system that benefits both States and investors, but its current interpretation and application hinder its effectiveness.

Numerous efforts to conclude a comprehensive multilateral agreement on foreign investment have failed, with notable successes like the International Centre for the Settlement of Investment Disputes (ICSID) Convention. International arbitration became the primary mode of dispute resolution, with ICSID acting as the central institution. However, the significant use of investment arbitration facilitates bypassing national courts. Strikingly, international investment arbitration embodies the unique feature under which only investors can initiate arbitration proceedings and seek compensation for violations of investment protections.

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11 Sornarajah 2021a: 2148.
12 Sornarajah 2021a: 2151.
13 UNCTAD 2016.
14 Sornarajah 2021a: 2151.
15 UNCTAD 2023a.
16 Sornarajah 2021b: 18.
17 Simmons 2014: 17.
19 Choudhury 2013: 484.
20 Wouters et al. 2013: 33.
21 UN 1966.
23 ICSID 1966.
24 Subedi 2016: 727.
25 Davitti 2012: 421.
The evolution of investor protection in BITs is seen as revealing conflicts of interest in investment relations between capital-exporting and capital-importing States. Utilising BIT frameworks, developed countries imposed their liberal and protective view on developing countries which weren’t available under the customary international law. On the other hand, developing countries have accepted increasingly strong terms in BITs for getting necessary capital and competitive advantages. This lead to significant influence on their regulatory sovereignty. Kate Miles, after employing case studies, contends that international law has been changed to prioritise the interests of foreign investors which neglects interests of local communities and environmental concerns. Moreover, Choudhury’s analysis of investor–State arbitration shows a tendency to pay insufficient consideration regarding public interest, favouring investor claims. This imbalance is exacerbated by ambiguous BIT clauses that lacks specifics related to several provisions, such as fair and equitable treatment and expropriation, with arbitral tribunals contributing to the problem through broad interpretation.

Various criticisms have been directed towards ISDS since the 2000s, because of alarming increase in investment disputes and pro-investor climate at the arbitral tribunals. With more than 1,200 investment treaty arbitrations filed by 2023, many concerning sensitive regulatory areas, ISDS has become a contentious element of international economic governance. Recent sensitive cases, including Vattenfall v. Germany, Philip Morris v. Australia, Philip Morris v. Uruguay, and Lone Pine Resources Inc v. Canada have engendered public outcry and shaped sentiment against ISDS. Critics question not only the legal merit but also legitimacy of the arbitral tribunals’ jurisdiction.

ISDS has drawn criticisms from a diverse range of stakeholders, including academics, jurists, non-governmental organisations, States, citizens, and lawmakers. One of the central criticisms involves the substantive provisions of ISDS, where

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26 Wouters et al. 2013: 25.
28 Miles 2015: 32.
29 Choudhury 2013: 488.
30 Wouters et al. 2013: 49.
32 ICSID 2021.
33 ICSID 2021.
34 UNCTAD 2023b.
40 Víg–Hajdu 2018: 49.
concerns are raised about host States prioritising investors’ rights over the public interest.41

Another central criticism is related to expansive interpretation of treaties. Scholars contend that the broad interpretations of jurisdictional principles and substantive rules within the treaties have been exercised. This approach involves establishing jurisdiction through expansive interpretations of corporate nationality,42 including bonds sold in foreign stock markets in the definition of investment,43 allowing forum shopping based on corporate nationality,44 asserting that the State must maintain a climate of confidence by interpreting the full protection of security standard,45 and upholding the international minimum standard by interpreting fair and equitable treatment.46 The expansion of legitimate expectations became evident in awards like the four Argentina Gas Cases – *LG&E*,47 *CMS*,48 *Enron*,49 and *Sempra* 50 at the beginning of 2000s.51 Moreover, Mercurio has highlighted particular ways that IIL might violate public policy, like including intellectual property rights in the definition of investment.52

Moreover, another focal point in ISDS criticism concerns the independence and impartiality of arbitrators.53 There is added scrutiny on arbitrators’ interpretation, and the limited diversity in their appointments.54 Empirical studies indicate a handful of arbitrators from Western countries served as both arbitrators and legal counsels, a practice referred to as “double hatting.”55

Furthermore, another principal criticism involves inconsistency of the awards,56 especially in the interpretation of the Fair and Equitable Treatment (FET) standard. Unlike the court system, arbitral tribunals are not bound by precedent, leading to varying interpretations.57 In addition, this inconsistency in the awards has resulted in conflicting decisions on similar factual matters, exemplified by cases like CME v. Czech Republic and Lauder v. Czech Republic.58

41 Chaisse et al. 2021: 2133.
42 Sornarajah 2021a: 2154.
43 Sornarajah 2021a: 2154.
44 Sornarajah 2021a: 2154.
45 Sornarajah 2021a: 2155.
46 Sornarajah 2021a: 2155.
51 Sornarajah 2021a: 2156.
53 Khalique 2024: 94.
58 De Brabandere 2018: 2607.
Another point of contention centres on the absence of standardised criteria for awarding damages.59 This allows tribunals to employ diverse valuation methods, leading to inconsistent decisions.60 The case of CME Czech Republic B.V. v. Czech Republic61 illustrates this concern, as the awarded compensation substantially surpassed the actual value of the investment.

Another concern involves the intervention into a host State’s domestic proceedings, challenging its sovereignty.62 For instance, in the Puma Energy Holdings v. Benin case, the emergency arbitrator directed Benin’s executive authority to prevent its judiciary from enforecng a judgment until the resolution of the arbitral dispute.63 Additionally, critique affirms the restriction of States’ regulatory authority through regulatory chill, where evidence may be limited but indicates its existence.64

Moreover, ISDS is criticised for its bias toward foreign investors, providing them the right to initiate proceedings while restricting direct access for States.65 The Ubraser Case66 at ICSID showcases this bias, with States expressing that counterclaims is the available remedy. Another criticism asserts that ISDS primarily protects resourceful investors due to the significant legal and administrative costs.67 This affects both claimants and respondent States.

Furthermore, criticism is raised for its lack of transparency, with no limited public access to proceedings. The historical context illustrates that this issue wasn’t a significant consideration during the peak period of IIA signings.68

In addition, another source of concern is high cost and duration of a case, which may continue to exist.69 Moreover, winning party often find itself with substantial bills as arbitral tribunals typically avoid issuing orders for the reimbursement of its legal expenses. According to the findings of Zamir, the average costs in investor–State arbitration amount to approximately 10–11 million USD for both claimant and respondent.70 This is one of the central issues for the UNCITRAL WGIII.

Mounting concerns and criticisms have prompted reform efforts within UNCITRAL and ICSID. ICSID began the process of updating its rules and regulations in October, 2016.71 Meanwhile, UNCITRAL’s WGIII was tasked with

59 Marboe 2018: 2.
60 UNCITRAL 2018.
63 Touzet – Vienot De Vaublanc 2018.
64 Bonnitcha 2014: 154.
65 Pauwelyn 2014: 373.
68 Maupin 2013: 151–152.
69 Zárate et al. 2020: 309.
70 Zamir 2021: 1456.
71 ICSID 2019.
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discussing and recommending potential ISDS reforms at its 50th Session in 2017.72
In reality, stakeholders hold diverse views on how to approach the reform. Research
categorises them into three main groups: incrementalists, systemic reformers, and
paradigm shifters.73

The above-mentioned international investment law climate has certainly
prompted some actions by the States. Some States opted out, e.g. Indonesia, India,74
South Africa,75 from the BITs and some withdrawn from the ICSID Convention, e.g.
Bolivia, Ecuador, Venezuela.76 Moreover, the growing concerns about international
investment law, the criticisms of ISDS, and the ongoing reform initiatives have
provided the space for further research to delve into the ISDS system’s weaknesses
and explore possible solutions.

It is against this backdrop of heated discussions and ongoing reform efforts, the
question arises about the need for reforming the international investment dispute
settlement system, specifically the ISDS. Moreover, considerations include examining
the viability of the reforms proposed by UNCITRAL WGIII and the necessary
elements that should be integrated into any reform process.

Evaluating the focus of reform initiatives

Identifying the focus of reform initiatives

The focus of the UNCITRAL Working Group (WGIII)

United Nations Commission on International Trade Law (UNCITRAL) delegated the
following broad mandate on the WGIII:

To work on the possible reform of investor–State dispute settlement. In line with
the UNCITRAL process, Working Group III would, in discharging that mandate,
ensure that the deliberations, while benefiting from the widest possible breadth
of available expertise from all stakeholders, would be government-led, with
high-level input from all governments, consensus-based and fully transparent.
The Working Group would proceed to: (a) first, identify and consider concerns
regarding investor–State dispute settlement; (b) second, consider whether
reform was desirable in the light of any identified concerns; and (c) third, if the
Working Group were to conclude that reform was desirable, develop any relevant
solutions to be recommended to the Commission.77

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72 UNCITRAL 2017b.
73 Roberts 2018: 410.
75 Chidede 2017.
76 Markert–Titi 2015: 427.
77 UNCITRAL 2017a: para. 264.
It can be observed that the very mandate to the WGIII limited its scope to issues related to the ISDS mechanism. At the 34th Session of the WGIII, it was again reiterated that “the mandate given to the working group focused on the procedural aspects of dispute settlement rather than on the substantive provisions.” Moreover, it was also mentioned that the recommendations of WGIII would also consider relevant works from other international organisations. Furthermore, each State would have the opportunity to select from a range of solutions. Therefore, Diamond and Duggal thinks that this reform initiative has shifted its focus away from the substantive aspects of IIL. The WGIII’s preliminary focus was on evaluating the consistency, coherence, predictability, and accuracy of arbitral decisions. Additionally, they examined the costs and duration of arbitration proceedings, along with the independence and impartiality of arbitrators.

The WGIII currently preparing and receiving comments on drafts related to various important issues. So far, there are draft proposals on procedural and cross-cutting issues, draft guidelines on prevention and mitigation of international investment disputes, draft statute of an advisory centre, Draft provisions on mediation, Draft code of conduct for arbitrators in international investment dispute resolution, Draft code of conduct for judges in international investment dispute resolution, selection and appointment of ISDS tribunal members and related matters, Appellate mechanism. A close observation to these drafts showcases that the focus of the WGIII is on procedural aspects. Currently, with a deadline of 2026 in mind, the focus is on drafting legal text, and securing political consensus with an urgency. The WGIII could complete anywhere from six to twelve legal instruments intended for inclusion in a multilateral convention focused on procedural reform.

78 UNCITRAL 2017d: para. 20.
79 UNCITRAL 2017a: para. 264.
80 Diamond–Duggal 2021: 141.
81 UNCITRAL 2018a.
82 UNCITRAL 2018b.
83 UNCITRAL 2018c.
84 UNCITRAL 2023a.
85 UNCITRAL 2024a.
86 UNCITRAL 2024b.
87 UNCITRAL 2023d.
88 UNCITRAL 2023b.
89 UNCITRAL 2023c.
90 UNCITRAL 2022.
91 UNCITRAL 2023e.
92 Roberts – St John 2022c.
The focus of the ICSID

ICSID has initiated its rules amendment process in October 2016. It has invited proposals from all member States regarding potential amendments to the rules. Between 2017 and 2018, ICSID opened the floor to wide-ranging discussions about possible changes to its rules for handling investment disputes through conciliation, arbitration, and fact-finding. In August 2018, ICSID proposed major amendments to its rules in a working paper. The consultation found 16 areas for amending ICSID rules, echoing concerns raised by UNCITRAL WGIII about inconsistent awards, limited transparency, potential conflicts of interest, and high costs and delays.

Proposed changes to the ICSID rules include improving drafting and language, reducing time and cost, clearer instructions for filing a case, obligation to disclose third-party funding, enhancing transparency, new rule on security for costs, disqualification of arbitrators, timing of awards, expedited proceedings. After reviewing proposed changes submitted in January 2022, ICSID member States endorsed amended rules in March 2022 and became effective on July 1st of the same year.

Upon closer scrutiny, it becomes apparent that the amendments made by ICSID focused on procedural matters, reinforcing its role as an institution of arbitration facilities. Moreover, these amendments didn’t deal with any substantive matters related to international investment agreements.

The focus of the UNCTAD

UNCTAD did not initiate any reform process, however, it contributes to the ISDS reform debate by offering comprehensive guidelines, prioritising areas, and suggesting phases for IIA reform. In its 2018 reform package, key recommendations include reviewing BITs, promoting responsible investment, addressing procedural aspects, and safeguarding consistency across agreements and policies. Moreover,
it advocates for a transparent, inclusive reform process to improve the multilateral support structure for ISDS. UNCTAD’s investment reform suggestions focuses on modernising outdated treaties. It assists states in changing investor-friendly BITs with more balanced ones. It recommends updating treaty provisions with global standards, maintaining similar treaty standards, reinterpreting treaty provisions where necessary. It also supplies essential database of modern IIAs.

UNCTAD’s recognises broader critiques of IIAs, however, it addresses them incrementally rather than through a unified approach. Moreover, UNCTAD aims to balance States’ regulatory rights with safeguarding FDI. Although multilateral engagement remains a possibility, UNCTAD isn’t leading any efforts for a multilateral investment agreement. Alvarez thinks that UNCTAD promotes a liberal structure for foreign investment. Moreover, it maintains the current framework of protecting foreign investment.

**Critique of the focus reform initiatives**

There’s agreement on the need for comprehensive reform of IIL to make ISDS effective. Yet, issues with ISDS go beyond systemic flaws also entrenched in substantive deficiencies in existing IIAs. Indonesia contends that both the substantive and procedural aspects of IIAs are interconnected and require same attention. However, South Africa questions the rationale behind granting businesses the ability to initiate legal action against governments. Singh argues that achieving effective and sustained ISDS reform needs substantive changes to existing IIAs within a multilateral framework. She stresses that problems related to ISDS derive from the language and provisions of IIAs. Moreover, Alvarez warns against only tackling procedural issues in investment arbitration reform. He thinks that overlooking substantive concerns weakens not only immediate but also long-term reform objectives. Simply improving arbitration and enforcement mechanism without addressing fundamental legitimacy issues won’t stabilise or legitimise the legal regime. Furthermore, Shan thinks that the current legitimacy crisis provides

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109 UNCTAD 2017a.
111 Alvarez 2021: 262.
113 Alvarez 2021: 262.
114 UNCTAD 2018.
115 Singh 2020: 134.
118 Singh 2020: 133.
119 Singh 2020: 133.
120 Alvarez 2021: 254.
a unique chance to amend the international IIAs comprehensively.\textsuperscript{121} A multilateral investment law framework would be coherent and would provide the legal clarity.\textsuperscript{122} In addition, this would end fragmented nature of current IIL.\textsuperscript{123}

In the approach of the investment arbitration, there is considerable conflict when it comes to deal with other fields of international law.\textsuperscript{124} This aspect is crucial for international community. Without harmonisation, this aspect cannot be properly dealt with.\textsuperscript{125}

Previous efforts to create a multilateral investment treaty were not fruitful.\textsuperscript{126} Despite shifting attitudes backing a unified approach, reaching consensus at the multilateral level remains uncertain.\textsuperscript{127} Singla sees incremental routes to multilateral consensus,\textsuperscript{128} while Sauvant highlights challenges due to opposing views on multilateral framework.\textsuperscript{129}

Conclusion

The normative structure of IIL is highly asymmetrical.\textsuperscript{130} Generally, current IIAs grant investors significant substantive and procedural rights, while States and affected communities often lack equivalent safeguard.\textsuperscript{131} Therefore, fixing this structural imbalance warrants a holistic approach, rather than incremental or regional solutions. However, the WGIII and ICSID reform initiative primarily focuses on procedural aspects of ISDS, avoiding substantive issues raised by various stakeholders.\textsuperscript{132} While procedural reforms are essential, resolving substantive issues is equally necessary.\textsuperscript{133}

Based on the amended ICSID Rules and Regulations effective on July 1, 2022,\textsuperscript{134} it can be concluded that the amendments represent incremental changes to the procedural aspects of ISDS. On the other hand, analysis of WGIII’s drafts\textsuperscript{135} suggests a focus on systemic changes to the procedural aspects of ISDS. Although the WGIII plays a vital role as a platform for State discussions, but its current mandate complexity makes adding substantive reform agenda unlikely.\textsuperscript{136}

\textsuperscript{121} Shan 2015: 1.
\textsuperscript{122} Shan 2015: 2.
\textsuperscript{123} Sauvant 2016: 34.
\textsuperscript{124} UNCTAD 2017b: 129.
\textsuperscript{125} UNCTAD 2017b: 130.
\textsuperscript{126} Supnik 2009: 357.
\textsuperscript{127} Wouters et al. 2009: 288.
\textsuperscript{128} Singla 2020: 162.
\textsuperscript{129} Sauvant 2016: 33.
\textsuperscript{130} Garcia et al. 2015: 869.
\textsuperscript{131} Arcuri–Montanaro 2018: 2793.
\textsuperscript{132} Khalique 2022: 64.
\textsuperscript{133} Khalique 2022: 64.
\textsuperscript{134} ICSID 2022.
\textsuperscript{135} UNCITRAL 2024c.
\textsuperscript{136} Alvarez 2021: 260.
There are continued concerns from various stakeholders. They maintain that solely focusing on procedural aspects would not be ideal utilisation of the current reform opportunity. Scholar likens this approach to cosmetic changes on a fundamentally flawed system.

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138 UNCITRAL 2019a.
139 Alvarez 2021: 276; Sachetim–Codeco 2019: 58.
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