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Research on the Legitimate Expectation Principle in International Investment Arbitration

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Abstract: The legitimate expectation principle, as an important legal principle developed in the practice of international investment arbitration, originated from the concept of reliance protection in domestic administrative law of countries like the UK and the US. Currently, in investment arbitration, more and more arbitration tribunals regard the legitimate expectation principle as one of the significant considerations for interpreting the fair and equitable treatment clauses. However, due to the ambiguity of the principle itself, there is still no unified interpretation and regulation on the application requirements of this principle in the academic circle and practice. Therefore, this paper studies the legal basis of the legitimate expectation principle in domestic and international law, discusses the advantages of its application, compares various academic viewpoints, and finally proposes three core application requirements of this principle. The intention is to establish a standardized criterion for the determination of reasonable expectation, narrow the differences in the application of the principle by arbitration tribunals, achieve the legal unity and practical coordination of it, thereby limiting the arbitration tribunal's discretionary power, balancing the interests between investors and host countries, and promoting the good development of international investment rule of law.

Keywords: The legitimate expectation principle, International investment law, Investment arbitration, Fair and equitable treatment

1. Introduction

To safeguard the legitimate interests of foreign investors and attract them to engage in international investment activities, when signing international investment treaties, various countries generally draft provisions stipulating fair and impartial treatment for foreign investors and their investments. When disputes arise between investors and host countries, investors often initiate arbitration lawsuits against the host country on the grounds that the latter has violated the fair and impartial treatment provisions. According to the statistics of the United Nations Conference on Trade and Development (UNCTAD), as of December 31, 2022, there were a total of 1,257 "investor-nation" dispute settlement cases based on treaties, approximately 52% of which involved fair and impartial treatment provisions. Among the 890 cases that have been concluded, a total of 652 cases involved fair and impartial treatment provisions, and 179 cases were ruled by the arbitration tribunal as violating such provisions [1]. This shows that the role of fair and impartial treatment provisions in international investment activities is of great significance. However, the fair and impartial treatment provisions themselves have great abstraction and broadness, and there are also significant

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differences in the concepts and application scopes of the academic community. There is no unified recognition standard. Therefore, many arbitration tribunals gradually take the legitimate expectation principle (legitimate expectation principle), that is, the basic expectations of investors, as relevant considerations in the judgment process.

However, the legitimate expectation principle also has ambiguity in legal practice. This principle not only has different constituent elements in individual cases, but also has different attitudes towards it in investment treaties of various countries. For example, in the Comprehensive Economic and Trade Agreement signed between the European Union and Canada, it is clearly stipulated that when applying the obligation of fair and impartial treatment, the arbitration tribunal can consider the element of "reasonable expectation", that is, whether the contracting parties have made specific expressions to induce investors to make investments, so that investors have reasonable expectations and make decisions to invest or maintain investment based on such expectations, but the contracting parties later made such expectations fall through [2]. Moreover, in recent agreements signed by the United States, it directly denied the illegality inconsistent with the investors' expectations. The different provisions and understandings of the legitimate expectation principle by various countries will lead to distinct arbitration results applying the reasonable principle when investors have disputes with different countries.

However, currently, the legitimate expectation principle has not only been widely applied by arbitration tribunals to interpret fair and impartial treatment provisions, but even expanded to interpret indirect expropriation provisions, umbrella provisions, and the definition of investment, etc. [3]. Therefore, the application of the legitimate expectation principle in international investment law has been widely applied. Thus, clarifying the connotation and application conditions of the legitimate expectation principle has great theoretical significance for the determination of relevant provisions in international investment treaties.

At the same time, as an explanatory consideration factor for the fair and impartial treatment principle, the legitimate expectation principle is of great significance for arbitration tribunals to correctly apply the fair and impartial treatment principle. Whether the fair and impartial treatment principle can be correctly applied, achieving a balance between the management rights of the host country, domestic public interests, and the interests of multinational companies, is an important guarantee for the development of international investment activities. Therefore, the current problem of ambiguity of the legitimate expectation principle needs to be solved more urgently.

This paper will use the case analysis method and literature research method to analyze typical international investment arbitration cases related to the legitimate expectation principle in recent years, summarize the connotation, source, and current application status of the legitimate expectation principle, and study its legality and rationality, providing new ideas for how to improve and unify the application conditions of the principle in practice.

2. The Legitimacy and Rationality of the Legitimate Expectation Principle

2.1. The Legitimacy of the Legitimate Expectation Principle

2.1.1. The Domestic Legal Theoretical Basis of the Legitimate Expectation Principle

The legitimate expectation principle can be traced back to domestic administrative law in the UK, which is used to constrain the stability of government commitments and prevent administrative entities from abusing their administrative powers. The term "reasonable expectation" was first proposed by Lord Denning in the case of Schmidt v Secretary of State for Home Affairs (1968). He believed that in appropriate circumstances, administrative entities have an obligation to give those affected by their decisions the opportunity to present their opinions. This entirely depends on whether

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the affected person has some kind of right or interest, or some reasonable expectation. It is unfair to deprive this person of his rights or interests without listening to his opinions. Besides procedural reasonable expectations, the UK courts also recognize substantive reasonable expectations, that is, substantial reasonable expectations arise when the administrative entity makes a legitimate statement indicating that the relative party will obtain or continue to obtain some substantive benefit.

The United States also developed a similar principle through insurance law precedents. The legitimate expectation principle first appeared in the case of Garnet in 1947. In this case, the insurance agent stipulated in the "conditional premium receipt" issued to the insured that the insurance contract would only take effect after the insured passed the physical examination and was approved by the insurer and the endorsement. However, the insured died after the physical examination without undergoing the approval and endorsement. The insurer argued that the meaning of the conditional premium receipt was clear, and since the completion of the approval procedure was not carried out, the insurance contract did not take effect. The plaintiff argued that the premium receipt, in this provisional insurance policy form, made the insured believe that they had been provided with insurance coverage. Ultimately, the judge made a favorable judgment for the insured. At that time, many insurance law scholars in the United States believed that the judgment in this case was based on the principle of doubt interpretation - the corresponding clause in the premium receipt was in doubt. But Judge Robert Keeton believed that in this case, the terms in the conditional premium receipt were clear and unambiguous. In essence, the court applied a brand-new legal concept - the legitimate expectation principle to guide the judgment of this case. In subsequent insurance law precedents in the United States, courts also applied this principle and provided more detailed explanations, (1) in insurance transactions, the insurer cannot obtain any unreasonable benefits. (2) the reasonable expectations of the insured and the beneficiary should be protected by law, even if this expectation does not conform to the explicit provisions of the insurance terms [4].

Therefore, although the legitimate expectation principle is not an inherent principle in international law, it has shown a relatively mature and comprehensive trend in the development of domestic laws in various countries, laying a solid foundation for subsequent international arbitration tribunals to draw on and cite it.

2.1.2. The International Legal Theoretical Basis of the Legitimate Expectation Principle

Although the legitimate expectation principle originated from international arbitration practice, it has been mentioned in many regional and bilateral agreements around the world to varying degrees. This has provided a relatively sufficient legal basis for the application of this principle in international dispute arbitration.

Initially, the legitimate expectation principle was mainly realized through the implicit infiltration of the fair and equitable treatment clauses in international investment agreements. For instance, in the major regional agreements such as the Regional Comprehensive Economic Partnership Agreement (RCEP), the Transatlantic Trade and Investment Partnership Agreement (TTIP), the United States-Mexico-Canada Agreement(USMCA),and the Trans-Pacific Partnership Agreement (TPP), the existence of actions that harm the legitimate expectations of investors was regarded as a consideration factor for judging whether the contracting parties violated the fair and equitable treatment clauses in their provisions of the fair and equitable treatment clauses [5]. When the arbitration tribunal interprets this clause, protecting the reasonable expectations of investors is regarded as one of the core obligations of the contracting parties. Some treaties also indirectly embody the legitimate expectation principle in the provisions on indirect expropriation. For example, Article 13 of the Energy Charter Treaty (ECT) requires that the policy adjustments of the host country must not substantially deprive the investment value.

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With the gradual development of the theory and practice of the legitimate expectation principle, many international treaties around the world have begun to explicitly stipulate this principle. Recently, signed agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the United States-Mexico-Canada Agreement (USMCA) have directly cited the legitimate expectation principle, but at the same time, strictly limited its scope of application. For instance, Article 9.6 of the CPTPP requires that the specific commitments or legal framework of the host country constitutes the basis for reasonable expectation, which can exclude the subjective presumption of investors regarding policy stability. The Annex 14-B of the USMCA clearly associates reasonable expectation with explicit and verifiable commitments of the host country. Thus, with the clarification of the content of the provisions, more and more international treaties can become important international law legal bases for the arbitration tribunal to apply the legitimate expectation principle in the future.

2.2. The Rationality of the Legitimate Expectation Principle

First of all, the legitimate expectation principle strengthens the protection of investors and provides a concrete basis for the arbitration tribunal to interpret the fair and just treatment clauses in BITs. By assessing whether the policy changes of the host country violate the reasonable expectations of investors based on laws, contracts, or government commitments, this principle transforms abstract treaty obligations into quantifiable legal standards. For instance, in the Tecmed case, the Mexican revocation of the administrative license was determined to violate the reasonable expectations of investors [6]. Besides, this principle also gives substantive connotations to ambiguous treaty provisions through case practice, providing relief paths for investors and filling the gaps in relevant regulations.

Secondly, the legitimate expectation principle can flexibly balance public interests and private rights. It allows the arbitration tribunal to assess the legitimacy of the host country's policy adjustments based on specific circumstances. For example, in the Saluka v. Czech case, the arbitration tribunal recognized the necessity of the host country's adjustment of bank supervision policies in response to the financial crisis, but also required it to provide transitional compensation to affected investors, reflecting the dynamic balance of public and private interests [7]. Moreover, this principle can also protect the host country's regulatory power from being overly restricted. In recent arbitration practices, this principle has shown a trend of "limited application", requiring that the reasonable expectations of investors must be based on clear and specific government commitments or legal frameworks, rather than subjective speculation by investors. For example, in the Glamis Gold v. United States case, the arbitration tribunal rejected the investor's claim that "the environmental protection policies of the host country cannot be changed", emphasizing that the reasonable expectations cannot override the public governance rights of sovereign states. This restrictive interpretation avoids investors abusing this principle to suppress the legitimate regulatory space of the host country.

Finally, the legitimate expectation principle can enhance legal stability and promote the unification of international law adjudication rules. Although there are differences in the determination standards of the arbitration tribunal for the legitimate expectation principle, it has formed a relatively unified application logic through the practice of a large number of cases. The international community generally believes that the applicable conditions of this principle are: first, the host country makes specific commitments or releases policy signals. Second, investors implement investment behaviors based on such commitments. Third, the host country's actions substantially damage the expected interests. This relatively standardized composition of requirements enhances the consistency of decisions in different cases.

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In conclusion, the legitimate expectation principle has become a core tool for balancing international investment relations by protecting investors' trust interests and constraining the abuse of regulatory power. Its advantages lie in the objectification of legal standards, the dynamic balance of public and private interests, and the continuous optimization of the international investment rule system.

3. The Applicable Requirements of the Legitimate Expectation Principle

3.1. Divergences in Theories Regarding the Applicable Requirements of the Legitimate Expectation Principle

From the above text, it can be seen that the legitimate expectation principle, as a legal principle developed in international investment arbitration practice, still has strong ambiguity in its application. The application requirements of this principle show significant differences in the interpretations of different arbitration tribunals and academic research. The following are several main schools of thought in the academic circle:

3.1.1. The Theory of Protection of Legitimate Expectations

This theory holds that as long as investors have reasonable expectations based on the explicit commitments of the host country or the continuous legal environment, and the host country's actions result in the failure of those expectations, it constitutes a breach of contract [8]. Supporters of this theory cite the Philip Morris v. Uruguay case and argue that the arbitration tribunal should focus on reviewing whether the host country has created a "predictable, stable and transparent legal environment" through legislation, policy statements or specific commitments [9]. However, critics point out that this interpretation can easily lead to the generalization of investors' expectations. For example, in the Saluka v. Czech case, the arbitration tribunal equated reasonable expectations with the "legal stability" requirement, which actually granted investors rights beyond the treaty text [7], resulting in an arbitration outcome that favored protecting the interests of investors.

3.1.2. The Theory of Objective Element Limitation

This theory advocates for a restrictive interpretation of the legitimate expectation principle, emphasizing three core elements: (1) The host country must make a specific, clear and targeted commitment to a particular investor; (2) The commitment must be legally binding; (3) The investor must complete the necessary due diligence [1]. This theory limits the discretion of the arbitration tribunal by setting objective standards, but in practice, it still faces the challenge of how to determine "a specific commitment", that is, whether the commitment is made by the host country through the promulgation of laws and regulations for unspecified investors or through the provision of targeted guarantees for specific investors. If it is made for unspecified investors, how to demonstrate the causal relationship between the promulgated laws and regulations and the reasonable expectations of the investors. These are all issues that need to be discussed in practice.

3.1.3. The Theory of Balancing Interests

This theory advocates seeking a dynamic balance between the expectations of investors and the regulatory powers of the host country, and emphasizes that three elements need to be comprehensively considered: (1) the inherent possibility of changes in the legal system of the host country; (2) the professional risk perception ability of investors; (3) the social public welfare attributes of the host country's actions. In the case of EDF v. Romania, the arbitration tribunal clearly pointed out that investors cannot expect the legal environment to be completely static, and that

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reasonable regulations by the government for purposes such as public health and environmental protection do not constitute a breach of contract [3].

3.1.4. The Theory of Dynamic Hermeneutics

This theory focuses on the evolution interpretation of international investment treaties and advocates that the legitimate expectation principle should be dynamically interpreted in light of the purpose of the treaties. Specifically, it includes: (1) Differentiating the intensity of expectation protection in the investment access stage and the investment operation stage; (2) Introducing the proportionality principle to assess the rationality of government actions; (3) Requiring investors to prove that the expectation is "decisive for investment decision-making". This interpretative approach has been reflected in the new generation of international investment agreements after 2016, such as in the CPTPP, which through an annex form has limited the interpretation scope of the FET clause, stipulating that the FET should include two contents: acting in accordance with the due process principles in the major legal systems of the world and not refusing judicial procedures in criminal, civil, and administrative judicial proceedings, which are included. At the same time, Article 9 of the CPTPP text also clearly stipulates that if only one contracting party takes or does not take actions that may be inconsistent with the expectations of investors, even if the investment thus suffers losses, it will not constitute a violation of this treaty [10].

3.2. The Author's Viewpoint

Even if the various theories have their own viewpoints on details, the main divergence lies in whether to adopt an expansive or restrictive interpretation when explaining the legitimate expectation principle. Arbitration tribunals that support an expansive interpretation mostly adopt the "effectiveness standard", focusing on the result of investors' rights being damaged, and tend to protect the trust interests of investors, regarding the legitimate expectation principle as an important weapon for investors to resist the regulatory power of the host country. Arbitration tribunals that support a restrictive interpretation mostly adhere to the "textualism", requiring strict interpretation based on the wording of the treaty, emphasizing the sovereignty interests of the state, and believing that excessive protection of investors will erode the space for the host country to formulate management policies. If only one of the above interpretation methods is adopted simply, it will lead to an imbalance of interests between investors and the host country. Therefore, this article holds that the application of the legitimate expectation principle should be based on a dynamic interpretation framework constructed on the basis of the refinement of treaty texts and the unification of review standards, in order to further achieve a positive interaction between investors' rights and the public interests of the host country, and reach a state of relative balance of interests between the two.

Based on the balance of interests, this article holds that the application requirements of the legitimate expectation principle should be based on restrictive interpretation, and adopt both expansive and restrictive interpretations. Combine the objective requirement theory and the dynamic interpretation theory, that is, to dynamically interpret the three core requirements claimed by the objective requirement theory. (1) The host country needs to make specific, clear, and targeted commitments to specific investors. Regarding the form of the commitment, in order to unify the review standards and clarify the source of investors' reasonable expectations, the arbitration tribunal can follow the restrictive interpretation trend of the new generation of investment agreements. For example, the CPTPP through an annex explicitly excludes the implied obligation of legal stability and limits the reasonable expectation to specific written commitments. At the same time, to protect the interests of investors, the dynamic interpretation rule of "subsequent practice" can be introduced to comprehensively judge the rationality of investors' expectations when determining the legal environment at the time of the treaty and subsequent practices. (2) The commitment must have legal binding force. This requirement actually also requires the commitment to have corresponding legal stability. However, the arbitration tribunal can support the legitimate defense reasons of the host country for policy changes within a certain limit. For example, policy changes are for major public interests, the implementation measures are non-discriminatory, or an alternative solution with the minimum damage has been selected, etc. (3) Investors need to complete necessary due diligence, and it should be substantive investigation. That is, the scope of investigation should not be limited to the form investigation of the host country's written law, but should also include policy change trends, industry risks, etc.

4. Conclusion

The fair and impartial treatment clause is an important provision in the field of international investment arbitration at present. However, the reasonable expectation principle, as the core element for interpreting the fair and impartial treatment clause, has not yet reached a unified and clear definition. Through the research on the application of the reasonable expectation principle in current international investment arbitration practice and the differences in related theories, this paper, based on the consideration of the balance of interests between investors and host countries, combined with restrictive interpretation and expansive interpretation, and on the basis of relevant theories, comprehensively proposes three core application requirements for the reasonable expectation principle. Currently, due to the differences in value orientation among arbitration tribunals, there are still significant differences in arbitration results. However, in the future, by establishing standardized requirements for reviewing the elements, improving the treaty interpretation restraint mechanism, and applying multilateral rules, the arbitration tribunal's discretionary space can be limited, striving to achieve a rational balance between investment protection and regulatory power. Only in this way can the good development of international investment law be promoted.

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