

University Doctoral (PhD) Dissertation Abstract

LEGAL ASPECTS OF FOREIGN DIRECT INVESTMENT IN ASIA

Ninjin Bataa

Supervisor: Dr. habil. Zsolt Hajnal PhD, Assistant Professor of Law



University of Debrecen
Marton Geza Doctoral School of Legal Studies

Debrecen, 2021

a. Scope of the research

This dissertation focuses on foreign investment regime of Asian countries including Mongolia and Association of Southeast Asian Nation's Member States, and their general response to international investment regime. These regions of Asia were chosen due to their relatability to the topic on the basis of the following: foreign investment flow, relatively smaller economies and less explored areas in previous scholarly works.

This research aimed to review host countries' reactions towards influence of international investment regime (IIR) presented by international investment agreements (IIA) and investor-state dispute settlement mechanism (ISDS). Usually, the international investment regime influences all the global actors of the system. However, host states are more susceptible for such influence than the investors or the home country of foreign investors. The dissertation suggests that the international investment regime influences the investment regimes of host states and as a result host states respond to said influence: a) by improving and amending their investment legislation in order to facilitate foreign investors or b) by attempting to reform existing regime and enacting changes to its investment legislation.

In order to analyze the reactions of the Asian host states, the dissertation reviews the following:

- historical development of the investment policy and evolution of the foreign investment related legislation in the regions of Mongolia and Association of Southeast Asian Nation's Member States;
- the involvement of the European Union, its new free trade and investment protection agreements with Asian countries; and
- the investor-state dispute settlement mechanism, its recent criticisms and reaction of host countries and global actors to the recent criticism.

Deeper analysis of investor-state dispute settlement and its criticism shed light on the responses of the host countries to the developments, as seemingly unsuccessful investment treaty arbitrations commenced series of negative reactions towards ISDS from traditional host countries. In regard to this issue, another question came to light: whether the criticism and its responses were towards the investor-state dispute settlement system or international investment law (IIL) regime as a whole.

So as to answer the research questions regarding the influence of international investment regime and host countries' counter reaction towards it, the dissertation focused on following topics. Firstly, the evolution of the investment system as a whole, including its origin, sources,

fundamental economic theories and definition of core terminologies and problematics of named areas. Defining the basic notions of the international investment field was crucial in understanding its need for reform and criticism that it's facing now.

Secondly, the dissertation addressed the three individual regions and their investment regimes: Mongolia, ASEAN and the EU. The selected Asian regions were relevant to the topic due to their traditional host country status which presented perfect examples to reflect the reaction towards the international investment regime. Traditionally host state countries such as Mongolia and ASEAN Member States heavily depended on foreign investment flow and reformed their foreign investment policies in order to attract more investment into their economy. In their foreign trade and investment history, the roots of different policies towards foreign investment and reactions to international investment regime as a whole can be observed. The inclusion of the European Union was necessary due to its grand role in shaping the future of investment agreements and novelty dispute settlement mechanisms not only in the EU but in Asia as well. Its foreign investment policy was facilitating to understand Asian investment and trade tendencies. In recent years EU have concluded several new generation Free Trade Agreements and Investment Protection Agreements with number of Asian countries including Singapore and Vietnam. These new generation agreements could fully demonstrate certain reactions towards the traditional international investment regime.

Thirdly and lastly, the dissertation explored the investor-state dispute settlement mechanism. ISDS initiated the process of reform as countries started taking bold measures after being exposed and defeated in investment arbitral proceedings. Such reforms would entail 'negative' effect as the traditional system is being abolished.

Therefore, by exploring the host countries' (Mongolia and ASEAN Member States) the research questions were answered. Precisely, by researching the evolution and historical aspects of investment regimes and investor-state dispute settlement mechanism that came under harsh criticism that initiated the reform process in many countries. ISDS was more relevant than other topics as ISDS was the fundamental feature of the international investment law that was targeted in reform initiatives.

b. Conceptual background

International investment law is unarguably one of the most important fields of international law. It covers foreign investment regime, cooperation of host and home countries of foreign investment, and protection of investment by all means. The biggest push to the foreign direct investment flow started with the collapse of communism more than twenty years ago. This

event unleashed a historically unprecedented process of economic restructuring and political transformation in the former communist countries. It was a lengthy process which did not happen over a year: there was a transition period. This transition process involved certain changes in the politics and in the economies of the countries involved, including democratization, institution building and for the economic sector, - marketization, liberalization, restructuring. In the transition process, foreign direct investment proved to be the most effective instrument.

The notion of international investment law became of importance when countries started concluding more precise and targeted treaties on investment besides the traditional trade agreements. The purpose of investment treaties was to ensure protection of foreign investor's properties in foreign land. So to speak the home country of the investor was ensuring that property of their nationals would be regarded with utmost care in foreign land, where the regulations differ. Around 1990s with the increase of investment treaties, the number of disputes regarding the investment also increased, therefore making the investment regime complete with its legislation and dispute settlement mechanisms.

Traditionally, international investment law was targeted to protect the interest of capital exporting countries and capital importing countries were accepting any terms of agreement that were presented to them as it entailed economic gain in the future through flow of foreign investment.¹ Therefore, host countries tend to amend their legislation and improve economic and legal atmosphere to make it more favorable for foreign investors. For example, host countries would offer foreign investors advantages from custom and tax incentives that would make the transaction smoother; non-tax incentives including social benefits; and most importantly host countries waive their right to regulate the foreign investment by offering ISDS in their treaties and domestic legislation. More recent reactions of the countries include harsher strategies including denunciation of Convention on the Settlement of Investment Disputes between States and Nationals of Other States, removing investor-state dispute settlement from their existing bilateral investment treaties or terminating the bilateral investment treaties altogether. Therefore, the hypothesis requires to research what are the reactions of Asian host countries towards international investment regime and the reason behind it.

This dissertation sets out to examine the reaction of host countries to the international investment regime, including investment agreements and investor-state dispute settlement

¹ RUDOLF DOLZER & CHRISTOPH SCHEUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 2, Oxford University Press (2008).

mechanism. As a general rule, the international investment agreements and dispute settlement mechanisms one way or another are influencing the host countries of foreign investment. For instance, host countries amend their legislation, introduces various incentives and consent to resolve disputes in the international tribunal in order to make their economic and legal environment more attractive for foreign investment flow. At a first glance we can say that overall reaction of host countries towards international investment is positive as they aim to strengthen their rule of law and consequently attracting more foreign investment flow. However, deeper study is needed to understand if that is the case, especially for Asian countries regarding this research.

Positive influence would entail that host countries adopt more friendly regulations regarding entry and admission of foreign investment and its utmost protection. Negative influence would reflect mostly on investor-state dispute settlement mechanism, therefore host countries would reform the ISDS or completely abolish it. Further negative influence can entail in termination of investment treaties including numerous bilateral investment treaties. Another influence presents in regulatory chill of host countries regarding their environmental and basic human right regulations in order to avoid potential investment arbitration proceedings. For example, recent cases of Australia and Germany where the tribunal intervened with the regulatory power of the states in the sectors of environment and health. More precisely, Australia enacted a law enforcing plain packaging for tobacco products, therefore making the product less desirable. Australian governments agenda was to improve the overall health of its citizens by reducing the use of tobacco products. And plain packaging would reduce the purchase of tobacco products. Subsequently, a mega tobacco company brought claim against the plain packaging law, stating that such decision has a negative effect on their investment.² Nonetheless, the dispute was settled in favor of the state. As for Germany, the case was related to termination of nuclear power plants.³ Germany enacted a legislation to phase out the nuclear power plants till 2022. Consequently, foreign investors who has shares in German nuclear power plants brought arbitration claim. The decision is still pending.

Until recently most Asian countries were mainly host countries of the foreign investment. Many researches targeted bigger economies such as China, India, Japan and South Korea. Thus examining the investment regime of minor economies was more relevant. Mongolia was of relevance as a less researched yet quite popular investment destination. And ASEAN countries

² Phillip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12, 17 December 2015.

³ Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No. ARB/12/12, 2 July 2013.

were more popular in academic world, however recent reforms in the region made it pertinent to this research. The foreign investment is one of the biggest clogs that move market economy in selected regions. More precisely, Mongolia and southeast Asian countries receive the biggest share of foreign investment in Asia after mega economies such as China and Japan.⁴ Global investors find ASEAN's service sector and Mongolia's mining sector attractive with their generally welcoming incentives for foreign investment. For instance, in 2019 Mongolia have received 2.4 billion USD in foreign investment flow and it covers 15% percent of whole economy of the country.⁵ As for the ASEAN countries the numbers were much higher.⁶

Therefore, with much of the spotlight on selected regions, importance of international investment regimes was inevitably grand. On top of that, recently the international investment law and regime were scrutinized harshly resulting in radical changes in some countries and initiated further reform in global actors of the field. Hence researching the regime and analyzing its impact on these regions were the purpose of my thesis.

The relevance of the hypothesis became apparent after completing almost half the research. After exploring Mongolia and ASEAN countries it became more evident that there was certain reaction towards international investment regime. Most host countries react positively to international investment regimes but recently some countries started taking step that would entail more negative reaction towards it.

c. Methods.

The dissertation was approached from a legal – historical and comparative perspectives. The legal – historical method includes normative legal analysis of core legal texts including international treaties and domestic legislation. The analysis incorporates core objectives of the legal texts, basic standards of investment protection and inclusion of investor-state dispute settlement clause. Exploring the foundations of the selected regions delivers a perspective of current investment regime, thus it was important to include to development of the investment legislation and regime in the dissertation. Research focused on the regional legislation and

⁴ China's investment inflow in 2019 in billion USD – 155.8; Japan – 37.1, Databank of the World Bank, Foreign Direct Investment net flows (Nov. 26, 2020, 15:30), <https://databank.worldbank.org/reports.aspx?source=2&series=BX.KLT.DINV.CD.WD&country=>

⁵ Quarterly Economic Repot, Central Bank of Mongolia (Nov. 26, 2020, 15:30), <https://www.mongolbank.mn/documents/statistic/chartpack.pdf>.

⁶ For instance, in 2019 foreign investment flow in ASEAN countries were following (in bn. USD): Singapore – 105,4; Indonesia – 24.9; Vietnam – 16.2; Philippines – 7.6; Malaysia – 7.6; Thailand – 6.1; Cambodia – 3.6; Myanmar – 2.2; Lao PDR – 0.5; and Brunei Darussalam – 0.3. Databank of the World Bank, Foreign Direct Investment net flows (Nov. 26, 2020, 15:30), <https://databank.worldbank.org/reports.aspx?source=2&series=BX.KLT.DINV.CD.WD&country=>

investment regime in some Asian countries, including Mongolia and ASEAN countries, focusing more on the regional organization rather than all member states. Needless to say, some member states needed more individual observation than others depending on their participation in international investment law regimes. For instance, the dissertation assesses Indonesia's bold strategy towards investor-state dispute settlement system.

Historical methodology provides foundation of current investment regimes around the world, dichotomy of developed and developing countries and understanding their future trends. This method was selected as it facilitates to examine the reaction of the countries towards international investment law regime. More precisely, it helps to understand the current objectives, regimes and policies of some countries and to determine the causal link of current decisions and past experiences. It is essential to apprehend the historical aspects of investment policy development in order to perceive the overall response to international investment regime. Furthermore, the dissertation integrates methodologies of other discipline such as politics and economy in order to provide the understanding of evolution of international investment law and the economic theories at its basis.

Secondly, the regional investment policy aspects of Asian countries and the European Union were analyzed by utilizing the comparative methods between each other and within themselves. The comparative method is used to demonstrate the differences of investment regimes in traditional host countries (Mongolia and ASEAN) and home countries of foreign investor (EU). Furthermore, it is used to exhibit the potentially differing responses of Mongolia and ASEAN Member States to the general international investment regime. Primarily, the past foreign investment legislations and policies were compared to current instruments. Therefore, the policy shift and its reasoning became apparent. Later the historical aspects of aforementioned regions were compared to one another in order to clarify the world trend on international investment regime influence, especially towards the potential reform of international investment law and investor-state dispute settlement system.

The methods fit the question as it dissects the historical evolution of regimes and presents the current system. The topics that need to be covered in order to explain the methods are investment regime and legislation of individual counties of Asia.

d. Findings of the research

From 17th century till nowadays, international investment law has evolved a long way. Main instrument and sources of international investment law started with treaties of friendship, commerce and navigation and developed into bilateral investment treaties, multinational

agreement, customary international law, domestic law and debated rule of precedent. However, in current international investment regime, with ongoing amendment negotiations and proposals, the precedent could become legitimate source of international investment law. Current amendments include International Centre for Settlement of Investment Disputes and UNCITRAL Working Group III negotiations. Main sectors of these amendment proposals cover investor-state dispute settlement. More precisely, transparency of proceedings, third party funding, amicus curiae briefs, code of conduct for arbitrators, possibility of appeal mechanism and enforcement issues, and possibility of establishing a multilateral investment court system. Dispute resolution evolved from applying only domestic laws to having specialized bilateral investment treaties that regulate investment matters between states. Now bilateral investment treaties are the most important instruments of international investment law as it incorporates the main principles of international investment law such as most favored nation, national treatment, principle of fair and equitable treatment and compensation for expropriation.

This dissertation aimed to examine the influence of international investment regime on Asian host states, and their responses to the system overall. Research has unfolded that both positive and negative reactions of host states persisted; moreover, neither manner of reaction dominated the other. Positivity represented in the ultimate support of the system without attempts to change or renounce it; and negativity represented in efforts to reform the core idea of the system that is envisioned in international investment agreements and investor-state dispute settlement mechanism. However, neither positive nor negative reactions entail ultimate total positivity or negativity.

Mongolia

Positive reaction entails various actions of host country's government, including amendment of legislation other instruments in order to improve economic and legal atmosphere for the foreign investor. These improvements consequently increased the foreign investment flow to the country. Generally, a foreign investor seeks full protection of investment and full consent to the investment treaty arbitration. Positive reaction of a host country was identified in Mongolia's foreign investment policy. Mongolia has amended its foreign investment law four times and each time was targeted to improve the legal atmosphere in the country towards foreign investors. Since the very first foreign investment law of Mongolia, foreign investors had preferential treatments including tax and custom incentives and flexibility towards investment. After the introduction of democratic regime in 1990 Mongolia enacted first ever

Foreign Investment Law in 1993, which aimed to encourage foreign direct investment flow by defining special tax preferences and privileges only available for foreign investors; had clear distinction between foreign and domestic investor; introduced the basic rules of investment protection; and defined ‘investment’ and ‘business entities with foreign investment’.⁷ 1993 FIL was amended in 2002 as a result of complaints from domestic investors regarding foreign investors’ exclusive tax preferences and requirements of the World Trade Organization regarding safety and stability of investments. In 2011-2012, Mongolian GDP rose dramatically as a result of increased foreign investment in mining sector and exploitation scales of natural resources skyrocketed. Thus Government of Mongolia enacted Law on Foreign Investment in Strategic Sector (SEFIL) in 2012, main agenda of which was to keep control over Mongolia’s natural resources and prevent the establishment of undesired foreign investment in strategic sectors by State-owned entities.⁸ Law on Foreign Investment in Strategic Sector allowed both foreign private and state-owned investments to be screened and admissions to be denied in the public interest. Nevertheless, SEFIL aroused some uncertainties among investors alongside with the significant drop of foreign direct investment flows, which made the longevity of the law only one year.

In 2013, Mongolian Investment Law (MIL) was enacted to cover all the gaps that its predecessors left.⁹ The MIL applies to both foreign and domestic investors, therefore avoids reverse discriminations of the latter, secures the former equal legal treatment and it keeps the entry screening process of State-owned investments. Unless prohibited or restricted by the applicable domestic laws, private foreign investors can freely make investments in all sectors, including production and services. Main novelties of Mongolian Investment Law were the introduction of tax stabilization certificates, which is issued by the Government of Mongolia to the investors who qualify to certain requirements of the law; inclusion of an open offer to arbitrate investment treaty related disputes in international arbitration and sanctioning of number of clauses to sustainable development of host country. In essence, MIL’s investment protection clauses reflected internationally accepted standards and principles, including fair and equitable treatment, national treatment, free transfer of funds, compensation for expropriation and standing offer for arbitration.

⁷ Foreign Investment Law, Official State Journal Toriin Medeelel No. 4–5, (1993).

⁸ Law on the Regulation of Foreign Investment in Entities Operating in Strategic Sectors, Official State Journal Toriin Medeelel No. 23, (2012).

⁹ Mongolian Investment Law, Official State Journal Toriin Medeelel No. 41, (2013).

Every amendment of investment legislation in Mongolia was driven by the will to improve the legal regime in order to increase foreign investment flow and keep existing ones in the country. Therefore, it constitutes positive response to the international investment regime as it was accepting its clauses without question. Mongolia's attempt to improve domestic investment laws in order to meet international standards and requirements of the foreign investors reflect that country is leaning towards maintaining the status quo of the international investment regime.

Association of Southeast Asian Nations

Further the dissertation focused on Association of Southeast Asian Nations and the European Union's investment policy that affected Asia Pacific region directly. The exploration carried out through its regional and international investment agreements and "ASEAN Way" lenses. ASEAN's modern foreign investment regime and related policies are heavily influenced by its Member States' pursuit to keep their sovereignty intact as most of them gained independence recently. Furthermore, the chapter explores ASEAN Comprehensive Investment Agreement in great detail including novelties that it introduced; and comparing it to the previous foreign investment regulation instruments.

As one of the most attractive destinations for the foreign investment, Association of South East Asian Nation tried to keep its independence from strict standard treaty rules for a very long time. This over cautiousness correlated to recently gained independence for the majority of the Member States. But ever changing and developing market demanded a change of the regime from relation-based regulation to the rules based one. After transitioning to rules based regulation in the region focused on two pillars: keeping the independence of the Member States and enacting international law standards. The biggest leap towards internationalization of investment rules started with the ASEAN Comprehensive Investment Agreement (ACIA). However, ASEAN did not mean to change the regulative policies completely and rather decided to combine the two by making the treaty rules flexible and in favor of host state's discretionary powers. Because of the flexible discretionary powers of the host state, views on ACIA being a multilateral agreement or a regional one have divided. But it is safe to say that ACIA is more of a regional agreement with elements of international law standards. It combined the existing agreements under one document and introduced international treaty standards on investment protection and its liberalization, facilitation, promotion. These are the four innovations pillars of ACIA. ASEAN Comprehensive Investment Agreement's aim to complete and consolidate the investment regulations that were scattered in various sources into

one complex document was reached. With the one centralized instrument investors gained more confidence in the treaty protection of their investment. Nonetheless, when ACIA entered into force, it did not abolish the coverage of the previously existing investment treaties and free trade agreements, which opened doors to the possibility of forum shopping and left investors confused about the promised investment protection of ACIA.

On multilateral level, Association of Southeast Asian Nations Member States have concluded two mega agreements: Regional Comprehensive Economic Partnership¹⁰ and CPTPP. Both agreements bare great potential to broaden the trade and investment flow of the region. However, it could be confusing for foreign investors to which agreement to turn to as both RCEP and Comprehensive and Progressive Agreement for Trans-Pacific Partnership¹¹ mostly consist of same contracting parties. Nonetheless, ASEAN's Member States continue to exercise broad discretionary power in multilateral agreements.

European Union

Nowadays, ASEAN's future investment regime is being heavily influenced by the investment policy of the European Union. Prior to the Lisbon Treaty, Member States of the European Union were encouraged to enter into bilateral investment treaties while the EU was securing the liberalization of foreign investments and focused on negotiating free trade agreements. The Lisbon Treaty abandoned such dualism and devolved the competences in relation to foreign direct investments, including the negotiation and conclusion of bilateral investment treaties with non-EU states, to the European Union. What was missing in the Lisbon Treaty and became an issue in practice were transitional provisions clarifying the status of existing extra-EU bilateral investment treaties. Furthermore, CJEU's opinion 2/15 made it clear that investor state dispute settlement clauses fall within the Member States' competence. Thus being an important part of investment protection realm, it could cause uncertainties among the investors. Moreover, the future of Intra-EU bilateral investment treaties became apparent after the opinion of the CJEU on *Achmea v. Slovak Republic*¹² case came out. The Court decided that investment arbitration clauses in intra-EU bilateral investment treaties were infringing the Union's law and had discriminatory character, ergo it contradicts to the nature of the Union. Consequently, twenty-three Member States of the European Union signed Agreement on

¹⁰ RCEP signed on 15 November 2020. Contracting parties are Australia, Brunei, Cambodia, China, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, Philippines, Singapore, South Korea, Thailand and Vietnam.

¹¹ CPTPP signed on 8 March 2018. Contracting parties are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

¹² CJEU C-284/16, *Achmea v. Slovak Republic*, Judgement ECLI:EU:C:2018:158, 6 March 2018.

Termination of the Bilateral Investment Agreements in May 2020.¹³ It can take decades to finally stabilize the investment policy of the Union. The reform steps taken by the EU towards new regulations on investment have shown the Union's determination. Regardless of the numerous problems, including previous, agreements that the EU is dealing with, the process itself is quite successful. After long-term negotiations, the multilateral agreements of the Union are waiting for approval from Member States' Parliaments, and the proposal regarding the single judicial system is getting positive feedback from the observers. The single judicial system is striving to live up to the standards set by international tribunals', and this is evidenced by the use of approaches developed by the WTO.

European Union's influence on Asia Pacific is seen in the new generation free trade and investment protection agreements of the Union. When traditional investor-state dispute settlement system is replaced by new investment court system in the new generation agreements, Asian contracting parties are accepting such novelty by default and are motivated to reform their investment regimes. For example, novelties of EU-Singapore Investment Protection Agreement (EUSIPA) and EU-Vietnam Investment Protection Agreement (EUVIPA) effectively influences the tendency of future bilateral investment agreements in Southeast Asia. Such novelties included not only protection for the foreign investor but expressly stated host state's right to regulate. Further novelties included newly formulated fair and equitable treatment principle, instruments to lessen the arbitrators' interpretative powers and two-tier investor-state dispute settlement mechanism with tribunal of first instance and appeal body. Therefore, introducing new international investment agreements with novelty clauses is one of the main pillars of international investment regime and prompts ASEAN Member States' to shift their foreign investment regime to new level.

State's right to regulate is expressly incorporated in the Preamble of EUSIPA by reaffirming each party's right to adopt and enforce measures to pursue legitimate policy objectives.¹⁴ Such explicit expression represents that new generation free trade agreements are moving away from traditional pro-investor investment agreements and towards an agreement that promotes not only investment protection but respects the host state's right to regulate. Most of the host state's discontent regarding investor-state dispute settlement were coming from the belief that arbitral tribunals favor foreign investor regardless of that fact that investment itself

¹³ Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union, The European Union (Jan. 18, 2021, 01:06), [https://eurlex.europa.eu/legalcontent/EN/TXT/HTML/?uri=CELEX:22020A0529\(01\)&from=EN](https://eurlex.europa.eu/legalcontent/EN/TXT/HTML/?uri=CELEX:22020A0529(01)&from=EN).

¹⁴ Preamble para 6, EUSIPA.

is made in a public interest sector of the host state. Thus expressly formulated state's right to regulate clause in EUSIPA preamble manifests the importance of state's right to regulate to the parties. Moreover, the most debated principle of fair and equitable treatment is elaborately defined in the new generation agreements. EUSIPA and EUVIPA both give definition of fair and equitable treatment by listing the components of what kind of breaches would constitute the breach of the principle. EUSIPA's list of components include denial of justice, a fundamental breach of due process, arbitrary conduct of parties and abuse of power or bad faith.¹⁵ EUVIPA on the other hand includes the same list with addition of targeted discrimination on the basis manifestly wrong grounds such as gender, race or religious belief.¹⁶

Investor-State Dispute Settlement

With the increased number of international investment agreements respectively the number of investor-state dispute settlement have risen. Consequently, with the higher number of cases in investment arbitration, the criticism against ISDS mechanism became a fiercely debated topic. In relation to this, countries began taking various measure to change their policy towards foreign investment.

Negative reaction of host countries towards international investment regime was reflected in the criticism of investor-state dispute settlement mechanism and international investment tribunals. As number of investor-state dispute settlement proceedings started to rocket, the discontent of respondents, that are usually host states, grew more. With more data that appeared after hearing over 600 cases, International Centre for Settlement of Investment Disputes became a target for criticism from investors and contracting states. Criticisms towards ISDS covered transparency, jurisdiction and inconsistency in decisions. Lack of transparency has several negative impacts on international investment law and arbitration. Firstly, it weakens the legitimacy of investor-state dispute settlement system and the decisions delivered with it. Secondly, it eliminates the possibility of access the decision reasoning which could explain the way investment agreements perceived in practice. And lastly, lack of transparency violates the public's right for information that affect them directly or indirectly. Often investment treaty disputes arise from matters affecting public interest that are related but not limited to natural resources, environmental and health regulations or disputes with significant financial impacts on the state budget hence tightly affecting the taxpayers. Therefore, the subject matter of the

¹⁵ Article 2.4. Standard of treatment. EUSIPA

¹⁶ *Ibid*, Article 2.5. Treatment of investment.

dispute is of a great importance to the people of the host state. Hence the lack of transparency also entails violation of public's right for information.

Recent developments in international investment law is aiming to eliminate transparency issues. In multilateral level, UNCITRAL Rules on Transparency in Investor-State Arbitration came into effect in 2014. These rules apply to the cases that were initiated after 1 of April 2014, or it can cover cases that were initiated before the given date as well if the parties consent to that. Transparency Rules cover issues ranging from disclosure of the initiation of arbitral proceedings, to specifying the documents to be disclosed, to requiring open hearings and publication of awards. UNCITRAL made it clear that the rules do not exclusively apply to UNCITRAL arbitration, but other arbitral institutional and *ad hoc* tribunals can apply the rules. As for the Asian states, ACIA and other ASEAN FTAs include transparency provision.

Jurisdictional criticism was related to the use of umbrella clause in order to bring claims in investment treaty arbitration based on the contractual violations of the host state. International organizations such as UNCTAD was supportive of umbrella clause mentioning that the purpose of the umbrella clause is to protect the foreign investor in all possible circumstances. However, this kind of broad protection clauses were likely to put the host state in undesirable situation; therefore, intensifying discontent of host states towards the international investment regime.

Inconsistent decisions of the investment treaty arbitration are reasoned by the fact that every case is based on differing investment treaties and is conducted in ad hoc nature. Some scholars supported the idea of consistency in the decision, stating that it will only increase predictability and consequently the rule of law. Others disagreed, stating that giving the arbitrators potential legislative power will do more harm than good and potential solution for inconsistent decisions would be introduction of appellate mechanism. However, appellate mechanism would require integrated dispute settlement mechanism, which is problematic to achieve with thousands of bilateral investment treaties that differ in wordings. In light of such criticisms, host states came to realize that investor state dispute settlement is not favourable for them and their investment regime. Furthermore, inconsistent decisions of investment treaty arbitration are related to the excessive interpretational power of arbitrators, who are in position to interpret broadly defined principles of international investment law such as fair and equitable treatment. Moreover, there are no precedent system in international investment arbitration and cases are decided on the ad hoc basis with differing treaties and different arbitrators for each case. Thus consistency in treaty wording is nearly impossible to achieve. To resolve this concern, states started establishing joint interpretational committees or other institutions with sole purpose of interpreting the international investment treaty.

The next procedural concern is availability of the *appeal court mechanism*. In current ISDS system, there is no hierarchy like in national court systems. There is no possibility to check the errors of the arbitral tribunal and ensure coherence of interpretations in dispute resolution which results in distrust of the investment arbitration parties. Therefore, the clash is originated in existence of disputes with public and private law mixed characteristics and their settlement in arbitral tribunals that historically established as a traditional commercial arbitration. One of the serious concerns for ISDS was the fact that its decisions are inconsistent. And criticism hovered around the structure of the investment arbitration tribunals which do not have an appeal mechanism that can check their decisions' correctness. There are two perspectives regarding appellate mechanism: multilateral investment court with its own appellate body or adding appellate bodies to existing arbitral tribunals. However, it would trigger the issue of structure of such body including idea of tenured judges.

Developments of this criticism can be seen in individual country's investment treaties and legislations. India's new model BIT and US-Singapore FTA and IPA considers the inclusion of appeal mechanisms. Furthermore, CETA and EU-Vietnam FTA and IPA have established Investment Court System. Within existing dispute settlement bodies, World Trade Organization's Appellate Body hears only issues of law covered in first instance. Same mechanism is at work in Southern Common Market (Mercosur) where only matters of law is included in the scope of appellation. Decisions of ICSID cannot be appealed, however, it can be annulled on limited and procedural grounds included in Article 52 of the Convention.

The negativity in the sense of this dissertation entailed the attempts to reform the international investment regime by reforming the international investment agreements and opting to remove investor-state dispute settlement mechanism from the investment regulation. As number of investor-state dispute settlement proceedings started to rocket, the discontent of respondents, that are usually host states, grew bigger. Many host states came to realize that investor state dispute settlement is not favourable for them and their investment regime. Some were explaining it as the regime needed an update as most of their Bilateral Investment Treaties are several decades old. The countries which had the most investor-state disputes against them are responding strongly and unfavorably and consequently reforming their ISDS approaches in international investment agreements.

The concerns regarding the ISDS as a whole system rooted from the view that arbitral tribunals favor investors over host countries. The nature of most investment arbitration in a way or another touches upon the public interest of the host country, including public health,

environment, infrastructure, labor standards and depending on the decisions awarded the influence covers the economic and financial situation of the host state.¹⁷ Aforementioned issue also can be explained by the hybrid nature of the investment treaty arbitration.¹⁸ Firstly, most states require the foreign investor to have a company incorporated according to host state's law; therefore, claimants in the investment treaty arbitration are mostly corporate entities established under domestic law of the host state. Secondly, the tribunal in investment treaty arbitration refers to the domestic law of the host state in order to determine whether foreign investment in question falls under the terminology of such legislation. Lastly, investment protection standards are incorporated in international investment treaties; however, rendered award of investment arbitration is enforced through national courts of the host state.

In addition, host states came to believe that investment arbitration is biased towards the foreign investor. The author believes that host countries' belief of biased investment arbitration that favors investors is not entirely false. It is related to the bilateral investment treaties that govern the investment arbitration. Most of the BITs in the world was concluded in 1990s which evidently protected the capital exporting countries given the that periods' economic circumstances. As we remember, the main capital exporting countries were the developed north and southern states were usually capital importing host states.¹⁹ These host states were put in a position where they had to accept the bilateral investment treaties with strict provisions that grant greater freedom to investors over economic advantage.

However, circumstances have changed. The flow of foreign investment has shifted, north started investing in the north and south in the south. The line dividing the north and south has blurred. The distinction between north and south being only investors and host states respectively is no longer true. Previous capital exporting states have become host countries themselves. And therefore consequently have become respondents in the investment arbitration as investor-state dispute settlement procedure can be initiated only by the investor against the host state, not vice versa.

Thus the international investment agreements that were concluded in the past century does no longer serve its purpose. Such notion has awakened within the traditional host countries hence they have started initiating reform procedures of their existing BITs and started

¹⁷ Most of the ISDS cases concern state's regulation policy towards public interest that violates investor's treaty rights. For example, Australia's plain packaging law for tobacco, Germany's termination of nuclear power plants.

¹⁸ ZACHARY DOUGLAS, THE HYBRID FOUNDATIONS OF INVESTMENT TREATY ARBITRATION, 74 *The British Yearbook of International Law* 151, 152-155 (2003).

¹⁹ See Chapter 1. North, South dichotomy was developed by the trade relationship of the USA and Latin American states.

introducing new ones that serve their investment regime purpose as well. For instance, Indonesia terminated its first BIT with the Netherlands that was concluded in 1994. Termination of BITs and renegotiation of other international investment agreements are host countries fight for its regulatory power over public interest areas including health, human rights and so on. In other words, private institution, the investment arbitration, deciding on matter of host countries public interest is what triggered such bold strategy of termination of BITs and removal of ISDS system altogether.

The negative reaction was mostly observed in south east Asian host states. The clear example was Indonesia. Indonesia has terminated over 65 bilateral investment treaties that were signed in the past decades. Purpose was to renew the investor-state dispute settlement system within their investment regime. In practice, Indonesia's decision to terminate and renegotiate investment agreements were driven by the number of investment treaty arbitration proceedings that Indonesia has lost as a Respondent. The officials stated that such actions were necessary as current existing BITs were outdated and did not cohere with Indonesia's future visions on foreign investment. Generally negative reactions became more popular. For instance, denunciation of ICSID by Latin American states; Australia's exclusion of ISDS from its BITs and termination or renewal of existing BITs by Indonesia and India.

Since 2007, the year when Bolivia denounced the ICSID Convention, international investment law been confronted by 'resistance and change'.²⁰ Resistance and change means abolishing the status quo of the current investment treaty regime. Therefore, renegotiating existing bilateral investment treaties and introducing new model BITs may be interpreted as attempt of the host state to have more control over their treaty obligations.

Furthermore, international organizations initiated their negotiations regarding amendment and reform processes to balance the international investment regime that is losing its popularity little by little. Most organizations, including International Centre for Settlement of Investment Disputes, United Nations Commission on International Trade Law and the European Union are proposing procedural amendments to the proceedings of investment treaty arbitration. for example, introducing system of tenured judges and appellate body for arbitral tribunals. However, in author's opinion reforming the procedural aspects first would be a better idea in the aspect of timely manner. About appellate mechanism, it seems like it will be shaped as a court in Anglo-Saxon legal regimes as international investment field do not have constituted

²⁰ MUTHUCUMARASWAMY SORNARAJAH, RESISTANCE AND CHANGE IN THE INTERNATIONAL LAW ON FOREIGN INVESTMENT, Cambridge University Press (2015).

unified substantive legal instruments. It is rather based on various investment agreements and only partially unified procedural rules that differs from tribunal to tribunal. Therefore, starting the reform with easily unifiable procedural aspects is more plausible. With ongoing negotiations by UNCITRAL, ICSID and other tribunals, only future will show whether reforms will take place and what exactly would that be.

In 1960s Broches idea that founded ICSID then was inclined towards procedure before substance. In modern world, not much has changed and consent of all the parties to establish a multilateral investment court seems like a time consuming project that might not come to life. However, this does not insinuate that it is an impossible task. The author suggests that procedural development, reform and changes would be easier to reach and have a valid result in shorter period of time. The substantive reforms can come after procedural one. Right now it is important to address the procedural concerns that were criticized harshly by parties of investment treaty arbitration, including transparency and independence of the arbitrators. It is in the country's discretion to reform their investment agreement; however, investment arbitration issues must be dealt with international organizations that represent arbitration parties.



Registry number: DEENK/258/2021.PL
Subject: PhD Publication List

Candidate: Ninjin Bataa
Doctoral School: Géza Marton Doctoral School of Legal Studies
MTMT ID: 10061226

List of publications related to the dissertation

Articles, studies (6)

1. **Bataa, N.:** Mongolian Investment Regulation and Arbitration.
Acta Universitatis Sapientiae Legal Studies. [Accepted by publisher], 1-12, 2021. ISSN: 2285-6293.
2. **Bataa, N.:** ASEAN Foreign Investment Regime.
Mongolian Journal of Law. 80 (5), 40-50, 2020. ISSN: 2226-9185.
3. **Bataa, N.:** ICSID Amendment Proposal: What is changing?
Gemt Yavdaltai Temtsekh Asuudal. 74 (4), 112-116, 2020.
4. **Bataa, N.:** European Union Policy on Foreign Direct Investment.
Gemt Yavdaltai Temtsekh Asuudal. 70 (4), 65-75, 2019.
5. **Bataa, N.:** European Union public policy on Foreign Direct Investment.
Public Goods & Governance. 3 (1), 25-31, 2018. EISSN: 2498-6453.
DOI: <http://dx.doi.org/10.21868/PGnG.2018.1.4>.
6. **Bataa, N.:** Foreign Direct Investments and International Tribunals: Why the connection is important?
Public Goods & Governance. 2 (1), 5-10, 2017. EISSN: 2498-6453.
DOI: <http://dx.doi.org/10.21868/PGnG.2017.1.1>.

The Candidate's publication data submitted to the iDEa Tudóstér have been validated by DEENK on the basis of the Journal Citation Report (Impact Factor) database.

07 May, 2021

