

University Doctoral (PhD) Dissertation Abstract

SMALL AND MEDIUM-SIZED INVESTORS'  
ACCESS  
TO INVESTOR-STATE DISPUTE SETTLEMENT

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## **1. The Topic of the Dissertation**

The dissertation addresses the significant challenge that small and medium-sized investors (SMIs) face in accessing investor-state dispute settlement (ISDS) mechanisms, especially investor-state arbitration (ISA). While on the face of it they are accessible to claimants of any size, these dispute resolution mechanisms often impose barriers that are prohibitive for SMIs. The thesis explores the intricacies of these challenges and evaluates potential solutions and reforms aimed at making ISDS more accessible for SMIs, thus maintaining access to justice for this category of investors.

The purpose of this research is to analyse the barriers SMIs face and to suggest practical reforms that could enhance their ability to resolve disputes through ISDS. Key questions addressed in this research are the following:

- (1) Is the ISDS system one that was designed to be accessible only to the large few?
- (2) Is the solution for improving access of SMIs to ISDS to be found within the existing system and how would the current reform efforts assist in finding a solution?

The thesis argues that the current system of ISDS, which revolves principally around ISA, is one that is not inherently imbalanced in favour of the large claimant, but its specialised nature makes it fairly difficult to access in both a jurisdictional and a material sense. This results in a

dispute resolution system, in which SMIs may find themselves locked out of this avenue of access to justice.

The thesis critically analyses the reform process underway at the United Nations Conference on International Trade Law (“UNCITRAL”) in its Working Group III, in terms of the suitability of those proposals to resolve these issues of asymmetric access to justice.

## **2. The Structure of the Dissertation**

The thesis consists of five chapters. The first chapter contain introductory remarks on the background of the research, its purpose, its main questions, the challenges faced during research, a section on legal scholarship tied to the matter, and brief notes on methodology.

The second chapter addresses to some detail the matter of small and medium-sized investors and access to justice, introducing the concept of the small and medium-sized investor and turning to matters regarding their definition, their participation in the transnational economy as foreign investors. The chapter ends on a section dedicated to access to justice, ISA as access to justice, and SMI access to ISA. It concludes that there is asymmetric access to ISA, which constitutes a challenge to the legitimacy of the system, and has multiple negative effects on smaller investors.

The third chapter addresses the principal impediments for accessing ISDS. It first addresses jurisdictional

impediments to accessing ISA, as the main ISDS mechanism, going through international agreements, and jurisprudence. It then addresses to some detail the thorny issue of costs in ISDS, especially ISA, which may objectively be considered as being astronomical. This subsection not only looks at empirical evidence regarding the costs of ISA, but also how tribunals address the matter of costs, who bear such costs, various aspects of this, and the factors that drive up the costs.

The fourth chapter aims to look at various solutions that have some bearing on the matter of SMI access to ISDS. This chapter takes a look at the proposed Investment Court System, the Multilateral Permanent Investment Court, and the advisory centre on international investment dispute resolution as various modalities to reduce costs in ISDS. It then turns to investor-state mediation, and expedited proceedings, as less costly ISDS mechanisms. The last two sections address ways in which costs can be shared, via mass claims-type proceedings, and the question of third-party funding.

The fifth and last chapter contains some conclusions about the research.

In the following sections below, some of the analysis engaged into within the dissertation will be reflected.

### **3. Research Methodology**

In analysing the matter of SMI access to ISDS and especially ISA, various sources of law, such as international conventions, national laws, and arbitration rules are used. The research also analyses relevant jurisprudence stemming from arbitral awards and court decisions. The principal source that was utilised is legal scholarship. These tools have been put to use in order to identify the challenges faced by SMIs in accessing ISDS, but also to explore and propose potential solutions to this weakness of the system.

The methodology used in this research consists of doctrinal analysis, the non-doctrinal method, the comparative method, as well as the evolutionary method. In this sense, there is extensive comparison between provisions of various IIAs, and between the principal arbitration rules. The doctrinal method was used to identify the law, engage in its analysis, and critique. Non-doctrinal research was employed in a qualitative sense, especially in terms of exploring the ongoing reform process concerning ISDS. For a topic characterised by such dynamism, it was only fitting to engage in an evolutionary view, and study the developments in the field of ISDS. Accordingly, the conducted research presents historical analysis, exploring negotiation documents, and past jurisprudence. The research also involved, albeit to a small extent, interdisciplinary approaches, especially by engaging the relevant work of economists and political scientists. Empirical data used within the research is primarily sourced from other scholars' work. In a

qualitative sense the author has engaged in extensive discussions with highly regarded, reputable individuals, both scholars and practitioners in the field of international investment law, in order to gain some insight, and tips on relevant jurisprudence.

#### **4. Small and Medium-Sized Foreign Investors**

The dissertation addresses the difficult task of identifying a fitting definition, turning to definitions used for Small and Medium-sized Enterprises (SMEs). While these definitions are important in noting the approximate size of the investors of interest to the research, it is also argued that selecting “the appropriate” definition is actually a moot question. Regardless of the nuance chosen, it is a fact that there are small and medium-sized foreign investors and investments, and that there is an asymmetry in their ability to access ISDS as opposed to larger investors. The dissertation also turns to the matter of SMEs and their prevalence amongst foreign investors.

Since the 1960s, states have aimed to enhance the participation of SMEs in the global economy. This was a topic also featured in the negotiations on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). Despite this long-standing focus, progress has been slow, with data showing that SMEs have struggled to make a significant impact in foreign markets.

In 1988, SMEs represented 98% of US businesses but only 20% of multinationals, with less than 0.2% operating internationally. By 2010, only 2% of EU SMEs were involved in foreign direct investment (FDI), despite SMEs making up 99% of all companies in the EU. Data by the Organisation for Economic Co-operation and Development (OECD) indicates SMEs contribute less than 10% of FDI, with significant barriers limiting their international growth.

The challenges SMIs face are numerous. Limited resources be it financial or informational, obstruct their internationalisation. Smaller firms encounter higher entry barriers, such as financial market imperfections and cultural differences, which are more pronounced for their international expansion. SMIs often also lack the sophistication to navigate international contracts and face challenges in accessing fair dispute resolution mechanisms.

Governments have introduced various initiatives, including fiscal incentives, reduced red tape, and targeted support for innovation and research, to aid SMEs. Such efforts should also constitute an incentive for smaller business entities to invest abroad. Treaties for the promotion and protection of investments aim to protect property rights and reduce political risks for investors, but their impact on SMIs remains questionable.

Despite ongoing efforts, SMIs still face substantial barriers to internationalisation. While they contribute to

the global economy, their participation is limited, and existing support mechanisms and legal frameworks need further refinement to effectively support SMIs in becoming active players in the transnational economy. Part of this, is access to justice through ISDS.

## **5. Small and Medium-Sized Investors and Access to Justice**

SMI is a term derived from the well-known category of small and medium-sized enterprises (SMEs), and adjusted to include individuals, with the aim of referring to investors specifically. The accessibility of ISDS to this category of investors was present as a topic from the outset, at the negotiations carried out on the foremost institution for ISDS, which is the International Centre for Settlement of Investment Disputes (ICSID), and the underlying ICSID Convention.

The importance of access to justice for SMIs cannot be overstated. These investors play a crucial role in the global economy, yet they are disproportionately affected by the barriers to ISDS, such as high costs, complex procedures, and jurisdictional hurdles. Ensuring that SMIs have access to ISDS is vital for the legitimacy and credibility of the international investment system. If the system is perceived as being reserved principally for large corporations, it risks undermining confidence among smaller investors and may contribute to a broader sense of injustice in the global economy.

Access to justice is a fundamental right that ensures that all parties, regardless of their size or resources, have the ability to seek redress for grievances. For SMIs, access to justice in the context of international investment is particularly important because they often operate with fewer resources and greater vulnerability to the actions of host states compared to larger investors.

The concept of access to justice encompasses not only the availability of legal mechanisms but also the practicality of utilizing those mechanisms. For SMIs, this means that while ISDS may theoretically be available to them, the high costs, complex procedures, and jurisdictional challenges often render it inaccessible in practice.

## **6. Challenges Faced by SMIs in Accessing ISDS**

SMIs face a variety of challenges in investor-state arbitration, many of which stem from the inherent complexity and costliness of ISDS processes.

One of the primary challenges for SMIs in ISDS is jurisdiction. The definition of what constitutes an "investment" under various treaties may exclude SMIs from accessing ISDS. The arbitral jurisprudence of ICSID demonstrates that the inclusion of specific criteria that often do not align with the investment profiles of SMIs may render ISDS inaccessible.

In this regard, the thesis explores the so-called *Salini test* for determining whether a particular economic activity

should be considered an investments, in view of the material contribution, its duration, the presence of an element of risk, and the contribution to the economic development of the host state. In certain cases, the investigation carried out by arbitral tribunals have determined that certain smaller business ventures do not qualify as investments under these criteria. The latter condition, which derives from the interpretation of the preamble of the ICSID Convention has proven to be very much controversial, as some arbitral tribunals required this contribution to be *significant*. Accepting such an interpretation would introduce a supplementary condition that would see SMIs be denied access to this avenue of justice.

Costs are another significant barrier. The high cost of arbitration can deter SMIs from pursuing legitimate claims. These costs include legal fees, tribunal fees, and other administrative expenses, which are often beyond the financial capacity of SMIs. The costs associated with ISDS are often prohibitive for SMIs as they can run into the millions of dollars, which is beyond the financial capacity of many SMIs. The high cost of arbitration not only deters SMIs from pursuing legitimate claims but also creates a disparity between larger and smaller investors, where only the former can afford to access to justice through ISDS.

The challenges faced by SMIs in accessing ISDS highlight the need for reforms that address these specific barriers. Without such reforms, the international

investment system risks perpetuating inequalities and undermining the participation of smaller investors in the global economy.

## **7. Potential Solutions for Improving SMIs' Access to ISDS**

Reforming ISDS to support SMI access requires a multifaceted approach. Adjusting international investment agreements (IIAs) and arbitration rules to make sure that SMIs are not excluded from ISDS is one solution. Additionally, introducing cost management strategies, such as capped fees and expedited proceedings, could lower the barriers for SMIs.

Funding options like third-party funding and contingency fee arrangements are also explored as potential solutions. These mechanisms can provide SMIs with the financial resources needed to pursue their claims without bearing the full cost upfront.

Third-party funding has emerged as a possible viable option for SMIs to finance their participation in ISA. In a third-party funding arrangement, an external financier agrees to cover the costs of arbitration in exchange for a share of any financial award that the claimant might receive. This arrangement can provide SMIs with the financial resources needed to pursue arbitration without bearing the upfront costs. However, third-party funding is not without its challenges, including the need to negotiate

favourable terms with funders. In addition, considering the high costs involved in ISA proceedings, third-party funders may show limited interest in funding cases that do not hold potential for larger gains, possibly avoiding smaller claims from being funded. Similar concerns plague other means of third-party funding, such as contingency fee arrangements, or crowdfunding. In the latter case, however, crowdfunding may be requested in a manner that does not promise a return for the individual funders, but rather some other type of gratification.

Another part of the solution for SMIs is to engage in cost-sharing arrangements with other similarly situated investors, engaging in mass claims where possible. This approach can involve pooling resources to jointly fund arbitration, thereby spreading the financial burden across multiple parties. Such arrangements can be particularly effective in cases involving similar claims against the same respondent state, where collective action can enhance the bargaining power of SMIs. The thesis briefly outlines existing jurisprudence on cases brought by bondholders.

Reforming ISDS procedures to include expedited and simplified arbitration processes specifically designed for SMIs is another potential solution. These procedures could involve reduced documentation requirements, shorter timelines, and lower tribunal fees, making arbitration more accessible and affordable for smaller investors. Expedited procedures would be particularly beneficial for cases involving relatively low-value claims,

where the costs of a full arbitration process might otherwise be disproportionate to the amount in dispute.

In addition, IIAs could include provisions that encourage the use of alternative dispute resolution (ADR) methods, such as mediation or conciliation, before proceeding to arbitration. These methods can offer a less adversarial and more cost-effective way for SMIs to resolve disputes. So far, getting amicable dispute resolution methods to gain in popularity in ISDS cases has not been too successful, but the tools are there, and attitudes towards such solutions may change in time.

Concluding, it is noted that the financial barriers to ISDS present a significant challenge for SMIs, limiting their ability to protect their investments and seek redress when disputes arise. However, through strategies such as cost-sharing, third-party funding, contingency fee arrangements, and the adoption of expedited procedures, it is possible to reduce these barriers and enhance access to justice for smaller investors.

## **7. The Investment Court System and Additional Solutions Sought at UNCITRAL Working Group III**

The Investment Court System (ICS) is a concept that is included in some of the new investment protection agreements signed by the European Union (and also Canada). It is a concept for a standing international court meant to resolve ISDS cases, turning away from ISA. The EU has also been pushing this idea at UNCITRAL Working Group III, where it is arguing for the

establishment of a Multilateral Permanent Investment Court (MPIC). When the latter is created, the ICS is to be replaced by it. This concept of such an international court, it is argued, will reduce costs, and thus enhance access to justice. Previous experience with the Iran-US Claims Tribunal, and other similar structures, demonstrate their efficacy in resolving smaller disputes, serving justice in cases where claims are small. Despite the potential for such a court, it is still quite far from being implemented.

The system may be taken into a direction where states agree on an institution that would provide financial or legal support to SMIs pursuing ISDS claims. This could take the form of an advisory centre, similar to the Advisory Centre on WTO Law (ACWL), which provides developing countries with legal assistance in disputes before the World Trade Organization. An analogous centre that offers services to SMIs could help them navigate the ISDS process. Unfortunately, this idea was recently dropped when the statute for an advisory centre on international investment dispute resolution was agreed upon at UNCITRAL.

## **8. Conclusion**

The dissertation concludes that while SMIs face significant challenges in accessing ISDS, there are viable paths forward. By implementing targeted reforms that aim to reduce costs, ISDS can be made more accessible to SMIs. This would not only enhance access to justice for

SIMs but also contribute to a more equitable and balanced international investment environment. Reforms that solve the issue of asymmetric access to ISDS will also improve the legitimacy of international investment law and ISDS mechanisms.



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### List of publications related to the dissertation

#### Articles, studies (8)

1. Szilágyi, J. E., **Kovács, B.**: Acquirement of Land Rights by Foreign Investors: An International Investment Law Perspective.  
In: Acquisition of Agricultural Lands: Cross-Border Issues from a Central European Perspective / Szilágyi János Ede, CEA Publishing, Miskolc, 55-75, 2022. ISBN: 9786156474087
2. **Kovács, B.**: Emberi jogok a nemzetközi beruházásvédelemben: védekezéshez is kevés?  
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Level of HAS Committee on Legal and Political Sciences: B
3. **Kovács, B.**: Watch for the Ripples, Not Just the Splash: How the EU Position on Investment Arbitration Has Affected the Enforcement of Awards.  
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**By the directives of HAS Committee on Legal and Political Sciences:**

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