

# Investor Due Diligence and Legitimate Expectations

*Shaun Matos*

Faculty of Laws, University College London, London, United Kingdom

*shaun.matos.18@ucl.ac.uk*

## Abstract

This article examines the significance of investor due diligence in the context of a claim that a host State has breached its obligation to provide fair and equitable treatment (FET). Despite increasing reliance on due diligence exercises, there are considerable differences in how tribunals understand and use such exercises. These differences are related to different visions of the function and future of international investment law. After exploring the different approaches that are taken, this article will argue that the most coherent approach is to treat investor due diligence as merely a technique for assessing investor reasonableness and prudence, rather than a strict requirement.

## Keywords

due diligence – fair and equitable treatment – investor-State dispute settlement – legitimate expectations

## 1 Introduction

As States have carried out fewer direct expropriations, the focus of both investor-State disputes and academic writing in the field has turned to the impact of State regulation on foreign investments. Alongside claims of indirect expropriations, claims of breaches of the fair and equitable treatment (FET) standard, a common provision in investment treaties, now dominate the field. An important element of the FET standard as traditionally formulated is the

obligation to protect an investor's legitimate expectations.<sup>1</sup> Investor 'prudence' and 'reasonableness' have long been a part of the formula for assessing a claim of a breach of legitimate expectations as tribunals are keen to ensure that investment law does not become an insurance policy for the unrealistic hopes and aspirations of investors.<sup>2</sup> The rising number of legitimate expectation claims means that finding an effective way to filter out expectations which are not worthy of legal protection, and hence limiting the scope of protection, is more important than ever.

One way that tribunals have been limiting the scope of protection offered by the legitimate expectations doctrine is by examining whether investors have carried out legal or regulatory due diligence before making their investment. The tribunal in *Saluka v Czech Republic* was one of the first to apply the due diligence requirement in 2006, but the requirement has grown in prominence in recent years.<sup>3</sup> It has had particular significance in disputes concerning the regulation of renewable energy as States have sought to encourage private investment in that area through the use of financial incentives. Despite this, it has received little academic attention,<sup>4</sup> and tribunals have spent little time exploring the function that the due diligence requirement performs.

This article will argue that the best way for tribunals to use investor due diligence is as a technique for assessing investor prudence, rather than as a

- 
- 1 Significantly, some recent formulations of the FET standard which contain a more detailed formulation of its elements omit any mention of legitimate expectations. However, such provisions are in a small minority. See for example the Canada-EU Comprehensive Economic and Trade Agreement (signed 5 August 2014) (CETA) art 8.10(2) and (4); United States-Mexico-Canada Agreement (revised version signed 10 December 2019, entered into force 1 July 2020) (USMCA) art 14.6(2); Eric De Brabandere, 'States' Reassertion of Control over International Investment Law: (Re)Defining "Fair and Equitable Treatment" and "Indirect Expropriation"' in Andreas Kulick (ed), *Reassertion of Control over the Investment Treaty Regime* (CUP 2016) 285.
  - 2 *Emilio Agustin Maffezini v Kingdom of Spain*, ICSID Case No ARB/97/7, Award (9 November 2000) para 64; *MTD Equity Sdn and MTD Chile SA v Republic of Chile*, ICSID Case No ARB/01/7, Annulment Proceeding (21 March 2007) para 67; *HydroEnergy 1 and Hrdroxana Sweden v Kingdom of Spain*, ICSID Case No ARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum (9 March 2020) para 584; Zachary Douglas, 'Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 *Arb Intl* 27, 28.
  - 3 *Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL, Partial Award (17 March 2006).
  - 4 For some existing discussion, see Jorge Viñuales, 'Investor Diligence in Investment Arbitration: Sources and Arguments' (2017) 32(3) *ICSID Review* 346; Teerawat Wongkaew, *Protection of Legitimate Expectations in Investment Treaty Arbitration: A Theory of Detrimental Reliance* (CUP 2019) 166–67; Yulia Levashova, 'Fair and Equitable Treatment and Investor's Due Diligence Under International Investment Law' (2020) 67 *NILR* 233.

strict requirement. The argument will proceed in three stages. Firstly, it will clarify what is meant by due diligence in a legitimate expectations inquiry by distinguishing the concept from the due diligence obligation owed by States and from the other ways in which the language of due diligence is used in relation to investors. Secondly, it will identify the two main approaches which have been taken to investor due diligence and reflect on how each approach reflects a different understanding of the role of due diligence and of international investment law. Finally, each approach will be evaluated in light of its coherence and practical utility.

## 2 Distinguishing Due Diligence in Legitimate Expectations

The language of due diligence has a specific meaning in the context of legitimate expectations. Before exploring the way in which due diligence is used, two preliminary points should be made. Firstly, a lack of investor due diligence may be a reason for a tribunal to find that a State has not breached the FET standard, but will not lead to liability on the part of the investor. Investors are not under a positive obligation to conduct due diligence but a failure to do so may defeat their claim. Secondly, and relatedly, it is rare for tribunals to consider the capacities and resources of the investor when assessing whether due diligence has been carried out.<sup>5</sup> Instead, tribunals tend to only look at whether due diligence has been carried out, and what that exercise shows.

The concept of due diligence plays a different role in other areas of international law. The traditional understanding of due diligence can be found in many areas of international law,<sup>6</sup> but has been most extensively considered in cases concerning the international environmental obligations of States. The clearest judicial articulation of the concept can be found in the judgment in the *Case*

5 An exception is *Antin Infrastructure Services Luxembourg Sarl and Antin Energia Termosolar BV v Kingdom of Spain*, ICSID Case No ARB/13/31, Award (15 June 2018) para 537 where the Tribunal states '[a]ccordingly, the Tribunal must consider when the investment was made, what the circumstances were at that time and the information that the investor had or should reasonably have had, had it acted with the requisite degree of diligence (considering its expertise)'. This will be considered further below.

6 For an overview, see First Report of the International Law Association Study Group on Due Diligence in International Law (7 March 2014) <[https://olympereaseauinternational.files.wordpress.com/2015/07/due\\_diligence\\_-\\_first\\_report\\_2014.pdf](https://olympereaseauinternational.files.wordpress.com/2015/07/due_diligence_-_first_report_2014.pdf)> accessed 23 September 2020; Robert P Barnidge, 'The Due Diligence Principle Under International Law' (2006) 8 International Community Law Review 81; Joanna Kulesza, *Due Diligence in International Law* (Brill Nijhoff 2016); Heike Krieger, Anne Peters and Leonhard Kreuzer (eds), *Due Diligence in the International Legal System* (OUP 2020).

*Concerning Pulp Mills on the River Uruguay*. According to the International Court of Justice (ICJ) in that case, '[a] State is [...] obliged to use all the means at its disposal in order to avoid activities which take place on its territory, or in any area under its jurisdiction, causing significant damage to the environment of another State'.<sup>7</sup> The obligation of due diligence was said to require 'not only the adoption of appropriate rules and measures, but also a certain level of vigilance in their enforcement and the exercise of administrative control'.<sup>8</sup> Elsewhere, due diligence has been described as requiring States to undertake 'all possible measures that could be reasonably expected' to prevent the relevant harm occurring,<sup>9</sup> and as 'an obligation to deploy adequate means, to exercise best possible efforts, to do the utmost' to achieve a particular result.<sup>10</sup>

A number of key features of this traditional understanding should be recognised. Firstly, it imposes a positive obligation on the State to take certain measures; a failure to take such measures may lead to international responsibility. Secondly, the focus of the inquiry is on the conduct of the State.<sup>11</sup> Although the 'knowledge' of a State may be relevant to the inquiry, such 'knowledge' is only relevant insofar as it reveals whether a State has taken sufficient steps to meet the due diligence obligation. Many international environmental obligations, for example, require States to carry out an environmental impact assessment (EIA) which may affect the State's 'knowledge' of certain issues or problems.<sup>12</sup> The focus, however, is whether a suitable EIA has been carried out, not the level of knowledge a State has. Thirdly, the obligation is often flexible and dependent on the capacities of the State concerned.<sup>13</sup> Richer countries

7 *Pulp Mills on the River Uruguay (Argentina v Uruguay)* (Judgment) [2010] ICJ Rep 14, para 101. See also *Corfu Channel Case (United Kingdom v Albania)* (Judgment) [1949] ICJ Rep 22; *Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Serbia and Montenegro)* (Judgment) [2007] ICJ Rep 43, para 430.

8 *Pulp Mills* (n 7) para 197.

9 *Asian Agricultural Products Ltd v Republic of Sri Lanka*, ICSID Case No ARB/87/3, Final Award (27 June 1990) para 85(c).

10 *Responsibilities and Obligations of States Sponsoring Persons and Entities with Respect to Activities in the Area*, Seabed Dispute Chamber of the International Tribunal of the Law of the Sea, Case No 17 (1 February 2011) para 110.

11 Draft Articles on the Prevention of Transboundary Harm with Commentaries, Report of the International Law Commission, 53rd Session (November 2001) UN Doc A/56/10, commentary to art 3, para 7.

12 *ibid* arts 3 and 7; *Certain Activities Carried Out by Nicaragua in the Border Area (Costa Rica v Nicaragua)* and *Construction of a Road in Costa Rica Along the San Juan River (Nicaragua v Costa Rica)* (Judgment) [2015] ICJ Rep 665, paras 104–05; *Pulp Mills* (n 7) paras 101 and 205.

13 For example, Draft Articles on the Prevention of Transboundary Harm (n 11) commentary to art 3, paras 7, 12 and 13; Rio Declaration on Environment and Development

will consequently be expected to take greater steps than poorer countries to reach a particular goal.

The concept is also found in non-binding instruments which provide standards of behaviour for private actors in relation to human rights and the environment.<sup>14</sup> Such instruments are increasingly being referenced in investment treaties, albeit couched in non-binding language.<sup>15</sup> Additionally, the language of diligence is sometimes used in connection with a jurisdictional condition that an investor does not breach the host State's domestic law,<sup>16</sup> or with reference to investor action which at least partially justifies the State's otherwise wrongful conduct.<sup>17</sup> More controversially, some tribunals have invoked due diligence obligations in the context of a counterclaim brought by the host State against the investor.<sup>18</sup>

### 3 The Different Approaches to Investor Due Diligence

Despite using the same language, tribunals have not adopted a consistent approach to the function and significance of investor due diligence in the context of a legitimate expectations inquiry. Nor have tribunals sought to justify divergent approaches on the basis of different treaty language. An obvious problem with this is that arbitral practice is inconsistent, and it is difficult for the disputing parties to anticipate whether a tribunal will find the existence of

---

(12 August 1992) UN Doc A/CONF.151/26, principle 11; *Pantechniki SA Contractors & Engineers v The Republic of Albania*, ICSID Case No ARB/07/21, Award (30 July 2009) para 77; Tim Stephens, *International Courts and Environmental Protection* (2009) 158. But see the *Seabed Advisory Opinion* (n 10) where the Chamber stated that although a due diligence obligation owed directly by the State should take into account the capacity of the State (ibid para 161), obligations owed by States in their capacity as sponsors of commercial entities should not differentiate between states (ibid paras 158–59).

14 UN Human Rights Council, 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' (21 March 2011) UN Doc A/HRC/17/31, Guiding Principles 15–21.

15 For example, Canada-Cote D'Ivoire BIT (2014) art 19(1); USMCA (n 1) art 14.7.

16 *Plama Consortium Limited v Bulgaria*, ICSID Case No ARB/03/24, Award (27 August 2008) 138–39; *Phoenix Action Ltd v The Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) para 101.

17 *Robert Azinian, Kenneth Davitian & Ellen Baca v United Mexican States*, ICSID Case No ARB(AF)/97/2, Award (1 November 1999) paras 103–05; *Alex Genin, Eastern Credit Ltd Inc and AS Baltoil v The Republic of Estonia*, ICSID Case No ARB/99/2, Award (25 June 2001) para 361.

18 *Perenco Ecuador Ltd v Republic of Ecuador and Empresa Estatal Petroleos del Ecuador*, ICSID Case No ARB/08/6, Interim Decision on the Environmental Counterclaim (11 August 2015) para 611. See more broadly Viñuales (n 4).

a legitimate expectation protected by the treaty. A broader issue, however, is that the various approaches reflect different understandings of the purpose of due diligence assessments, and of international investment law more generally.

Two main approaches to investor due diligence can be identified in arbitral practice. The first, or the 'broad' approach, is to deny that due diligence is a strict requirement and consider only whether the claimant's expectations would have been shared by a prudent or reasonable investor. For tribunals following this approach, due diligence should be 'taken into account' when determining what the expectations of the hypothetical reasonable investor would be, but is not determinative.<sup>19</sup> On this understanding, the assessment of investor due diligence is merely a technique a tribunal can utilise in the broader and more holistic exercise of determining reasonableness. A claimant which is able to show that a comprehensive due diligence exercise has been carried out is more likely to be able to persuade a tribunal following the broad approach that its expectation was objectively reasonable, but there is no guarantee of this. Moreover, the absence of due diligence may not be problematic if the investor can show that its expectations were reasonable for other reasons.<sup>20</sup> Cases in which due diligence is utilised in this way are therefore a continuation of earlier cases concerning legitimate expectations in which investor due diligence is not mentioned at all.<sup>21</sup>

Notably, investor due diligence may be given little or no weight where a tribunal following the broad approach is able to make an assessment of reasonableness on other grounds. An example of a case in which such an approach was taken is the decision in *PV Investors v Spain*. That case was one of many dealing with changes to the remuneration for photovoltaic energy through feed-in tariffs (FiTs). The Tribunal began its analysis of the legitimate expectations claim by examining legislation and relevant case law of the host State, finding that it was not objectively reasonable for an investor to have formed an expectation that there would be no regulatory changes affecting their

19 *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case ARB/05/22, Award (24 July 2008) para 601; *Georg Gavrilovic and Gavrilovic DOO v Republic of Croatia*, ICSID Case No ARB/12/39, Award (26 July 2018) paras 986, 987–1018.

20 *Isolux Netherlands BV v Kingdom of Spain*, SCC Case V213/153, Final Award (17 July 2016) para 781; *Wirtgen v The Czech Republic*, PCA Case No 2014-03, Dissenting Opinion of Mr Gary Born (11 October 2017) paras 98–99; *Antaris Solar GmbH and Dr Michael Gode v Czech Republic*, PCA Case No 2014-01, Award, Dissenting Opinion of Mr Gary Born (2 May 2018) paras 73–77; *Antin* (n 5) para 537; *SolEs Badajoz GmbH v Kingdom of Spain*, ICSID Case No ARB/15/38, Award (31 July 2019) para 331.

21 For examples, see *Generation Ukraine v Ukraine*, ICSID Case No ARB/00/9, Award (16 September 2003); *LG&E v Argentine Republic*, ICSID Case No ARB/02/1, Decision on Liability (3 October 2006); *Toto Construzioni Generali SpA v Republic of Lebanon*, ICSID Case No ARB/07/12, Award (7 June 2012).

investment. Only then did the Tribunal turn to the issue of due diligence, finding that the issue was besides the point given its earlier conclusion:

For the Tribunal, this debate [on due diligence assessments] lacks relevance for present purposes. Indeed, whether the Claimants engaged in diligence or not and whether that diligence was 'due' or not, cannot alter the fact that on the basis of the law and the jurisprudence the Claimants knew or should have known that changes to the regulatory framework could happen. As a consequence, expectations that they would not happen cannot be deemed legitimate.<sup>22</sup>

Similarly, the Tribunal in *Belenergia v Italy* held that the relevant question was whether the Claimant's expectations were reasonable in light of the information which the prudent investor would have known at the time the investment was made.<sup>23</sup> The Tribunal expressly denied the existence of a strict requirement to carry out due diligence.<sup>24</sup> In *Cube Infrastructure v Spain* the Tribunal held that if two investors were closely related and the investment could be regarded as a joint venture, it was not necessary for both to have conducted their own due diligence. The Claimant's understanding, rather than how that understanding came about, was said to be the key factor.<sup>25</sup>

This approach has a number of notable aspects. Firstly, in taking as axiomatic the proposition that FET clauses do not prevent States from making regulatory changes once an investor has invested in its territory, tribunals adopting this approach favour the public law rather than private law paradigm.<sup>26</sup> That there is some evaluation of whether the claimant's expectation is 'legitimate' provides a clear point of distinction with what Anthea Roberts calls the contractual or 'estoppel-like' approach in *Tecmed v Mexico*.<sup>27</sup> In *Tecmed*, the Tribunal (in)famously said that host States must treat investors in such a way 'that does not affect the basic expectations that were taken into account by the

22 *The PV Investors v Kingdom of Spain*, PCA Case No 2012-14, Final Award (28 February 2020) para 613.

23 *Belenergia SA v Italian Republic*, ICSID Case No ARB/15/40, Award (6 August 2019) para 584.

24 *ibid.*

25 *Cube Infrastructure Fund and others v Kingdom of Spain*, ICSID Case No ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019) paras 388–406.

26 Anthea Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System' (2013) 107 AJIL 45. See also Alex Mills, 'Antimonies of Public and Private at the Foundations of International Investment Law and Arbitration' (2011) 14 J Intl Econ L 469.

27 Roberts (n 26) 66.

foreign investor to make the investment', and did not appear to pay any attention to whether the Claimant's expectations were reasonable.<sup>28</sup>

The second notable feature of this approach is that it has both subjective and objective elements. It is subjective in the sense that the starting point of analysis is the claimant's expectations. Importantly, however, the evaluation of whether these expectations were reasonable or those of a prudent investor is carried out according to an objective standard. The claimant's expectation is considered in light of both what it knew and what it ought to have known when it made the investment. Due diligence might have evidential value here as it can help to justify an expectation, but it is neither necessary nor sufficient for a successful legitimate expectations claim. A tribunal faced with a claimant which has carried out some degree of due diligence may still reject a claim if it finds that the prudent investor would have had a different expectation based on factors which the claimant should have taken into account but did not. Conversely, ignorance of a particular fact or failure to carry out a due diligence assessment at all will not defeat a claim unless knowledge of a fact the claimant ought to have known about would have changed the expectations of a prudent investor.

Finally, the fact that this approach has both subjective and objective elements means that it can be labelled a 'traditional' public law analysis. Under such analyses, the purpose of the legitimate expectations doctrine, and the law more generally, is to regulate State and not investor behaviour. The relationship between the host State and the investor is understood as a vertical one in which the State is seen as all-powerful and the investor as vulnerable and in need of a certain level of protection. The State alone is treated as responsible for the investment environment in its territory.<sup>29</sup> The concept of reasonableness is therefore used to provide a balance between the public interest and the investor's interests.

Under a second approach, tribunals have taken the position that there is a strict rule requiring claimants bringing a legitimate expectations claim to that

28 *Tecnicas Medioambientales Tecmed SA v The United Mexican States/Mexico*, ICSID Case No ARB(AF)/00/2, Award (29 May 2003) para 154. See criticism in *MTD v Chile* (n 2) para 67 and Douglas (n 2) 28.

29 Rudolf Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 *NYU J Intl L & Pol* 953; Gus Van Harten and Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *EJIL* 121; Stephan W Schill, 'International Investment Law and Comparative Public Law – An Introduction' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 3; Stephan W Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 151.



they have undertaken a due diligence exercise. This could be termed ‘the strict approach’. A number of tribunals have stated that in the absence of such an assessment, an FET claim based on the breach of legitimate expectations is bound to fail. In *Stadtwerke München v Spain*, for example, the Tribunal stated:

In the absence of a specific commitment contractually assumed by a State to freeze its legislation in favor of an investor, when an investor argues – as is the case here – that such expectation is rooted, among others, in the host State’s legislation, the Tribunal is required to conduct an objective examination of the legislation and the facts surrounding the making of the investment to assess whether a prudent and experienced investor could have reasonably formed a legitimate and justifiable expectation of the immutability of such legislation. For such an expectation to be reasonable, it must also arise from a rigorous due diligence process carried out by the investor.<sup>30</sup>

Similarly, in *OperaFund v Spain* the Tribunal stated that ‘the absence of “real due diligence” on the part of the investors would vitiate a legitimate expectation claim.’<sup>31</sup> The tribunals adopting such an approach do not consider whether the claimant’s expectations may be reasonable for other reasons.

This had particularly significant consequences in *Antaris and Gode v Czech Republic*. The dispute concerned the Czech regulatory framework for renewable solar energy. The Claimants argued that changes to the regulatory framework which affected the FiTs to which their investment was entitled amounted to a violation of their legitimate expectations. Yet the Claimants could not point to any due diligence exercise carried out by them or on their behalf to support their expectation. This was fatal to the claim. According to the Tribunal, the failure to conduct a due diligence assessment meant that the Claimants were

<sup>30</sup> *Stadtwerke München GMBH and others v Kingdom of Spain*, ICSID Case No ARB/15/1, Award (2 December 2019) para 264.

<sup>31</sup> *OperaFund Eco-Invest SICAV PLC and Schwarb Holding AG v Spain*, ICSID Case No ARB/15/36, Award (6 September 2019) para 486. See also *Parkerings-Compagniet AS v Lithuania*, ICSID Case No ARB/05/8, Award (11 September 2007) para 333; *Charanne BV and Construction Investments SARL v Kingdom of Spain*, SCC Case No 062/2012, Final Award (21 January 2016) para 505; *Foresight and others v Kingdom of Spain*, SCC Case No 2015/150, Final Award (14 November 2018) paras 379–80; *HydroEnergy* (n 2) para 600; *Sun Reserve Luxco Holdings SRL v The Italian Republic*, SCC Arbitration V (2016/32), Final Award (25 March 2020) para 714; *Naturgy Energy Group SA and Naturgy Electricidad Colombia SL v Republic of Colombia*, ICSID Case No UNCT/18/1, Award (12 March 2021) paras 278–330; *Eurus Energy Holdings Corp v Kingdom of Spain*, ICSID Case No ARB/16/4, Decision on Jurisdiction and Liability (17 March 2021) para 423.

'opportunistic' investors who should not receive the protection of the investment treaty.<sup>32</sup>

As in the broad approach, the claimant's expectations are evaluated, signalling a rejection of the private law paradigm favoured in *Tecmed*. Where the two approaches differ is in the factors which they take into account when evaluating the reasonableness or prudence of the claimant. In imposing a strict requirement that due diligence is carried out, tribunals following this approach introduce a subjective element into the reasonableness inquiry. The function of this element appears to be to determine whether the claimant took the risk of regulatory change occurring.<sup>33</sup> This is distinct from the question of whether there was, objectively, a risk of regulatory change; completing a due diligence exercise does not alter whether such a risk existed. It is instead a subjective inquiry into the state of mind of the investor, which looks to whether the investor deliberately sought to assess and minimise the risk.

In some cases, it can be difficult to determine whether the tribunal is following the broad or strict approach due to the close scrutiny of due diligence. In *Stadtwerke München*, for example, the Claimants presented due diligence which analysed the regulatory framework in the host State at the time of the investment. The Tribunal, however, took the view that the Claimants' due diligence was insufficiently detailed as it did not take into account numerous decisions of the Spanish Supreme Court.<sup>34</sup> More recently, the Tribunal in *Eurus Energy Holding v Spain* was faced with a due diligence exercise which presented some analysis of the host State's domestic law but did not make any mention of EU State aid law. As there were aspects of State aid law which affected the regulatory environment of the host State, the Tribunal took the position that the Claimant's due diligence was insufficient and rejected the legitimate expectation claim.<sup>35</sup> This interrogation of the substance of investor due diligence shows that objective factors did play a role in the Tribunals' assessment of reasonableness, but only once the framework of risk-taking reasoning had been adopted. In other words, the Tribunal is assessing the whether the claimant has gone far enough in assessing and minimising the risks, not whether its expectation is reasonable in light of objective factors. Moreover, the sole focus of the Tribunal is on due diligence, and no attention is paid to other factors which might be relevant to an assessment of objective reasonableness.

32 *Antaris and Gode* (n 23) paras 397–440.

33 *Wongkaew* (n 4) 166–67.

34 *Stadtwerke München* (n 33) paras 281–82.

35 *Eurus Energy* (n 34) paras 424–28. See also *Charanne* (n 34) para 507; *OperaFund* (n 31) Dissenting Opinion of Professor Philippe Sands, paras 20–31; *HydroEnergy* (n 2) paras 611–30.

The notion that investment law should not protect claimants from risks they unnecessarily assumed is related to a view of investment law which is distinct from the ‘traditional’ public law approach. In this ‘differentiated’ public law paradigm investment law constrains State action for instrumental reasons, namely encouraging investments and creating a favourable investment environment, rather than as an end in itself.<sup>36</sup> Further, although States are recognised as retaining sole regulatory authority, investors are perceived to be powerful and influential actors in their own right with the ability to impact other policy concerns. This has led some to argue that viewing the relationship between investors and host States as a vertical one is unrealistic, and investment law should therefore be concerned with the conduct of investors as well as that of States.<sup>37</sup> Although the obligations contained in investment treaties remain those of States alone, investor actions which are considered antithetical to these objectives may result in the rejection of claims which are otherwise sound. The increasing reliance on due diligence suggests that risk-taking is an example of behaviour which is considered undesirable or counterproductive.<sup>38</sup> As will be discussed below, this is problematic for a number of reasons.

## 4 Assessing the Approaches

In light of both the practical and conceptual uncertainty caused by the existence of these different approaches, this section will determine which is preferable. It will argue that although the strict approach benefits from simplicity in some cases, it has a number of theoretical flaws. For this reason, the broad approach is preferable.

### 4.1 *The Strict Approach*

As noted above, the two approaches reflect different views on the purpose of the legitimate expectations inquiry and international investment law more generally. Although the ‘traditional’ public law paradigm associated with the broad approach has some relevance due to the regulatory authority retained

36 Jeswald Salacuse, ‘The Emerging Global Regime for Investment’ (2010) 51 *Harv Intl LJ* 427; Wongkaew (n 4) 24–29.

37 Peter Muchlinski, ‘“Caveat Investor”? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard’ (2006) 55 *ICLQ* 527; Muthucumaraswamy Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (CUP 2015) 278–80; Wongkaew (n 4) 162–70; Jean Ho and Mavluda Sattorova (eds), *Investors’ International Law* (Hart 2021).

38 Wongkaew (n 4) 166–67.

by host States, it is unable to reflect the political and economic reality in many investment cases. The 'differentiated' public law paradigm associated with the strict approach seems to have greater normative force as it recognises the de facto power and influence which many investors have. Despite the instinctive feeling that there is a certain justice in following the strict approach, the relationship between investor risk and the more balanced 'differentiated' public law paradigm is problematic for a number of reasons.

Firstly, risk-taking is an inherently vague and ambiguous concept which can be defined in a number of ways. There is no common scale which exists to measure risk-taking, and no threshold at which risk-taking becomes unacceptable. Tribunals which have adopted the strict approach to due diligence have been prepared to accept that the existence of some investor due diligence is enough to show that the investor has not consciously taken a risk, but there is no reason why tribunals could not impose either stricter or looser requirements. A certain level of regulatory risk will always exist, no matter how much preparatory work an investor does. Tribunals could require multiple due diligence reports at different points in the investment process, or evidence that the claimant sought to obtain a specific guarantee from the host State. Alternatively, tribunals could adopt a more flexible view and consider other evidence that might show that the claimant did not consider that they were taking a risk, or only require due diligence when the host State is politically unstable. These potential requirements all presuppose a different level of acceptable risk-taking, and none is more or less legitimate than the others. In light of this, the implementation of the strict approach appears arbitrary.

Secondly, the strict approach does not rest on a concern about investment law being used as an insurance system. The language of risk-taking may appear to provide a connection to concerns around insurance, but on closer inspection this link is shown to be superficial. The strict approach only looks to the investor's own perception of whether they are taking a risk, not whether they are actually taking a risk. It asks only whether the investors view themselves as using investment law as an insurance system at the time that they make their investment. It attaches normative significance to the subjective beliefs of an investor at the time of investment, rather than to an objective assessment of whether the effect of the claim is to treat investment law as insurance for a risky venture. Under the strict approach investors who are considered to have subjectively taken a risk are denied the protection of the investment treaty, even if their venture was objectively low-risk. Yet investors who are not considered to be risk-takers because of the existence of a due diligence exercise are able to enjoy the protection of the investment treaty, even if the project is objectively high-risk. In many cases, this is the outcome even where the

investor's due diligence was limited or defective. In *OperaFund*, for example, the investor may have believed that it was not taking the risk of regulatory change when it made its investment as it had undertaken some due diligence. Nevertheless, the effect of the award was to make the host State a guarantor for the investment, even though the investor arguably could have foreseen the risk of regulatory changes if the exercise had been more comprehensive.<sup>39</sup>

This leads to the third problem, which is that risk-taking reasoning is inherently circular. The conclusion that an investor does not have a legitimate expectation itself drives the argument that it has taken a risk. The investor is only a risk-taker because the tribunal has made it so by applying the legitimate expectations doctrine so as not to guarantee all of its hopes and beliefs. The Claimants in *Antaris and Gode* were only treated as risk-takers because the Tribunal determined that expectations which were not supported by a formal due diligence report were not legitimate expectations and were hence not protected by the treaty. Conversely, an investor which is not treated as a risk-taker is only treated in this way because the Tribunal took the view that the investment treaty did protect an investor who had acted in that way. There is nothing in the due diligence exercises carried out by the Claimants in *Foresight* or *OperaFund* (see further below) which means that they were not risk-takers but the Claimant in *Eurus Energy* was. If the strict approach understood risk-taking differently, the results in these cases could have been decided differently.

In light of this, it is best to recognise that the 'differentiated' public law paradigm has limited relevance in the discussion of due diligence assessments. Instead, due diligence assessments should be understood to be part of the 'traditional' public law paradigm which takes an objective approach to the question of reasonableness. The utility of due diligence assessments should be understood as being the evidence they can provide of what the claimant actually knew, what the claimant ought to have known and whether the claimant's expectations were objectively reasonable.

The strict approach does have the benefit of providing a certainty in particular cases, but a degree of ambiguity persists. Imposing a requirement that claimants carry out a due diligence requirement provides a simple and bright line rule which excludes a number of potential claims. This may encourage the settlement of disputes, or reduce the number of claims brought in the first place. The picture is murkier, however, in cases where the claimant has carried out some due diligence. As noted above, in some cases tribunals have subjected due diligence exercises to very close scrutiny and have rejected legitimate

---

39 See particularly the Dissenting Opinion of Professor Philippe Sands (n 35).

expectation claims where they were considered insufficiently detailed. Yet, in other cases, tribunals have paid little attention to the content of due diligence assessments at all. In *Foresight v Spain*, another case concerning FiTs, the Tribunal acknowledged that the due diligence assessment upon which the Claimant sought to rely was 'rather vague'.<sup>40</sup> Nevertheless, the Tribunal found in favour of the Claimant on this point on the basis that the Claimant was entitled 'to assume that its legal advisors would have raised a red flag had they detected any risk of fundamental change to the regulatory regime'.<sup>41</sup> Similarly, the majority in *OperaFund* found that a due diligence exercise which analysed only the specific regulations the Claimant sought to rely upon and not the broader regulatory framework was not problematic.<sup>42</sup> This conclusion was in large part due to the view that the Claimant was entitled to simply rely on the advice of its external lawyers. In light of this, investors preparing to implement their investment will find it difficult to know where the protection of the investment treaty begins and ends.

#### 4.2 *The Broad Approach*

As it does not pay any attention to whether the investor is a risk-taker, the broad approach does not suffer from the same theoretical problems as the strict approach. Under the 'traditional' public law paradigm, the broad approach to limiting the scope of the legitimate expectations doctrine can be justified on the basis that holding States liable each time an investor's expectation is disappointed risks freezing the domestic regulatory environment and unjustifiably elevating the investor's interests above the public interest. Treating investor due diligence as a technique rather than requirement allows tribunals to use the reasonableness requirement to strike a balance between giving investors a degree of certainty and preserving the State's regulatory autonomy.

Some who favour the strict approach may object that the 'traditional' public law paradigm associated with the broad approach does not adequately capture the dynamic between investors and host States. This may be true, but it does not explain why it should affect the basic structure of the legitimate expectations inquiry. That modern investors are often powerful and sophisticated economic actors may mean that tribunals can expect them to have a detailed understanding of the host State's regulatory framework. It does not, however, change the fact that host States retain sole regulatory authority. In any event,

<sup>40</sup> *Foresight and Others v Spain* (n 31) paras 379–80.

<sup>41</sup> *ibid.*

<sup>42</sup> *OperaFund* (n 31) para 487. Contrast the dissenting view of Professor Philippe Sands (n 35).

the broad approach does help achieve some of the goals embodied in the 'traditional' public law paradigm as holding host States to their representations is important in establishing a stable and predictable investment environment.

This does not mean that the broad approach is perfect. There are a number of practical issues which tribunals should resolve if the broad approach is to be an effective way of distinguishing between different investor expectations in the future. For instance, it is unclear whether the reputation and situation of the host State are relevant to the inquiry. The political stability of States, pre-existing international obligations and the tendency to comply with basic principles such as the rule of law are all factors which tribunals could expect a claimant to take into account. Yet there is little evidence of tribunals exploring the relevance of these issues. Even where tribunals have made reference to such factors they have done so in a manner which lacks clarity. Analysis is limited to broad statements with no explanation of how or why particular facts affect the whether the claimant's expectations are protected by the treaty. The analysis of the Tribunal in *Toto v Lebanon* is a good example of this. In response to the Claimant's argument that it had a legitimate expectation of stability with regard to customs duties the Tribunal stated that 'the post-civil war situation in Lebanon, with substantial economic challenges and colossal reconstruction efforts, did not justify legal expectations that custom duties would remain unchanged'.<sup>43</sup> At first glance this seems a reasonable statement, but a number of issues are left unanswered. The Tribunal does not explain whether the investor actually knew about the situation in Lebanon or whether it ought to have known about the situation. If the latter, it is unclear how much the investor ought to have known. Further, there is no attempt to explain why the situation in Lebanon meant that the Claimant's particular expectation regarding customs duties was unreasonable. The absence of a common approach on this point arguably results in investors being held to different standards when making investments in extremely similar circumstances.

Further, tribunals following the broad approach need to construct a hypothetical investor against which claimants are judged. One option is to imbue the hypothetical investor with the resources and limitations of the claimant. Individual claimants will have different levels of available funds at the time of investing, and some will have had more foreign investment experience than others. Some particularly sophisticated claimants may have experience of multiple projects in the host State, whilst others will only have experience of operating in States with radically different commercial and political environments. Imbuing the hypothetical prudent investor with these characteristics

---

43 *Toto* (n 21) para 245. See also *Generation Ukraine* (n 21) para 20.37; *LG&E* (n 21) para 130.

could affect both the information the claimant ought to have been aware of and the expectations it could reasonably have formed. Alternatively, the hypothetical investor could be treated as identical or stationary in each case, even where there are considerable differences between actual claimants. Currently, however, it is not clear which of these possibilities tribunals following the broad approach have adopted. The majority of tribunals do not make reference to the characteristics of the individual claimant, but nor do they explicitly disagree with awards such as the one issued by the Tribunal in *Antin v Spain* which suggested that the ‘expertise’ of the claimant was relevant.<sup>44</sup> Moreover, there is no attempt to describe the features of a stationary hypothetical investor which could be used to help determine of which facts the claimant should have been aware. The risk of the current approach is that arbitrators simply hold up a mirror to themselves, and expect claimants to match their own personal standards rather than those of a hypothetical investor.

## 5 Conclusion

Evaluating investor due diligence exercises can be a useful way for investment tribunals to assess the appropriate balance between investor protection and the regulatory autonomy of States. Yet they can only fulfil this function if tribunals reflect on their value and limitations. The case law explored above shows that there is currently a clear conflict in relation to the value and purpose of investor due diligence. Although each approach has certain strengths and weaknesses, the most coherent approach is to treat investor due diligence as merely a technique for assessing investor prudence, and to closely scrutinise the content of such exercises. A tribunal which treats investor due diligence as an absolute requirement or fails to properly scrutinise its contents risks ignoring the underlying policy concerns, at best, or engaging in circular reasoning, at worst. However even tribunals which follow the recommended approach have further issues to address if the assessment of reasonableness or prudence is to be more than an unconstrained exercise of a tribunal’s discretion.

44 *Antin* (n 5) para 537. See also *Metalpar v Argentine Republic*, ICSID Case No ARB/03/5, Award (6 June 2008) paras 187–88.



### **Biographical Note**

PhD Candidate; LLM (UCL); BA (Cantab).

### **Acknowledgements**

With thanks to Alex Mills, Martins Paporinskas, Antony Crockett, Julia Weston, Paul Fradley, and the journal's editors and reviewers for their comments on earlier drafts. All errors remain the author's own.